

August 26, 2016

City of Morgan Hill  
Dat Nguyen  
17575 Peak Ave  
Morgan Hill, CA 95037

Dear Dat,

We have performed procedures which were agreed to by the City of Morgan Hill ("City"), solely to assist the City in reviewing 16 Hotel's compliance with the Morgan Hill Municipal Code Chapter 3, Article 24 for Transient Occupancy Tax with respect to the transient occupancy tax ("TOT") returns reported to, and subsequently received by the City for a three year period beginning January 1, 2013 to December 31, 2015. The Hotels' management are responsible for maintaining the Hotels' accounting records and other documentation to support the information reported on the TOT returns. This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of the management of the City. Consequently, we make no representation regarding the sufficiency of the procedures either for the purpose for which the report has been requested or for any other purpose. Our procedures discovered findings in all 16 hotels, resulting \$136,194 due to the City, including penalties and interest. Our findings and the related procedures are described below:

- We selected samples of guests for which the Hotels' claimed exemption from TOT due to guests having been residents of the Hotel for greater than 30 days, or having been a foreign government employee. We noted 12 hotels for which exemptions claimed were either unsupported or invalid, resulting in \$344,885 in additional taxable revenues upon which we have applied the TOT rate of 10% in our reports. Invalid exemptions would include those claimed for members of State or Federal Governments. Additionally, we noted that 4 of the hotels had substantial long term residency programs. See Schedules A and B for further information.
- We recalculated and reviewed information the monthly TOT returns with each Hotels' reports and accounting records. We noted 10 hotels for which information on TOT returns did not agree to the supporting accounting records or included calculation errors, resulting in \$163,469 in unreported revenues upon which we have applied the TOT rate of 10% in our reports.
- We reviewed the Hotels' financial reports to identify revenues that were not included in their calculation of TOT. We noted 7 hotels for which taxable revenues were not being included in the calculation of TOT, resulting in \$85,267 in unreported revenues upon with we have applied the TOT rate of 10% in our reports. The majority of these revenues were from Pet Fees, Cancellation Fees, No Shows Fees, and Late Checkout Fees.
- In the course of reviewing financial reports of the [REDACTED] we noted that they had been charging guests an Energy Charge of 2.5%. This charge had been classified as "City / County Tax" on guest folios, however it does not represent a valid tax by either the City or County. We have noted in our report that this is an invalid tax and have included the associated collections as part of room revenue in the amount of \$96,845 upon which we have applied the TOT rate of 10%.

- In the course of reviewing the financial reports of the [REDACTED] we noted that the hotel had charged guests a 0.5% Tourism Assessment. While all hotels are required to pay a Tourism Assessment to the State of California, through review of the Hotel's records it appears that the hotel collected amounts in excess of that remitted to the state for each of the three years under review. As these are over-collected we have included in our reports that the amounts over-collected by the hotel be remitted in full either the City or the State of California.
- In performing our procedures for the [REDACTED] we noted that none of the requested documentation was available for our review. As a result we questioned all exemptions claimed during the period under review in the amount of \$62,558 upon which we applied the TOT rate of 10% in our report. Due to the lack of documentation we were unable to perform any other procedures.

During our procedures, we reviewed the City's Transient Occupancy Tax Ordinance and the City's Transient Occupancy Tax Returns and we have the following suggestions to improve compliance with the Ordinance and ease of monitoring.

- Consider revising the Transient Occupancy Tax Returns to require reporting of Gross Rental Receipts less Long-Term Guests and Governmental Exemptions. Also consider including a few self-monitoring check boxes such as, "Have package fees net of amounts subject to sales tax been included in Gross Transient Rents", "Have resort fees been included in Gross Transient Rents", and "Have cancellation fees been included in Gross Transient Rents". These additions could help remind the preparer to include all taxable revenues.
- The City's Ordinance (section 3.24.010E) defines Rent as the consideration charged for the "occupancy of space in a hotel". The Ordinance could be expanded to specify the types of revenues that are considered taxable such as resort fees, cleaning fees, attrition, pet fees, cancellation fees, etc.
- The City's Ordinance (section 3.24.010G) specifies that "any such person so occupying space in a hotel shall be deemed to be a transient until the period of thirty days has expired, unless there is an agreement in writing between the operator and the occupant providing for a longer period of occupancy." The Ordinance could be expanded to specify what constitutes an "agreement", and that a simple reservation does not constitute an "agreement."
- We noted that the City's Municipal Code specifies that exemptions may be granted for officers or employees of foreign governments. However, it does not allow for exemptions by officers or employees of State or Federal employees as is the predominant industry practice. We recommend that the City consider revising the Municipal Code to allow for these additional exemptions in order to be in line with predominant industry practices.
- To improve the ease of monitoring the City could develop standard exemptions forms to be provided to the hotels for long-term guests and foreign government officials.
- To improve the ease of monitoring the City could incorporate occupancy statistics on its TOT Return, requiring hotel to report the total capacity, total occupancy from long term guests, total occupancy from government employees and total occupancy from transients.

- To improve the ease of monitoring the City could have all current hotels and new hotels complete a questionnaire regarding the types of revenues collected on site and the treatment of those revenues with respect to TOT.
- To improve the ease of monitoring the City could incorporate language governing the transfer of ownership of established hotels to ensure adequate retention of documentation for audit purposes or the City could require audits when a change of ownership occurs.

On Schedules A and B we have summarized the results of our audit including the amounts due to the City, the nature and extend of our audit findings and the prevalence of long term guest stays at the hotel.

We appreciate the assistance you have provided during the audits and look forward to the fiscal year ending December 31, 2016 audits.

Sincerely,

A handwritten signature in blue ink that reads "Jennifer Farr". The signature is written in a cursive, flowing style.

Jennifer Farr  
Davis Farr LLP

Schedule A

Hotel	Amount Owed (including Penalties & Int)	% of Long term Guests	Extensive Residency Program	Amount Over Collected
	\$ 679	29.40%	No	\$ -
	16,424	0.00%	No	99,526
	9,768	15.99%	No	-
	10,907	N/A <sup>1</sup>	N/A <sup>1</sup>	N/A <sup>1</sup>
	4,610	50.78%	Yes	-
	42,706	0.41%	No	37,003
	10,386	0.00%	No	-
	8,396	46.38%	No	-
	255	88.23%	Yes	-
	3,143	0.78%	No	-
	11,035	27.23%	No	-
	1,194	0.02%	No	-
	1,238	2.78%	No	-
	(460)	100.00%	Yes	-
	9,461	19.91%	No	-
	6,263	51.46%	Yes	-
	<u>\$ 136,194</u>			<u>\$ 136,529</u>

1 - Support for the three year period could not be provided. Therefore, this data is not available.

2 - Hotel paid amounts to City prior to auditor arrival.

City of Morgan Hill  
TOT AUP Results Details

Hotel	% of 30 Day Guests	Unallowable Exemptions				Unreported Revenue					Total
		30 Day	Gov't	Pet Fees	Roll-Away Beds	Cancellation / No Shows / Late Checkout	Room Upgrades	Calculation Errors	False Tax Collections	Other Collection Errors	
	29.40%	\$ 2,377	-	-	-	-	-	4,856	-	-	7,233
	0.00%	-	6,943	19,490	1,165	-	-	-	96,845	2,681	127,124
	15.99%	52,982	-	600	-	-	-	-	-	-	53,582
	N/A	-	62,558	-	-	-	-	-	-	-	62,558
	50.78%	469	-	20,130	301	21,550	-	(1,737)	-	-	40,713
	0.41%	19,262	21,366	-	-	-	-	1,563	37,003	-	79,194
	0.00%	-	-	450	-	-	-	78,312	-	-	78,762
	46.38%	53,561	-	-	-	-	-	(9,778)	-	-	43,783
	88.23%	-	-	-	-	-	-	1,948	-	-	1,948
	0.78%	-	24,238	-	-	-	-	-	-	-	24,238
	27.23%	6,837	77,636	-	463	-	-	-	-	-	84,936
	0.02%	835	-	-	-	557	43	6,587	-	-	8,022
	2.78%	2,496	-	-	-	-	-	5,234	-	-	7,730
	100.00%	13,325	-	-	-	-	-	-	-	-	13,325
	19.91%	-	-	19,108	1,410	-	-	49,419	-	-	69,937
	51.46%	-	-	-	-	-	-	27,065	-	-	27,065
<b>Totals</b>		<u>\$ 152,144</u>	<u>192,741</u>	<u>59,778</u>	<u>3,339</u>	<u>22,107</u>	<u>43</u>	<u>163,469</u>	<u>133,848</u>	<u>2,681</u>	<u>730,150</u>