Date: August 21, 2023

To: Sheryl M.M. Long, City Manager

From: Lauren Sundararajan, CFE, Internal Audit Manager *LS*

Copies to: Internal Audit Committee
William Weber, Assistant City Manager
Karen Alder, Finance Director

Subject: **Short Term Rental Audit**

Attached is the Short Term Rental audit report. The primary objectives of this performance audit were to assess short term rental (STR) operators' compliance with City Code requirements regarding registration, reporting, and remittance of all applicable taxes and fees, and determine if the City provides sufficient guidance and enforcement of STR laws and regulations. This audit was conducted in accordance with the current audit agenda.

We would like to thank the management and staff of the Finance Department for their assistance and cooperation during this audit.

If you need any further information, please contact me.

Attachment

Short Term Rental Audit

August 2023

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Internal Audit Manager

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Senior Internal Auditor

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Executive Summary

Internal Audit (IA) conducted a performance audit of the Short Term Rental (STR) program. The primary objectives of this audit were to assess short term rental operators' compliance with City Code requirements regarding registration, reporting, and remittance of all applicable taxes and fees; and determine if the City of Cincinnati (City) provides sufficient guidance and enforcement of STR laws and regulations.

A STR is a furnished living space available for occupancy for less than 30 days. STRs are also commonly known as vacation rentals and are considered an alternative to a hotel. The practice of renting a house or bedroom became increasingly popular in the City with the advent of various online platforms such as Airbnb, VRBO, HomeAway and others. The City sought to regulate and tax this home-sharing practice in 2019, when City Council passed Ordinance No. 125-219. Today, there are over 800 registered STR units.

The audit revealed several opportunities for improving the internal controls governing the operational practices over the STR program. For instance, the software currently utilized is limited in its effectiveness, functionality, and can be cumbersome for the user. Also, multiple processes are impacted, and slow performance has created inefficiencies in the day-to-day operations of the STR program.

IA also found only one employee is assigned to administer the program, and due to the high volume of work associated with processing STR documents, there is a backlog. Further, the STR policies and procedures manual needs to be finalized to ensure accountability and consistency, and additional guidance is needed on code compliance to offer a higher level of customer service and ease for the STR operator.

Overall, IA found that the Treasury Division (Treasury) is meeting the intended purposes of the ordinance, however, to strengthen the internal controls over the STR program, IA recommends investing in software that has the functionality to meet the needs of the program. Additionally, develop a more efficient solution to help tackle monitoring, compliance, and enforcement of the STR program, finalize the policies and procedures manual and expand communication. Implementing these recommendations will ensure the City fully benefits from the STR program, while responding to the many competing interests, and taxpayers are assured the City is providing strong stewardship and accountability over City funds.

I. Introduction

Background

STR refers to an activity in which one party, the "operator," agrees to rent out all or part of a home to another party, the "transient guest," on a temporary, time-limited basis. It is often used by people on vacation or who need temporary accommodation. It is also known as a vacation rental or a transient rental. An operator may be an owner, renter, or investor that does not occupy the property. The operator typically lists the unit on a hosting platform. Common hosting platforms include companies such as Airbnb, VRBO, Flipkey, and HomeAway.

In 2019, City Council passed Ordinance No. 125-2019 to ensure STRs met minimum safety and sanitation requirements and all applicable building, zoning, housing, and fire codes. Additionally, the City wanted to raise revenue through taxation of STRs to provide funds for the development of affordable housing.

All STR operators must register their rentals with the City prior to operation and remain in compliance with the ordinance. Registration is valid for three years from the date of issuance. The operator of an STR is responsible for maintaining records showing the gross revenues received. The City currently has a Voluntary Collection Agreement (VCA) with Airbnb to facilitate reporting, collection and remittance of applicable STR excise taxes. They have not been able to negotiate a VCA with any other hosting platform. Operators utilizing hosting platforms not in a VCA with the City are required to report the appropriate tax at the rate of 7% of the gross revenues generated quarterly.

In November of 2020, the City entered into a contract with third-party vendor, LTAS Technologies, Inc. "to track STR activity, identify owners or operators of STRs in the City, and determine whether STR owners or operators are in compliance with the registration and taxation provisions of City law."[1] The agreement was assumed by Avenu STR IP, LLC, in February 2023. Prior to entering into an agreement with the third-party vendor, the City had 357 registered STR units. From May 2021 through June 2022, the City increased registrations to 744, a 108% increase. Today, there are over 800 STR units registered.

Excise tax revenue for STR rental units has increased over the last three fiscal years (FY). In the exhibit below, you will notice a 368% increase in excise taxes from FY 2020 to FY 2023 (March) from $353,520.35 to $1,653,880.14, for a grand total of $3,866,722.14.[2]

Exhibit 1

Fiscal Year	Registrations - New and Renewal
2020	$82,437.00
2021	$46,000.00
2022	$70,500.00
2023 - Through March 2023	$79,000.00
Total Revenue	**$277,937.00**

Fiscal Year	Excise Tax
2020	$353,520.35
2021	$560,284.64
2022	$1,299,037.62
2023 - Through March 2023	$1,653,880.14
Total Revenue	**$3,866,722.75**

[1] Agreement For Short Term Rental Compliance Services.
[2] Figures were obtained from Treasury.

Audit Selection
IA conducted this audit in accordance with the current work plan.

Audit Objectives
The primary objectives of this performance audit were to assess STR operators' compliance with City Code requirements regarding registration, reporting, and remittance of all applicable taxes and fees; and determine if the City provides sufficient guidance and enforcement of STR laws and regulations.

Audit Scope and Methodology
To achieve the audit objectives, IA compared current practices to relevant department and City policies, the Cincinnati Municipal Code (CMC) and related ordinances, interviewed relevant staff members, examined applicable contracts and agreements, analyzed excise tax data, and reviewed database systems. Records reviewed included registration, tax reporting and payment activities from FY 2021-present.

Statement of Auditing Standards
As required by the Cincinnati Administrative Code Article II §15, this audit was conducted in accordance with the Generally Accepted Government Auditing Standards (GAGAS), except for standard 5.60 pertaining to external peer review requirements. This exception did not have a material effect on the audit.

IA continues to conduct internal quality reviews to assure conformance with applicable GAGAS. IA performed the fieldwork between March 2023 and June 2023.

Commendations
IA commends the management and staff of the Finance Department for their assistance and cooperation throughout the audit.

II. Audit Findings and Recommendations

The Short Term Rental management software is limited in its effectiveness.

Per the Standards for Internal Control in the Federal Government, “Management should design the entity’s information system and related control activities to achieve objectives and respond to risks.”[3] IA found several shortcomings with the STR management software.

Treasury uses the OpenCounter (OC) licensing software, designed for permitting and licensing, to manage the STR program. While OC has been the solution to help streamline the permitting process for customers, IA was informed that regarding management of the STR program, OC is limited in its functionality and can be cumbersome for STR operators as well as staff.

For instance, STR operators register, renew, and submit their quarterly reports in the OC portal. Once an application, a renewal or a quarterly return is submitted, if a mistake is made or an update needs to occur, the operator is not able to edit the information. The operator needs to contact Treasury to request any changes. Further, OC does not offer a “profile” section on their website where the user can save their contact information. The fields are only linked to the most recent quarterly report, and it is up to STR staff to either 1) search for the most recent tax return or registration application or 2) maintain a separate record of updated contact information for each registration. These steps add to an already high-volume workload for the STR staff.

Recommendation 1: Treasury should work with the Enterprise Technology Solutions (ETS) Department and Office of Performance and Data Analytics (OPDA) to invest in software that will meet the needs of the STR program.

Department Response: Agree. The Division of Treasury has been approved and funding is in place to purchase new licensing and tax program administration software, which includes the STR registration and excise tax programs. We are working with CAGIS and Purchasing to finalize the work order to be issued under an existing master services agreement.

Treasury is unable to reconcile the receivables from Airbnb.

Treasury has a Voluntary Collection Agreement (VCA) with Airbnb. Pursuant to the terms of the Agreement, Airbnb agrees to collect and remit the excise tax on behalf of the registered operator. While this allows for a steady stream of taxes, the terms Airbnb has agreed to only require them to report aggregate information (total amount of receipts, exemptions, adjustments and so forth) on the tax return form to the Taxing Jurisdiction (the City), and no personally identifiable information relating to the host or guest. IA was informed that Treasury cannot reconcile the aggregate information with the data submitted by the STR operator in OC, due to software limitations.

Recommendation 2: Treasury should ensure the new software has the capability that allows STR staff to reconcile the receivables from Airbnb.

Department Response: Agree. Treasury has been approved and funding is in place to purchase new licensing and tax program administration software, which includes the STR registration and excise tax programs. Treasury is working to ensure the new software will

[3] Green Book, GAO Standards for Internal Control in the Federal Government.

include account status features and management reporting which enable staff to more efficiently identify and address delinquent or non-compliant STR operators. However, the quarterly Airbnb report received from Airbnb provides very limited STR information which does not allow for Treasury staff to reconcile the receivables to individual customer accounts. Treasury staff has communicated directly with Airbnb to request additional information on the quarterly report but has remained unsuccessful.

Treasury is unable to perform an inquiry search of delinquent accounts.

Per the CMC Section 315-17, Penalties and Interest, the collection of penalties and interest are applied to an operator who does not remit any tax due and fails to meet the quarterly deadline. As explained in the previous finding, the City has a VCA with Airbnb. Airbnb is responsible for remitting all taxes due to the City for owners who advertise on their platform. Airbnb provides quarterly tax return forms to the City. These reports capture an aggregate of gross receipts, exemptions and adjustments, and all taxable receipts. The reports are due on the first of April, July, October, and January respectively.

Additionally, Airbnb operators are responsible for submitting quarterly reports to the City. These reports follow the same deadlines used for Airbnb and contain some of the same information including what sites they advertise their rentals on, revenue earned for the property, adjustments, etc. For owners who advertise on multiple platforms, such as Vrbo, FlipKey, HomeStay, and Booking.com, they are expected to remit taxes for any stays booked through these platforms along with their quarterly reports.

When the reports and taxes are received, the information is recorded in OC and FIS. FIS is the STR payment processor. However, once the deadline has passed, IA found that STR staff is unable to perform an inquiry search of the delinquent accounts, and instead must review each submitted report and determine who is delinquent. According to STR staff, the current system makes it difficult to determine whether an operator has filed all the required tax returns. STR staff must download two separate reports from OC and use an excel spreadsheet to compare the lists. Even this process is fraught with errors due to incomplete historical data. As a result, they are unaware of how many reports are missing and cannot promptly identify delinquent accounts to assess the penalties and interest. This also makes it difficult for a third party to review.

Recommendation 3: Ensure the new software has the functionality that will allow STR staff to identify delinquent accounts and effectively manage the STR program in accordance with the CMC.

Department Response: Agree. Treasury has been approved and funding is in place to purchase new licensing and tax program administration software, which includes the STR registration and excise tax programs. We are working with CAGIS and Purchasing to finalize the work order to be issued under an existing master services agreement. The new system will include functionality that will assist STR staff to quickly identify delinquent accounts and effectively manage the STR Program.

OpenCounter software does not integrate with Treasury's credit card processor.

Paying registration or renewal fees using a credit card is one payment method operators may use to remit fees. Integrated payment processing streamlines the checkout process to create a more efficient experience for customers. IA was informed that the current software does not integrate with the credit card processor. Instead, the STR operator completes the registration/renewal forms online. Once completed, the operator must wait for a confirmation email, where there is a link that directs them to a different site to make a payment. If an operator has multiple rental units, they must follow these steps for each unit, which can be a burdensome process.

Recommendation 4: Ensure the new software synchronizes with Treasury's credit card processor.

Department Response: Agree. Treasury is making progress with the procurement of new licensing and tax program administration software. Treasury is working to ensure the new system will fully integrate with Treasury's credit card processor.

STR data is not centralized.

Centralizing data sources across the entity can assure that everyone has access to a common source of trusted data allowing for optimized collaboration and confident decision-making. "Centralizing entity data eliminates data silos by integrating all information into a single, shareable source. This minimizes the time spent reconciling competing data sets and reduces the inefficiencies caused by inaccurate or incomplete data."[4]

Management of the City's STR program can involve a high volume of documents (registrations, renewals, emails, notification letters, violation letters and so forth). Although the process is digitized, STR staff informed IA that having a centralized location to easily access information and correspondence would help them to administer the STR program more efficiently.

It would be more efficient and convenient if correspondence to each operator could be attached in the OC portal in a centralized location to store correspondence; however, due to its limited functionality, the system prohibits this action. Currently, STR staff must research prior communications from email and mailings stored outside the system to ensure they are providing accurate information to customers, which creates an inefficient process.

Recommendation 5: With the new software, integrate all information into a single, shareable source, which would allow STR staff to actively manage documents through a centralized database.

Department Response: Agree. The Division of Treasury Division currently oversees over 800 active STR registrations, processing new applications, processing quarterly excise tax return submissions, along with other processes in the management of the City's STR Program. In the current system, all STR applications and quarterly excise tax returns are submitted on-line, in an electronic format. Treasury is working to ensure the new software will include all feasible data centralization features.

[4] Diligent, The Benefits of Centralized Data: A Single Source of Information for Your Business Entities. April 26, 2018.

Management or exception reports are not created.

Management or exception reports can help organizations identify and correct problems to improve their performance and take corrective action quickly and efficiently. The intent of the report is to focus management's attention on areas requiring immediate action (late quarterly reports, late excise tax payments, registration fees, overdue penalties and interest, backlogs) or even highlight areas where performance is excelling (identification of STR properties). IA was informed that no management or exception reports are created.

Recommendation 6: Create management or exception reports for review.

Department Response: Agree. Treasury is making progress with the procurement of new licensing and tax program administration software. Treasury is working to ensure the new software will include account status features and management/exception reporting which enable staff to more efficiently identify and address delinquent or non-compliant STR operators.

There is a backlog for processing Short Term Rental documents.

Treasury has one employee who handles the administration of the STR program. These duties include, but are not limited to, processing registration applications, review of excise tax returns, tracking status of each registration and return, and notify registrants of upcoming renewal deadlines and delinquencies. IA was informed that due to the high volume of work associated with processing the submissions, there is a backlog, and that no one has been able to successfully process 100% of submissions since the STR program started.

Recommendation 7: Develop a more efficient solution to help tackle monitoring, compliance, and enforcement of the STR program.

Department Response: Agree. The Treasury Division currently oversees over 800 active STR registrations, processes new applications, processes quarterly excise tax return submissions, reviews account delinquencies, notifies owners/operators, along with other processes in the administration of the City's STR program. When the program was established only one employee was assigned to the administration of the program. As the program has grown quickly, Treasury has had to reassess the work assigned. Additional staffing can help address the backlog, Treasury is working to obtain new licensing and tax program administration software that can streamline the review and reporting processes. Treasury is still working through the backlog and will continue to ensure the administration of the STR Program is completed thoroughly.

The STR policies and procedures manual needs to be finalized.

One of the components of a strong internal control system is information and communication. According to the Standards for Internal Control in the Federal Government, "Management should internally communicate the necessary quality information to achieve the entity's objectives,"[5] Treasury provides a policies and procedures manual that outlines the STR process. The manual is utilized by STR staff as guidance and an overview of the STR

[5] Green Book, GAO Standards for Internal Control in the Federal Government.

processes. Since the manual assists staff, it is imperative that a final version be completed to ensure staff accountability and consistency. IA found that the manual is still in draft form.

Recommendation 8: Finalize the STR policies and procedures manual.

Department Response: Agree. The Division of Treasury has compiled an initial draft of a policies and procedures manual entitled "City of Cincinnati Short Term Rental General Rules and Regulations For Cincinnati Municipal Code Chapters 856 & 315." Treasury will complete the manual as recommended.

STR operators need additional guidance on code compliance.

Treasury's responsibility is to ensure that STR operators register and remit taxes. Their website displays the ordinance, and FAQs in addition to the operators' responsibilities. However, STR operators must determine (on their own) who, what and where to go in the City to be in compliance with applicable building, fire, zoning, housing, and health codes.

Although operators self-certify compliance with these codes, links should be provided to the applicable website making it easier for STR operators to not only register their rental units, but also direct them to exactly where to go to facilitate code compliance. An accessible and easy-to-use webpage with all relevant STR information would limit the burden on internal staff and the operator.

Recommendation 9: Expand communication and marketing on the current website, by adding links to the applicable codes to make it easier for STR operators and ensure compliance.

Department Response: Agree. In response to this recommendation, Treasury worked with ETS to add a link on the STR website that directs customers to the "Relevant Codes" page on the Department of Building and Inspections website. The link provides additional information on applicable building, zoning, and other codes.

III. Conclusion

Treasury is responsible for managing over 800 STR units in the City, which has generated over $1.6 million dollars in excise taxes at the end of the third quarter, FY 2023. STRs provide an alternative to a hotel stay and “can be a boon to local economies spreading dollars across cities in ways that traditional lodging accommodations do not”[6] in addition to providing funds to be used to preserve and develop affordable housing in the City.

The audit revealed several opportunities for improving the internal controls governing the operational practices over the STR program. For instance, the software currently utilized by the STR program is limited in its effectiveness and functionality and can be cumbersome for STR operators as well as STR staff. Additionally, there is a backlog for processing STR documents, the STR policies and procedures manual needs to be finalized, and additional guidance is needed on code compliance to offer a higher level of customer service and ease for the STR operator.

Overall, IA found that Treasury is meeting the intended purposes of the ordinance, however, to strengthen the internal controls over the STR program, IA recommends investing in software that has the functionality to meet the needs of the program. Additionally, develop a more efficient solution to help tackle monitoring, compliance, and enforcement of the STR program, finalize the policies and procedures manual and expand communication. Implementing these recommendations will ensure the City fully benefits from the STR program, while responding to the many competing interests, and taxpayers are assured the City is providing strong stewardship and accountability over City funds.

[6] National League of Cities, Short Term Rental Regulations: A Guide for Local Governments.

IV. Finance Department Response

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