



CITY OF SAN ANTONIO

P. O. BOX 839966
SAN ANTONIO, TEXAS 78283-2966

June 21, 2006

Phil Hardberger
Mayor

Roger O. Flores
Councilman, District 1

Sheila D. McNeil
Councilwoman, District 2

Roland Gutierrez
Councilman, District 3

Richard Perez
Councilman, District 4

Patti Radle
Councilwoman, District 5

Delicia Herrera
Councilwoman, District 6

Elena Guajardo
Councilwoman, District 7

Art A. Hall
Councilman, District 8

Kevin Wolff
Councilman, District 9

Christopher "Chip" Haass
Councilman, District 10

Sheryl L. Sculley
City Manager

Michael Bernard
City Attorney

Ben Gorzell, Jr., CPA
Acting Finance Director

Ladies and Gentlemen:

RE: City Management's Corrective Action Plan Report and the Report on the Audit of the Finance Department – Hotel/Motel Occupancy Tax Collection Process

We are pleased to attach for your review the report of an audit of the Hotel/Motel Occupancy Tax Collection Process. The audit report, which includes detailed recommendations, and City Management responses are attached for your review. The Finance Department Corrective Action Plan indicates acceptance of the audit recommendations, for the most part. Finance Department Management and Staff should be commended for their cooperation and assistance during this audit.

The observations in the draft report raise significant management and internal control issues. Specifically, the allocation of resources to verify Hotel/Motel Occupancy Tax revenue and exemptions, as well as for the collection of delinquent accounts, should be re-evaluated. City Management has expressed that the Finance Department is being re-organized and resources will be realigned to meet mission requirements by September 2006.

The Internal Audit Department appreciates the opportunity to have performed this review because it highlights areas for improvement in compliance with City Ordinance 67104 (City Code on Hotel Occupancy Tax collection), process efficiencies, and internal controls. We are available to discuss this material with you individually at your convenience.

Sincerely,

A handwritten signature in black ink that reads "Mark Swann". The signature is fluid and cursive, with the first letters of the first and last names being capitalized and prominent.

Mark Swann CPA, CIA, CISA
Interim City Auditor

Cc: Leticia Vacek, City Clerk

Michael Armstrong, Assistant City Manager / Chief Information Officer



CITY OF SAN ANTONIO
INTERNAL AUDIT DEPARTMENT

Audit of Finance Department
Hotel/Motel Occupancy Tax Collection Process

Project No. AU05-014

Issue Date: June 21, 2006

Mark Swann CPA, CIA, CISA
Denis Cano CPA, CIA, CISA
Michael Ketterman CPA
Theresa Cameron CPA, CIA
Patricia M. Major CPA, CIA, CTP, CGFM

**Audit of Finance Department
Hotel Occupancy Tax (HOT) Collection Process**

Table of Contents

	PAGE
Executive Summary	1
Overview	1
Results in Brief	1
Background	3
Criteria	6
Audit Objectives and Scope	7
Methodology	7
Observations and Recommendations	8
Section I: Management and Internal Control Issues	8
1.1 Lack of formal written procedures	8
1.2 Lack of performance measures	8
1.3 Inappropriate segregation of duties	8
1.4 Inadequate allocation of resources to verify HOT revenue and exemptions	8
1.5 Inadequate reconciliation of HOT payments to amounts posted in the ERM/SAP System with deposit amounts	9
1.6 Inadequate method of locating new hotels	9
1.7 Insufficient monitoring and collection of delinquent accounts	9
Section II: Financial Accounting and ERM/SAP System Configuration Issues	11
2.1 Inappropriate HOT processing time	11
2.2 Lack of System configuration for assessing interest on delinquent payments	11
2.3 Lack of System configuration for calculating HOT accruals	11
2.4 Lack of System configuration for recording the reporting period of HOT payments	11
2.5 Inappropriate use of incomplete daily reports	11
2.6 Inaccurate recording of HOT accrual and receivable balances	11
2.7 Delay rollover of year-end HOT balances	12
Section III: Bexar County's Inter-local Agreement Issues	13
3.1 Outdated collection fee for Bexar County's HOT	13
Attachment	
A Risk Management Capability Matrix	15
Management Response	

Executive Summary

Overview

A review of the collection process for the Hotel/Motel Occupancy Tax (HOT) was completed. The objectives of this project were to:

- Evaluate the adequacy and appropriateness of the internal control environment and risk management processes used for the collection of and accounting for the HOT
- Determine whether hotel/motels complied with provisions of City Ordinance 67104, dated May 12, 1988
- Assess whether Hotel Occupancy Tax forms are accurately completed, revenue is properly recorded, and interest and penalties are properly assessed

The audit focused on transactions that occurred between October 2002 and December 2004. Fieldwork was conducted primarily from February 2005 to April 2005.

The report includes background information to assist the reader in understanding the HOT collection process. In 1968, the City of San Antonio (COSA) imposed a HOT. Since 1993, the HOT rate has been nine percent.

Any individual or organization that offers sleeping rooms are required to collect and remit monthly HOT payments to the City. A one percent discount is allowed if the report and the tax are submitted by the twentieth day following the end of the reporting period. If the report and tax are not submitted by the last day of the calendar month in which they are due, a five percent late penalty is assessed. Interest is also due on the first day of each month on delinquent taxes at an annual rate of ten percent.

The Revenue Billing and Collection Manager and a Cashier manage the HOT collection/processing for COSA. Approximately 346 hotels/motels reported HOT payments to the City in fiscal year 2004. As shown in **Exhibit A** on page 4, \$46.3 million was collected in HOT revenue.

Results In Brief

A number of issues and observations have been included in this report. Most of the issues identified in the audit relate to strengthening the internal control structure in the Finance Department's Revenue Collection Section in processing HOT payments. This conclusion was determined based on the following key facts relating to HOT collections:

- Lack of verification of reported Hotel gross revenue and exemptions; Hotels may not be reporting all HOT collections due to the City
- Inadequate monitoring of delinquent accounts
- Inadequate segregation of duties
- Lack of reconciliation of HOT collections to amounts posted in the ERM/SAP System
- Inaccuracies in HOT accrual and receivable balances
- No formal written procedures
- Lack of performance measures

With projected HOT revenue of \$48.7 million for fiscal year 2005, the Finance Department Director should coordinate with ITSD to implement ERM/SAP System improvements in processing and reporting HOT transactions. In addition, the Finance Department Director must evaluate current resource requirements and assign full-time Staff based on process needs to ensure that revenue is collected on a timely basis and accounted for properly.

The Finance Department Director should establish formal written procedures for processing HOT payments and define performance metrics for HOT collections.

Strengthening internal controls will help ensure accurate and timely collection of HOT payments and appropriate monitoring of delinquent accounts.

Based on a Risk Management Capability Matrix, included in **Attachment A** on page 15, it was determined that the maturity level of the Revenue Collection Section's process capabilities for HOT management was at a *Repeatable Stage* as some standard procedures exist with infrequent monitoring of performance. Given the length of time this important tax initiative has been in place, further developed management and internal controls were expected.

Background

Texas Tax Code Subtitle D, Chapter 351 "Municipal Hotel Occupancy Taxes", Subchapter A provides for the imposition and collection of a Municipal Hotel Occupancy Tax. Since 1968, the City of San Antonio has imposed a Hotel Occupancy Tax (HOT). City Ordinance 36347, dated March 14, 1968, authorized the City to assess and collect a one percent HOT.

In September 30, 1993, City Ordinance 78834 authorized the City to increase the HOT rate to nine percent. The ordinance also provided for a Capital Improvement Plan. All HOT and any attendant late penalty revenue collected above the seven percent rate is placed in the "Capital Improvement Plan for Convention Center Expansion". These funds were designated for expansion construction and debt service payments on a general obligation debt issue for construction of the Convention Center Expansion.

Hotel Occupancy Tax Guidelines

A sole owner, partnership, corporation or other organization that owns and/or operates any hotel, motel, "bed and breakfast inn", or other location offering "sleeping rooms" shall collect and remit HOT to the City. According to City Ordinance 67104, dated May 12, 1988, the following discounts, penalties, and interest apply:

- Discounts – A one percent discount is allowed if the report and the tax are submitted by the twentieth day following the end of the reporting period. This discount cannot be used if delinquencies exist for any prior reporting period.
- Penalties – A five percent late penalty is due if the report and the tax are not submitted by the last day of the calendar month in which they are due. After the first calendar month of delinquency, an additional five percent penalty shall be paid on the first day of each delinquent month. The penalty shall not be less than five dollars (\$5.00).
- Interest - Delinquent taxes accrue interest on the first day of each month at the annual rate of ten percent.

The HOT report and tax must be mailed to the City of San Antonio, Revenue Division by the last day of the calendar month following the last day of the reporting period. Reports must be filed for every period, even if there is no tax due.

In completing the HOT report, the City of San Antonio and Bexar County grant HOT exemptions that differ from the State of Texas. The following are local exemptions:

- A sleeping facility priced at less than two dollars (\$2.00) per day
- A hotel room or facility not ordinarily used for sleeping, such as a meeting room
- A sleeping facility occupied for 30 or more consecutive days
- A sleeping facility used by a United States officer or employee of a U.S. governmental entity in the course of conducting official business for the governmental entity
- A sleeping facility used by a State of Texas officer or employee in the course of conducting official business for the governmental entity

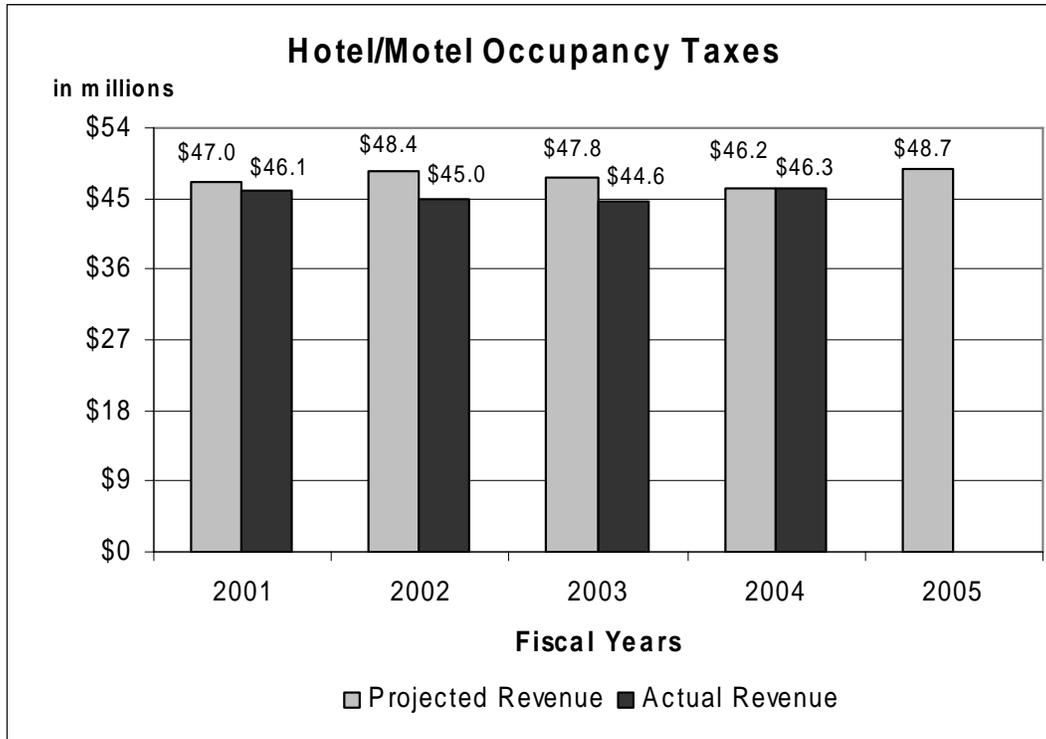
A Texas Hotel Occupancy Tax Exemption Certificate must be completed and retained for one year. A tax liability will be incurred for any "exemption certificate" that is not on file and available for review.

Projections and Actual Revenue

The City's Office of Management and Budget (OMB) prepares a five-year forecast based on information from the Convention and Visitors Bureau (CVB) and regression analysis from past years. CVB's information is based on events for the coming year, projected hotel occupancy tax rates, projected daily hotel rates, etc. In addition to the five-year forecast, OMB performs a mid-year assessment over the current year budget. This assists CVB in projecting HOT revenue for the coming budget year.

Exhibit A illustrates a five-year summary of projected and actual HOT revenue for the City of San Antonio. In fiscal year 2002, there was a \$3.4 million difference between projected and actual revenue as a result of the disaster of September 11, 2001 that had a negative impact on the economy in general, specifically the tourism industry. Despite the September 11 events, COSA was optimistic in forecasting HOT revenue for fiscal year 2003. However, as reflected for 2003, recovery from the September 11 events appeared to take longer than anticipated. In fiscal year 2004, COSA did not aggressively forecast HOT revenue as in prior years. Accordingly, HOT revenue approximated forecast amounts for the year. HOT revenue is forecast at \$48.7 million for fiscal year 2005.

**Exhibit A – Five Year Comparison of Hotel Occupancy Taxes – Fiscal Years 2001 through 2005
As of Summer 2005**



Source: City of San Antonio Adopted Annual Operating Budgets and Comprehensive Annual Financial Reports (various years)

In fiscal year 2004, there were approximately 346 hotels reporting HOT to the City of San Antonio. **Exhibit B** illustrates the thirty-five hotels with the highest HOT payments for the fiscal year, excluding September 2004.

**Exhibit B – Thirty-Five Hotels with Highest Hotel Occupancy Tax Payments
 Eleven Month Ended Fiscal Year 2004**

	Hotel Name	HOT Tax Payments	Percent of Payments Received
1	Marriott-River Center	\$3,442,617	
2	Hyatt Regency-Hill Country	1,766,175	
3	Marriott-Riverwalk	1,721,188	
4	Hyatt Regency	1,674,580	
5	Westin-Riverwalk	1,553,027	
6	Westin-La Cantera	1,471,740	
7	Hilton Palacio Del Rio	1,456,411	
8	La Mansion Del Rio	1,262,510	
9	Crowne Plaza	747,455	
10	Wyndham-St. Anthony	687,466	
11	Holiday Inn	680,245	
12	Menger	670,573	
13	Doubletree	649,448	
14	Marriott-Plaza	648,383	
15	Gunter	641,342	
16	Embassy Suites	640,238	
17	Omni	607,715	
18	Valencia-Riverwalk	559,967	
19	Hilton-Airport	524,292	
20	Marriott-Northwest	496,809	
21	Courtyard by Marriott	453,678	
22	Embassy Suites	440,721	
23	Radisson Resort-Hill Country	431,680	
24	Residence Inn by Marriott	427,305	
25	La Quinta Inn	395,653	
26	Drury Inn and Suites	390,549	
27	Four Points Riverwalk	389,618	
28	Ramada	384,680	
29	Holiday Inn Downtown	377,748	
30	Holiday Inn Select Airport	377,581	
31	Residence Inn by Marriott	353,884	
32	Radisson Hotel	352,147	
33	Drury Inn and Suites-Riverwalk	342,256	
34	Hampton Inn	333,284	
35	Hawthorne Suites	315,380	
	Subtotal for Thirty-five Hotels	27,668,345	66%
	Remaining Total for 311 Hotels	14,537,224	34%
	Total Payments for 346 Hotels	\$42,205,569	100%

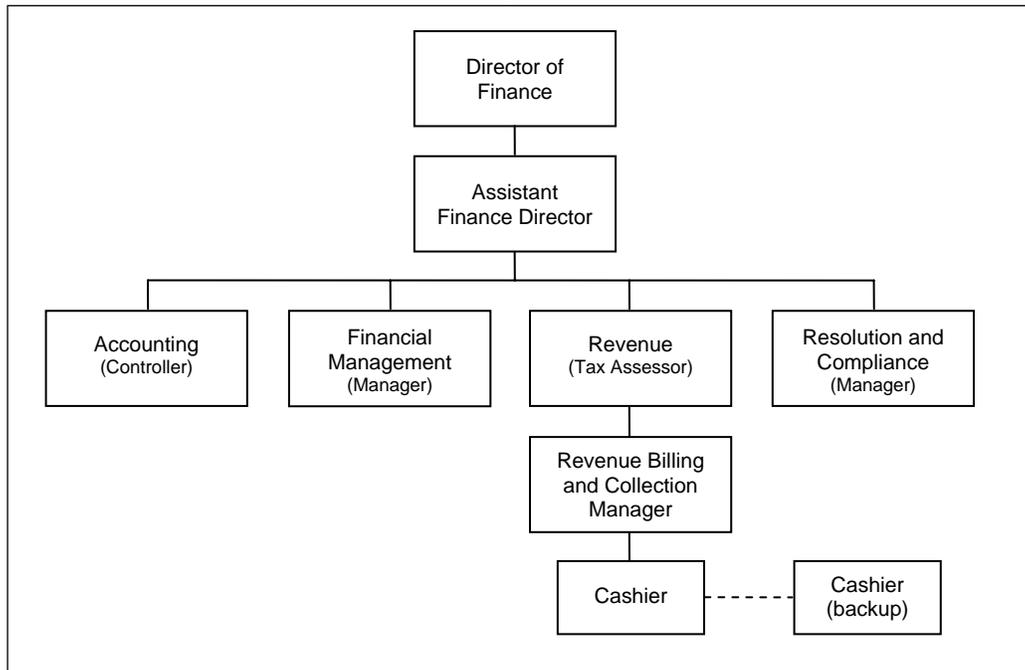
Source: Prepared by City Internal Audit Department

Billing and Collections Staff

The Revenue Collection Section in the Finance Department is responsible for the collection of the Hotel/Motel Occupancy Tax, along with receipting of the Alcoholic Beverage fee, sale of coin-operated amusement machine decals, and cashiering for building permits. The Revenue Collection Section is also responsible for contract billing and collection, lot cleaning and demolition billing and collection, revenue collection audits, returned checks, refunds, and petty cash disbursements.

The Revenue Billing and Collection Manager and a Cashier are essentially responsible for managing HOT collection/processing for the City of San Antonio's 9% tax rate and Bexar County's 1.75% tax rate. Currently, another Cashier in the Revenue Collection Section is being trained as backup for processing HOT collections. **Exhibit C** reflects an organizational chart for the Finance Department, including the Revenue Collection Section Staff in charge of collecting/processing HOT.

Exhibit C – Finance Department Staffing as of Summer 2005



Source: Prepared by the City Internal Audit Department

Inter-local Agreement with Bexar County

The City of San Antonio signed an Inter-local Agreement with Bexar County for the collection of the County's 1.75% Hotel/Motel Occupancy Tax. City Ordinance 91252, dated February 10, 2000, authorizes this Inter-local Agreement between the City and Bexar County. The agreement provides for a .5% collection service fee of gross collections, with the maximum payment not to exceed \$50,000 per year. The original term of the agreement was January 1, 2000 to December 31, 2000. This agreement renews automatically on January 1st of each year until the County's authority to collect HOT expires or either party gives written notice of their intent of non-renewal on or before December 1st of any given year.

Criteria

This audit was based on the Finance Department's procedures used for administering Hotel/Motel Occupancy Taxes, the Inter-local Agreement with Bexar County, and terms of applicable laws and regulations, including City Ordinance 67104, dated May 12, 1988.

Audit Objectives and Scope

The objectives of the audit were to determine the following:

- Evaluate the adequacy and appropriateness of the internal control environment and risk management processes used for the collection of and accounting for the HOT
- Determine whether hotel/motels complied with provisions of City Ordinance 67104, dated May 12, 1988
- Assess whether Hotel Occupancy Tax forms are accurately completed, revenue is properly recorded, and interest and penalties are properly assessed

The scope of the audit focused on transactions that occurred between October 2002 and December 2004. The audit was not designed to verify support documentation for gross revenue and exemptions reported by hotel/motels. It did not include specific efforts to select HOT revenue transactions of a specific hotel/motel for detailed review. Testing for these items was deferred for a subsequent audit.

Methodology

The methodology used for this project, generally, included the following:

- Gathering and reviewing information and documentation from the City and the Finance Department
- Performing a risk and control analysis
- Conducting interviews with the Revenue Collection Section Staff from the Finance Department
- Performing and evaluating transactional and other test work relating to HOT revenue
- Performing judgmental sampling techniques to select transactions for detailed testing

The review was performed in compliance with generally accepted government auditing standards issued by the U.S. Government Accountability Office.

Observations and Recommendations

This review provided evidence of significant control issues. The majority of the issues relate to management and internal control. The observations have been summarized for this report to give the readers a high level view of the existing conditions in relation to those expected. Issues are presented in three categories: Management and Internal Control; Financial Accounting and ERM/SAP System Configuration, and Bexar County's Inter-local Agreement.

1. Management and Internal Control Issues

City Executive Management is responsible to ensure that City Departments establish procedures and performance expectations for effective administration and efficient operations of City initiatives. Although the Hotel Occupancy Tax was established in 1968, appropriate internal controls have not been implemented to ensure this revenue is maximized.

According to Internal Control-Integrated Framework of the Committee on Sponsored Organizations (COSO) of the Treadway Commission, control activities are the policies and procedures that help ensure management directives are carried out.

1.1 Lack of formal written procedures

The Finance Department does not have formal written procedures for managing HOT revenue. Procedures have been communicated verbally to the small Revenue Collection Section Staff involved in processing HOT payments. Lack of written procedures has resulted in the process for delinquent tax collection being inconsistently applied.

1.2 Lack of performance measures

With projected HOT revenue of \$48.7 million for fiscal year 2005, this large revenue-producing function does not have established performance measures to determine whether revenue is collected on a timely basis and accounted for properly. Other than the high level data included in the City's Comprehensive Annual Financial Report, there has not been any monthly or quarterly reporting to key Management higher than the City's Tax Assessor regarding trend analysis or performance measures.

1.3 Inappropriate segregation of duties

There is a lack of segregation of duties in processing HOT payments in the Finance Department. The Cashier receives the checks for the day from the Revenue Billing and Collection Manager, posts payments to the ERM/SAP System, and prepares the daily deposits with no independent review. The Cashier, after posting the payments in the ERM/SAP System, places the daily deposit in a sealed manila envelope and hands it over to another employee for logging the daily deposit. The sealed envelope is then given to an Office Assistant for armor car pick up. There is no independent verification made to ensure that all payments received for the day are properly posted in the general ledger and deposited in the bank account.

1.4 Inadequate allocation of resources to verify HOT revenue and exemptions

The City is not allocating sufficient resources to support the collection of HOT payments. Four employees dedicate a portion of their time to this function. No analytical analysis is performed to identify irregularities in monthly trends, gross HOT amounts, and exemptions. The Finance Department does not perform any type of verification of gross revenue and exemptions claimed by hotels. The monthly HOT reports submitted by hotels are accepted at face value. An analysis of collections over time may detect if hotels are under-reporting HOT collected.

1.5 Inadequate reconciliation of HOT payments to amounts posted in the ERM/SAP System with deposit amounts

Since the implementation of the ERM/SAP System, the Finance Department has not performed a reconciliation of HOT payments with amounts posted in the general ledger and deposited in the bank account. According to Finance Department Staff, there was an issue in the ERM/SAP System that did not allow payments for October to December 2004 to be posted in the System. Although these payments were subsequently posted in late January and February 2005, no reconciliation was performed to ensure the accuracy of information in the ERM/SAP System.

It was noted that five hotels did not have their October 2004 HOT payments posted in the System totaling \$18,482. Since then, the Finance Department has applied these payments to the hotels.

1.6 Inadequate method of locating new hotels

The Finance Department has placed total reliance on new hotel/motels to perform self-reporting and remittance of HOT payments. The Finance Department lacks an effective method to identify new hotel/motels in San Antonio and Bexar County.

Once a year, the Yellow Pages is used to identify new hotels. Two of the City's Tax Investigators also research new liquor licenses issued in San Antonio for this same purpose. In addition, if Tax Investigators notice a new hotel while out in the field, it is reported to the Revenue Billing and Collection Manager for follow-up.

1.7 Insufficient monitoring and collection of delinquent accounts

Best practices dictate that a formal plan be established for monitoring and collection of revenue to ensure proper safeguarding of assets.

Previously, someone from the prior Office of Internal Review was responsible for actively monitoring and collecting HOT payments. Since his separation from COSA in July 2002, the Finance Department has been responsible for this activity. With the small staff assigned to collections, the Finance Department has basically been limited to processing HOT reports, with minimal efforts made towards monitoring and collection of delinquent accounts.

Given the magnitude of this tax, it would appear that a more proactive approach would be considered necessary. Currently, delinquent HOT accounts are not monitored appropriately:

- There is no systematic process in place to track when hotel/motels are late with their monthly payments. The Finance Department is unable to easily determine who has or has not paid for a particular month. A manual log is maintained to keep track of monthly HOT payments received from hotels.
- There is no documentation to support any active collection efforts made by the Finance Department on delinquent accounts.
- Delinquent accounts older than sixty days are not timely referred to the City Attorney's Office. Delinquent hotels are referred to the City Attorney's Office anywhere from six months to two years after delinquency begins.

City Ordinance 67104, dated May 12, 1988, provides the Finance Director with the following provisions that can be applied to delinquent accounts:

- Imposing daily or weekly collection/reporting periods
- Filing a suit to enjoin the hotel owner, operator, manager, and other persons in control from operating any hotel in the City of San Antonio until the tax is paid and/or the report filed
- Obtaining an acceptable surety bond in lieu of an injunction suit
- Filing Class "C" misdemeanor infractions against delinquent hotel owners

Risk

Without formal procedures to guide employees and performance measures to gauge HOT collections, there may be gaps in City Executive Management expectations and actual performance. Decisions may be made regarding this major taxing initiative with no or very limited information.

In addition, misappropriation of assets, failure to detect errors and/or irregularities, and loss in revenue to the City may result from the internal control weaknesses described above.

Recommendation

To improve the Management and internal control issues identified, the Finance Department Director should implement the following:

- Establish formal written procedures
- Develop, monitor, track, and report performance measures
- Segregate duties regarding the billing, recording, depositing, and reconciliation of HOT payments
- Evaluate the use of a commercial lock box for high value, low volume type of transactions
- Reconcile HOT payments received, posted in the City's ERM/SAP System, and deposited in the bank account
- Enforce City Ordinance 67104 and refer delinquent accounts to the City Attorney's office to ensure timely collection

The Finance Department Director should also re-evaluate current resource requirements and assign full-time Staff based on process needs.

2. Financial Accounting and ERM/SAP System Configuration Issues

Implementation of a new state of the art operating system should result in more efficient and user-friendly processes that address the inefficiencies of the prior system. However, since the ERM/SAP System came on-line in October 2004, the Finance Department has focused on learning the new system and dealing with its issues. The Finance Department has not fully evaluated all the functionality available through the System to increase the effectiveness and efficiency in processing HOT payments.

2.1 Inappropriate HOT processing time

The implementation of the ERM/SAP System has placed new demands on the Management and Staff of the Finance Department. Data input requires approximately four minutes per tax report, as compared to one minute with the prior Municipal Accounts Receivable and Receipts (MARR) System. In the ERM/SAP System, the Cashier has to locate the hotel, create a sales order, and create a billing document separately for the City and County. Previously, this transaction was performed together for the City and County.

Although the ERM/SAP System has the capability of uploading multiple transactions using an excel file, the Finance Department has not used this functionality. HOT reports could be entered in an excel spreadsheet and the data uploaded once a day to reduce processing time.

2.2 Lack of System configuration for assessing interest on delinquent payments

In recalculating the interest paid by delinquent hotels, it was determined that the ERM/SAP System is not configured to calculate interest on delinquent payments. The Cashier has to manually calculate interest on delinquent payments received. This increases processing time and subjects it to human error.

2.3 Lack of System configuration for calculating HOT accruals

The ERM/SAP System is not configured to calculate the monthly or year-end HOT accrual. According to Finance Department Staff, the Information Technology Services Department is currently working on a program to produce such a report.

2.4 Lack of System configuration for recording the reporting period of HOT payments

Since the implementation of the ERM/SAP System, there has been an issue in the System that does not allow the posting of the HOT reporting period. Although Finance Department Staff enter the reporting period as a description in one of the fields, monthly reports cannot be generated based on this field. There is no efficient method to determine who has or has not paid for a particular month.

2.5 Inappropriate use of incomplete daily reports

The end of day report "City Hotel/Motel Payments Collected", used by the Finance Department to reconcile, does not match daily deposits. This report does not include partial payments (i.e., total monthly amount due is not received) or payments received under contractual agreement.

2.6 Inaccurate recording of HOT accrual and receivable balances

The current practice for recording delinquent HOT accounts has resulted in duplication of accruals and receivables. Receivables are recorded based on the tax amount due on HOT reports submitted without payment. In contrast, accruals are estimated by the MARR System by multiplying the number of delinquent months times the average of the three latest monthly payments received for a hotel. It was determined that duplicate receivables and accruals are recorded for delinquent hotels that submit HOT reports without payment. During a cursory review of the September 30, 2004 HOT receivables and accruals, two hotels were noted having duplicate amounts totaling \$9,800.

In addition, a sample of 54 hotels was chosen to test the September 30, 2004 HOT accrual. It was noted that HOT accruals for these 54 hotels was overstated by \$55,147 or 10.5% of the accrual amount tested.

The September 30, 2004 HOT accrual is \$4,810,161. It includes a \$703,049 year-end adjustment for certain major hotels that do not report on a calendar-month basis. Upon review of the calculation, it was determined that the accrual included 30 more days than necessary. As a result, the year-end adjustment to the HOT accrual was overstated by \$343,145.

2.7 Delay rollover of year-end HOT balances

As of September 30, 2004, there were 36 hotels with a \$310,714 outstanding HOT accounts receivable due from prior reporting periods. In addition, there was \$4,810,161 recorded in accrued revenue for HOT. After seven months, the HOT receivable and accrual beginning balances have not been loaded into the ERM/SAP System.

Risk

The following are risks associated with the issues described above for financial accounting of HOT payments and the ERM/SAP System configuration:

- Lack of proper collection of HOT, including penalties and interest, may result in loss of revenue for the City
- Lack of proper System configuration results in increased inefficiencies in the amount of time required for processing and likelihood for human errors
- Receivable and accrual amounts are duplicated for hotels that submit reports without payment
- Lack of accounts receivable and accrual beginning balances in the ERM/SAP System can result in incomplete and/or improper collection of HOT payments

Recommendation

To strengthen Management Information Systems, the Finance Department Director should coordinate with ITSD to implement configuration improvements to the ERM/SAP System that address the accuracy and efficiency of the following areas:

- Processing HOT transactions and reporting, including the uploading of data using an excel spreadsheet
- Calculating and applying interest to delinquent accounts
- Calculating the monthly HOT accrual

The Finance Department Director should also review accounts receivable and accrual balances for duplicate transactions recorded in the ERM/SAP System.

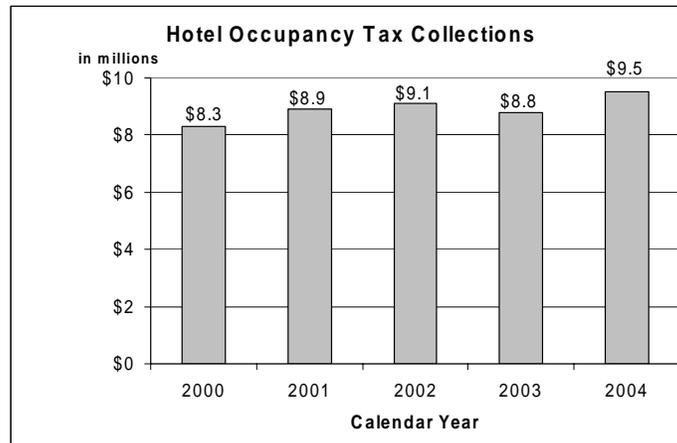
3. Bexar County's Inter-local Agreement Issues

In January 2000, the City entered into an Inter-local Agreement with Bexar County for the collection of the County's 1.75% hotel occupancy tax. The contract was established for one year with automatic annual renewal. The fee for providing this service was set at one half percent of gross County HOT collections, with the maximum payment not to exceed \$50,000. In assessing the financial impact of this Inter-local Agreement, the Finance Department concluded at the time that no additional resources would be needed to collect Bexar County's HOT payments.

3.1 Outdated collection fee for Bexar County's HOT

The rate charged to Bexar County for collecting their HOT payments has not changed since the original contract was signed in 2000. The rate is outdated since it is not based on current costs and activities. Despite rising costs in collecting HOT payments, such as personnel salaries, the Inter-local Agreement has not been renegotiated. **Exhibit D** illustrates a five-year summary of Bexar County's HOT collections.

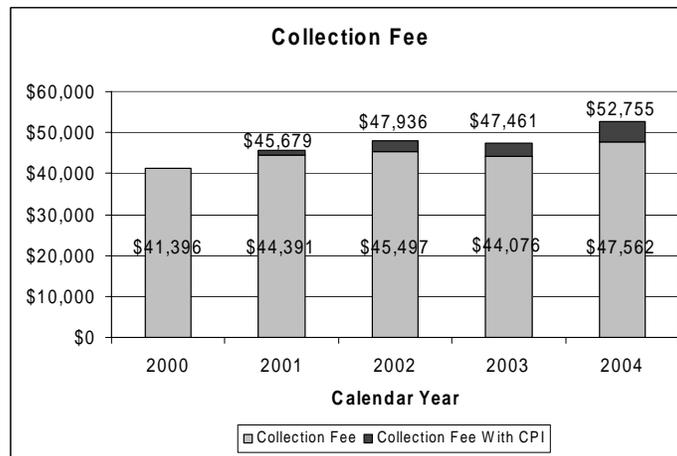
**Exhibit D – Five Year Comparison of Bexar County's Hotel Occupancy Tax Collections
 Calendar Years 2000 through 2004**



Source: Prepared by the City Internal Audit Department from unaudited data provided by the Office of Management and Budget.

Exhibit E shows the fee charged by the City to collect these taxes. For illustration purposes, the exhibit also reflects the amount that would have been collected with a Consumer Price Index added to the one half percent fee over this five-year period.

**Exhibit E – Five Year Comparison of the Collection Fee for Bexar County's Hotel Occupancy Tax
 Calendar Years 2000 through 2004**



Source: Prepared by the City Internal Audit Department from unaudited data provided by the Office of Management and Budget.

Risk

COSA may not be fully compensated for the work performed. The City may be absorbing increases in costs for collecting Bexar County's HOT payments, while the fee charged to the County remains the same. Although the overall number of hotels has not increased significantly from 2000 to 2004, the fee does not take into consideration the paperwork required for the number of small hotel/motels that are added and deleted during the year.

Recommendation

The Finance Department Director should develop a fee to be charged to Bexar County for processing and collecting HOT payments on their behalf, which is updated annually based on actual expenses.

Attachment A

RISK MANAGEMENT CAPABILITY MATRIX

In performing this audit, two risk management capabilities were considered for purposes of determining whether the Finance Department’s key risk to the City, as it relates to Hotel Occupancy Tax collection, was at an acceptable level. The capabilities included process and people. The matrix below outlines the characteristics of each capability needed for effective risk management. It highlights that the Finance Department’s performance in collecting/processing HOT payments is generally at the repeatable stage. However, it is important to note that most organizations reach a managed stage, while only a few attain an optimized stage.

Process Capabilities

Stage	Procedures	Controls and Process Improvements	Metrics
Ad Hoc	No formal <i>procedures</i> exist.	<i>Controls</i> are either non-existent, or are primarily reactionary after a “surprise” within the company.	There are no <i>metrics</i> or monitoring of performance.
Repeatable	Some standard <i>procedures</i> exist.	Detective <i>controls</i> are relied upon throughout the company.	Few performance <i>metrics</i> exist, thus there is infrequent monitoring of performance.
Defined	<i>Procedures</i> are well documented, but are not regularly updated to reflect changing business needs.	Both preventive and detective <i>controls</i> are employed throughout the company.	Some <i>metrics</i> are used, but monitoring of performance is primarily manual.
Managed	<i>Procedures</i> and <i>controls</i> are well documented and kept current.	Best practices and benchmarking are used to <i>improve</i> process in certain areas of the company.	Many <i>metrics</i> are used, with a blend of automated and manual monitoring of performance.
Optimized	<i>Processes</i> and <i>controls</i> are continuously reviewed and <i>improved</i> .	Extensive use of best practices and benchmarking throughout the company helps to continuously <i>improve</i> processes.	Comprehensive, defined performance <i>metrics</i> exist, with extensive automated monitoring of performance employed.

People Capabilities

Stage	Experience and Competence	Direction and Development	Authority and Accountability
Ad Hoc	<i>Inexperienced</i> personnel in most areas; no formal training programs are followed.	In most areas of the company there is little job guidance or other formal <i>direction</i> .	<i>Vague or conflicting authority and accountability</i> across business areas throughout the company.
Repeatable	<i>Competent</i> personnel in most areas; limited training; many functions tend to be under or over-resourced.	Some understanding of the basic job requirements in most areas, but still not much formal <i>direction</i> from management.	Lack of clear <i>authority and accountability</i> across business areas throughout the company.
Defined	<i>Experienced</i> personnel in most areas, but limited bench strength.	Job responsibilities and skill requirements are defined for all areas, but career <i>development</i> focus is lacking.	<i>Authority and accountability</i> are defined across the company, but not broadly or consistently understood by all affected areas.
Managed	<i>Strong</i> team in place with adequate bench strength in most areas.	A formal <i>development</i> program exists company-wide, with focus on both enhancing existing skills and developing new skills.	Clear articulation of <i>authority and accountability</i> , and consistent understanding among all affected areas.
Optimized	Formal succession planning and integrated resourcing program ensure <i>multiple sourcing options</i> for all key positions throughout the company.	Cross-training programs provide <i>job enrichment</i> opportunities for all employees and <i>multiple sourcing options</i> for all key positions.	A culture of empowerment engages employees throughout the company in exercising the <i>authority and accountability</i> they have been granted.

Source: Auditor’s Risk Management Guide: Integrating Auditing and ERM by Paul J. Sobel, CPA, CIA



CITY OF SAN ANTONIO

P. O. BOX 839966
 SAN ANTONIO TEXAS 78283-3966

June 13, 2006

Mark Swann, CPA, CIA, CISA
 Interim City Auditor
 111 Soledad, Suite 600
 San Antonio, TX 78205

RE: Management's Corrective Action Plan for the Audit of the Finance Department – Hotel/Motel Occupancy Tax Collection Process

City Management and the Finance Department have reviewed the audit report for the City's Hotel/Motel Occupancy Tax (HOT) Collection Process and herein is a Corrective Action Plan for the recommendations. Having an objective review of this process has resulted in better information for Management to develop operating strategies for the future.

Detailed Report					
#	Description	Audit Report Page	Accept, Partially Accept, Decline	Responsible Person's Name/Title	Completion Date
1.	Management and Internal Control Issues				
	The Finance Department Director should improve Management and internal controls by implementing the following:				
	• Establish formal written procedures	10	Accept	Gary Johnson, Tax Assessor	07/01/06
	Action plan: The Finance Department will update its formal written HOT procedures based on SAP functionality.				
	• Develop, monitor, track, and report performance measures	10	Accept	COMPLETED	05/01/06
	Action plan: The Tax Assessor maintains data on monthly HOT collections and percentage increase/decrease from the prior year. This report is available to the Finance Director upon request. The Convention & Visitors Bureau publishes the Monthly Measure and TAP report which compares monthly and year-to-date HOT revenue to the prior year.				
	• Segregate duties regarding the billing, recording, depositing, and reconciliation	10	Accept	COMPLETED	02/01/05
	Action plan: Segregation of duties regarding the billing, recording, depositing, and reconciliation was implemented in February 2005.				

	<ul style="list-style-type: none"> Evaluate the use of a commercial lock box for high value, low volume type of transactions. 	10	Decline	Gary Johnson, Tax Assessor	N/A
<p>Management comment: A lockbox solution is not feasible for receipt of HOT payments as customers remit payment without an invoice. As an alternative the use of on-line reporting and payment via the COSA website will be explored in the near future.</p>					
	<ul style="list-style-type: none"> Reconcile HOT payments received, posted in the City's ERM/SAP System, and deposited in the bank account. 	10	Accept	COMPLETED	01/01/05
<p>Action plan: Reconciliation of HOT payments posted and deposited utilizing SAP was implemented in January 2005 when SAP became functional for processing of HOT payments.</p>					
	<ul style="list-style-type: none"> Enforce City Ordinance 67104 and refer delinquent accounts to the City Attorney's office to ensure timely collection 	10	Accept	Partially Implemented Gary Johnson, Tax Assessor	07/01/06
<p>Action plan:</p> <p>The Finance Department is working with the ERM support team to establish SAP reporting to monitor hotels for compliance with required monthly HOT reporting. Further, the Finance Department written HOT procedures will detail specific timelines for dunning letters/notices and referral of non-compliant accounts to the City Attorney's Office.</p> <p>The Finance Department's Compliance and Resolution Office began performing randomly selected site visits to verify gross revenue and authorized exemptions in November, 2005. To date, 30 HOT reviews have been completed; these reviews have generated \$161,264 in additional net HOT revenue.</p> <p>The Finance Department has coordinated with Development Services Department to generate a report of hotels, motels, bed & breakfasts, etc. who have been issued a Certificate of Occupancy. This report will be generated quarterly and compared to a SAP database to insure all hotels are reporting HOT in compliance with the City Code. Additionally, the Bexar Appraisal District has been contacted regarding a similar report to insure compliance for properties outside the city limits.</p>					
	<ul style="list-style-type: none"> The Finance Department Director should re-evaluate current resource requirements and assign full-time Staff based on process needs. 	10	Accept	Ben Gorzell Jr., Acting Finance Director	09/01/06
<p>Action plan: The Finance Department is being re-organized and resources are be realigned to meet mission requirements.</p>					
2.	Financial Accounting and ERM/SAP System Configuration Issues				
<p>The Finance Department Director should coordinate with ITSD to implement ERM/SAP System improvements to address:</p>					
	<ul style="list-style-type: none"> Processing HOT transactions and reporting, including the use of data uploads. 	12	Decline	Gary Johnson, Tax Assessor	N/A
<p>Management Comment: Although the processing time has increased with the SAP application, the Finance Department feels the current processing of HOT payments provides the appropriate controls for posting HOT payments (e.g. calculating taxable HOT revenue, interest, etc.).</p>					

	<ul style="list-style-type: none"> Calculating interest for delinquent accounts. 	12	Accept	COMPLETED	05/01/06
<p>Action plan: SAP functionality now includes interest calculations on delinquent HOT receivables, thereby eliminating the possibility of human error.</p>					
	<ul style="list-style-type: none"> Calculating monthly accruals 	12	Accept	COMPLETED	10/01/05
<p>Action plan: SAP functionality now includes the ability to calculate HOT accruals based on historical collections; this HOT accrual method was utilized beginning in October 2005.</p>					
	<ul style="list-style-type: none"> The Finance Department Director should review accounts receivable and accrual balances for duplicate transactions recorded in the ERM/SAP System. 	12	Accept	Partially Implemented Gary Johnson, Tax Assessor	06/01/06
<p>Action plan: SAP functionality now includes configuration for recording the reporting period for HOT payments. The Finance Department is working with the ERM support team to generate end of the day detailed reports which will reconcile individual customer payments to the daily deposit. The Finance Department has updated SAP to include all outstanding HOT receivables as of September 30, 2004.</p>					

3.	Bexar County's Inter-local Agreement Issues				
	<p>The Finance Department Director should develop a fee to be charged to Bexar County for processing and collecting HOT payments on their behalf, which is updated annually based on actual expenses.</p>	14	Accept	Gary Johnson, Tax Assessor	12/31/06
<p>Action plan: The Finance Department will explore the possibility of amending the current contract with Bexar County to provide for increasing costs associated with this service. The current contract provides of fee of ½ of 1% of the gross HOT collected with a maximum fee of no more than \$50,000 per calendar year.</p>					

The Finance Department appreciates the City Auditor's comments on the HOT collection process. We are committed to addressing the recommendations in the audit report and the plan of action presented.

Sincerely,



Ben Gorzell Jr., CPA
Acting Finance Director



Sheryl L. Sculley
City Manager