State of Washington
Joint Legislative Audit & Review Committee (JLARC)

Lodging Tax Revenues:

About Eight Percent of Funds Sponsor Nonprofit Events and Facilities, But Information is Inadequate to Estimate Economic Impact

Report 12-3

May 17, 2012

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Audit Authority

The Joint Legislative Audit and Review Committee (JLARC) works to make state government operations more efficient and effective. The Committee is comprised of an equal number of House members and Senators, Democrats and Republicans.

JLARC's non-partisan staff auditors, under the direction of the Legislative Auditor, conduct performance audits, program evaluations, sunset reviews, and other analyses assigned by the Legislature and the Committee.

The statutory authority for JLARC, established in Chapter 44.28 RCW, requires the Legislative Auditor to ensure that JLARC studies are conducted in accordance with Generally Accepted Government Auditing Standards, as applicable to the scope of the audit. This study was conducted in accordance with those applicable standards. Those standards require auditors to plan and perform audits to obtain sufficient, appropriate evidence to provide a reasonable basis for findings and conclusions based on the audit objectives. The evidence obtained for this JLARC report provides a reasonable basis for the enclosed findings and conclusions, and any exceptions to the application of audit standards have been explicitly disclosed in the body of this report.

TABLE OF CONTENTS

Committee Approval

On May 17, 2012, this report was approved for distribution by the Joint Legislative Audit and Review Committee.

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STATE OF WASHINGTON

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REPORT SUMMARY

Cities, towns, and counties levy sales taxes on lodging in two ways. Local governments may collect a lodging tax up to 2 percent that is taken as a credit against the state sales tax due on lodging. Jurisdictions may also levy an additional sales tax of up to 2 percent on lodging stays. In Calendar Year 2010, local lodging taxes generated $65.4 million statewide.

Local governments may use lodging tax revenues for tourism promotion and tourism-related facilities. In 2007, the Legislature expanded the authorized use of lodging tax revenues to allow jurisdictions to fund certain nonprofit organizations' events and facilities such as community celebrations and museums. This expanded authority is scheduled to expire in June 2013.

The 2007 Legislature also directed the Joint Legislative Audit and Review Committee (JLARC) to report to the Legislature in September 2012 on the use and economic impact of the expanded authorization for use of lodging tax revenues. Based on the limited information available for the years 2008 through 2010, JLARC estimates that approximately 8 percent of lodging tax revenues has been spent for the newly authorized purposes, with 92 percent of revenues being used for purposes allowable prior to the change.

Given the study timeframe, JLARC would normally be releasing a Scope and Objectives for the study at this time. However, JLARC is providing this completed report earlier than scheduled because our review of the existing data shows that we will not be able to estimate the economic impact of the use of lodging taxes since the 2007 statutory changes. This is due to incomplete reporting by local governments and concerns about the reliability of the tourist-related data that local governments collected. In addition, local governments were not asked to collect and report information on tourist spending, which is necessary for estimating economic impact.

The Legislature may consider continuing the authorization for local jurisdictions to support nonprofit events and facilities beyond the scheduled June 30, 2013, termination date. If the Legislature wishes to obtain reliable information for estimating the impact of these expenditures, additional data, collection guidance, and oversight would be needed. JLARC notes that: 1) financial information on lodging tax expenditures is available from local jurisdictions; 2) information on tourist volume could be collected but would require ongoing oversight and review; and 3) collecting information on tourist spending and economic impacts across all of the involved jurisdictions and events can be costly.

In making its decisions, the Legislature may want to consider two important caveats:

- The available financial data shows that the expanded use of lodging tax revenues accounted for a small proportion of total lodging tax expenditures (8 percent), and
- There would be costs associated with improved data collection and oversight, particularly for collecting reliable information on tourist spending.

REPORT DETAIL

Legislature Expanded Use of Lodging Tax Revenues in 2007

Washington law allows local governments—cities, counties, and towns—to levy sales taxes on lodging provided for less than one month. Jurisdictions may levy a sales tax up to 2 percent which is taken as a credit against state sales tax revenues on lodging. Jurisdictions may levy an additional local sales tax up to 2 percent on lodging. During Calendar Year 2010, these local sales taxes generated $65.4 million in revenue statewide.

Prior to 2007, local governments were limited in using lodging tax revenues "…for the purpose of paying all or any part of the cost of tourism promotion, acquisition of tourism-related facilities, or operation of tourism-related facilities." (RCW 67.28.1815) A jurisdiction could use funds for a tourism facility that it owned, such as a performing arts center, and for visitor and convention bureaus operated by nonprofit organizations.

Attorney General opinions issued in 2000 and 2006 held that while cities, counties and towns could allocate lodging tax revenues to nonprofit organizations to advertise and promote tourism and local attractions, jurisdictions could not use these revenues to sponsor or support events or facilities in which the local government did not have an ownership interest.

In 2007, the Legislature enacted SSB 5647, which expanded the authorized uses of lodging tax revenues by local jurisdictions. This change allows local governments to provide lodging tax funds to support the operations and capital expenditures of tourism-related facilities owned by nonprofit organizations described under section 501(c)(3) and section 501(c)(6) of the Internal Revenue Code of 1986, as amended. This change allows jurisdictions to use lodging tax revenue to provide direct support to events and facilities, such as historical societies and community celebrations, in which the jurisdiction lacks an ownership interest. This authority terminates on June 30, 2013.

The legislation also directed local governments to report information about lodging tax funds they used and funds provided to nonprofit organizations. Beginning in 2008, local governments were required to report to the Department of Commerce (Commerce) on the funds used by the jurisdictions themselves and the funds allocated to nonprofit organizations. In addition to expenditure information, statute requires the reports to identify for each event the number of: 1) tourists attending, 2) tourists traveling over 50 miles to the event, 3) overnight stays, and 4) lodging stays. JLARC was directed to evaluate the economic impact of the use of these funds and report by September 2012.

How Commerce Implemented the Reporting Requirement

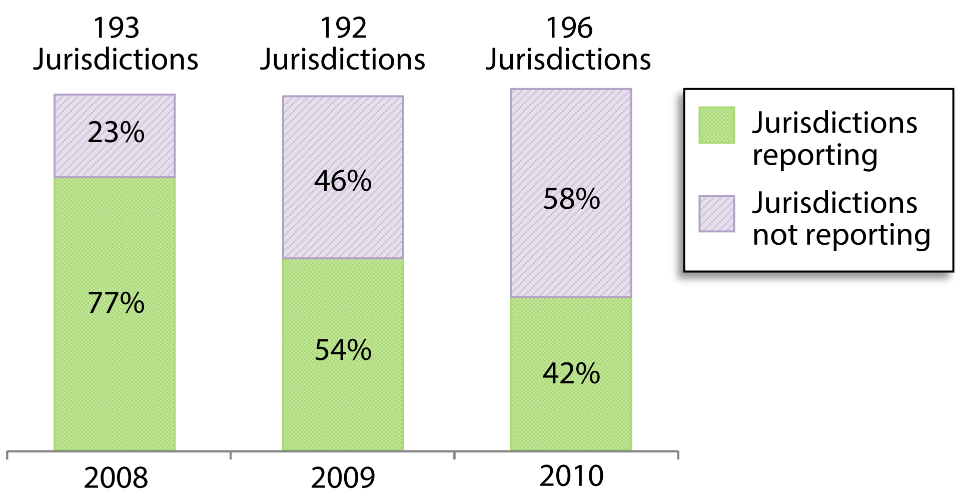
The Department of Commerce developed worksheets and report forms for this purpose. The Department engaged a consultant to develop guidelines to local governments on how to develop the information required for the report. The primary source of information about nonprofit events and festivals receiving lodging tax revenues is the sponsoring organization, which is supposed to submit a worksheet to the local jurisdiction. The jurisdiction is then supposed to combine information from the individual event worksheets with lodging tax revenue and expenditure information and submit the lodging tax report to Commerce.

The Department issued instructions and forms to cities, counties and towns in mid-2008 and received the first lodging tax use reports in the following year. Commerce did not follow up on non-responding jurisdictions or send reminder notices to jurisdictions in subsequent years. Commerce stated that it was "not required to evaluate the information provided by local jurisdictions." As a result, no quality control of the data collection was performed prior to JLARC's work.

Many Jurisdictions Have Not Reported

Reporting on the use of lodging tax revenues has declined steadily since the first year when three-fourths of Washington local governments submitted reports to the Department of Commerce. The overall response rate for all local jurisdictions for the three-year period is 58 percent. As a result, much of the information needed to assess the impact of the changes made by SSB 5647 is not available.

Exhibit 1 – Jurisdiction Reporting is Declining



Source: JLARC analysis of reports submitted to the Department of Commerce and lodging tax distribution reports provided by the Department of Revenue.

Approximately 8 Percent of Lodging Tax Revenues Allocated to Newly Authorized Uses

In reviewing the reports that were submitted, JLARC focused on 34 jurisdictions that account for approximately 75 percent of lodging tax revenues reported by the Department of Revenue.[1] Twelve of these jurisdictions submitted reports for all three years, 15 jurisdictions reported in one or two years, and seven did not report in any year. The reports submitted by the 27 reporting jurisdictions

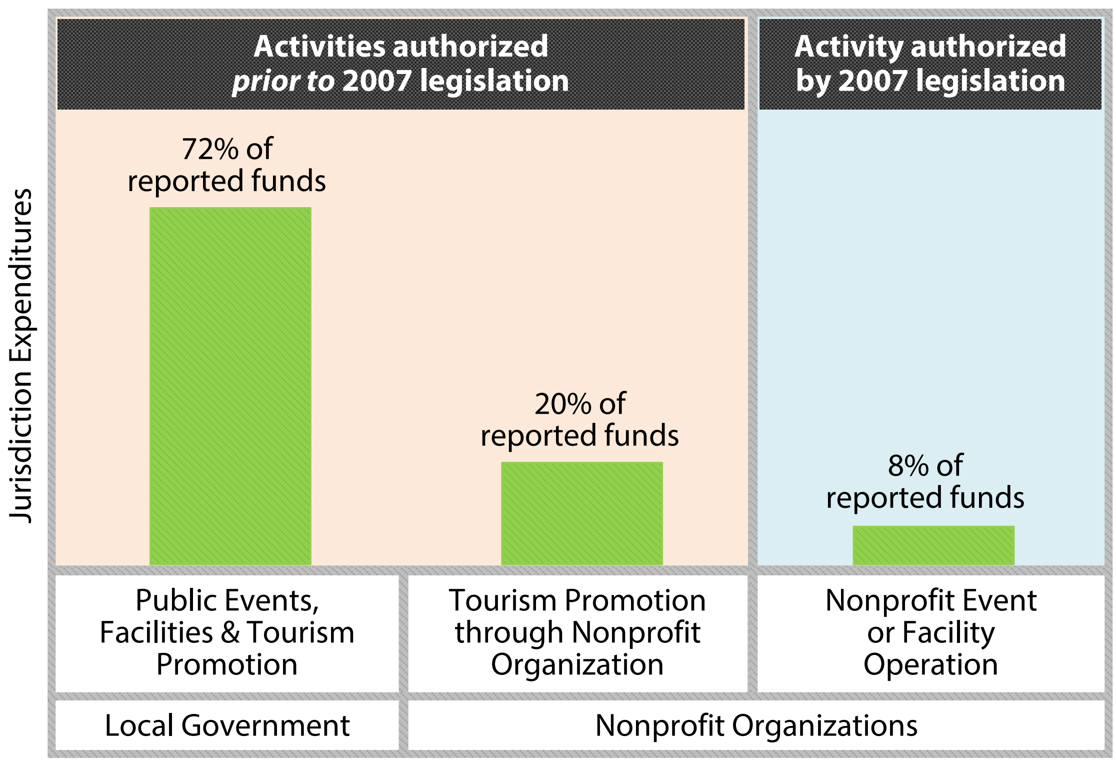
[1] King County is not included in this analysis because all King County lodging taxes are dedicated to retiring the public debt on the Kingdome. During the period reviewed, King County did not allocate lodging tax revenue to nonprofit organizations under the expanded authority established in SSB 5647.

account for approximately 41 percent of all lodging tax revenues collected statewide in 2008, 2009, and 2010 (King County excepted).

JLARC reviewed the financial information submitted by these jurisdictions to evaluate its accuracy and reliability. The financial information reported is generally consistent with financial information maintained by the Department of Revenue and the State Auditor's Office. However, the report format developed by Commerce is open to interpretation, and reporting is not uniform. As a result, further documentation of specific expenditures requires some judgment and significant follow-up.

The available financial information from the large jurisdictions that reported for one or more years indicates that the impact of the 2007 statutory change has been limited. While nonprofit organizations have received lodging tax funds from their local governments to support specific events and facilities, those funds amount to about 8 percent of the lodging tax revenues expended by reporting jurisdictions. An estimated 92 percent of the lodging tax expenditures reported by jurisdictions were used for purposes which were authorized prior to the 2007 legislation; this portion of the funding went to events and facilities in which the jurisdiction has an ownership interest or to fund tourism promotion generally, for example through visitor and convention bureaus operated by nonprofit organizations.

Exhibit 2 – Approximately 8 Percent of Reported Lodging Taxes Are Allocated to Newly Authorized Uses, 2008 through 2010



Source: JLARC analysis of reports submitted to Department of Commerce by local governments. Of the 34 jurisdictions that account for 75% of lodging tax revenues, 12 jurisdictions reported for all three years, 15 reported in one or two years, and seven did not report in any year. The data presented in this exhibit includes $57.5 million reported by 27 jurisdictions and accounts for 41% of lodging tax revenues collected statewide 2008 through 2010.

The Legislature may also be interested in the number of newly authorized events and facilities receiving lodging tax funds and the amounts the nonprofit organizations received. For the 12 jurisdictions that reported for all three years:

- 129 nonprofit events received an average of $12,140. Half of these events received less than $7,000. Allocations for individual events ranged from $281 to $75,000. Examples of events sponsored include local marathons, community celebrations, and national sporting championships.
- The 18 nonprofit facilities receiving lodging tax support averaged $24,971with half receiving less than $13,750. Allocations for individual facilities ranged from $710 to $105,798. Examples include local historical museums and performance venues.

Reported Information Not Adequate to Estimate Economic Impact

The information available from the lodging tax reports submitted to Commerce by local jurisdictions does not allow JLARC to report, as directed by SSB 5647, on the economic impact generated by nonprofit festivals, events, and facilities receiving support from lodging tax revenues. JLARC's review of jurisdiction reports identified concerns about the reliability of some reported information. In addition, the reports do not provide all information needed to estimate economic impact.

Some Tourist Volume and Lodging Information May Not Be Reliable

Although reporting jurisdictions made good efforts to obtain and report visitation and lodging stay estimates, the descriptions of how those estimates were developed provides little basis for assessing their reliability as required by government auditing standards. Where possible, JLARC compared data among jurisdictions and between years. That review identified inconsistencies and questions that limit our confidence in the data. Testing and validating the data would require examining each individual organization that received lodging tax revenues from local jurisdictions, a large undertaking. Absent some description of the methodology used to determine the number of tourists and lodging stays, JLARC cannot use these figures to draw reliable conclusions.

Key Tourism Information Is Not Reported

Although the Legislature asked JLARC for an economic impact evaluation, the reporting system created by SSB 5647 and implemented by the Department of Commerce lacks essential information for evaluating the economic impact of tourism.

- The lodging tax reporting form designed by Commerce does not collect information on the number of tourists traveling over 50 miles to an event or the number of tourists staying overnight, both of which are required by SSB 5647. This information may be available on worksheets submitted to the local jurisdictions by nonprofit organizations but it is not reported to Commerce.
- Neither the lodging tax reports nor the supporting worksheets include information on the total cost of an event. That information would allow an evaluator to assess the relative contribution of lodging tax revenues to the total cost of the event, as well as to the number of tourists and lodging stays reported for the event or facility.

- Statute does not require local governments to provide information on tourist spending for events and activities. According to the professional literature on tourism impact evaluation, tourist spending is an essential variable for estimating economic impact. Obtaining that information, however, can be difficult and costly. One such study, for a major facility operating year-round, cost approximately $40,000. A firm specializing in tourism evaluation estimated that a single event evaluation might cost between $4,000 and $10,000 depending on event length and level of analysis.

Obtaining Information to Estimate Lodging Tax Impacts

This report provides the extent of the analysis that JLARC is able to complete for this study based on the data collected under SSB 5647. The Legislature will not have complete or reliable information on the economic impact of lodging tax funds allocated to nonprofit organizations to operate facilities or hold events when this authority expires in 2013. The reporting system created in 2007 has not produced the data needed to evaluate economic impact.

The Legislature may consider continuing the authorization for local jurisdictions to support nonprofit events and facilities beyond the scheduled June 30, 2013 termination date. If the Legislature wishes to obtain reliable information for estimating the impact of these expenditures, additional data, collection guidance, and oversight would be needed.

Financial Information Is Available Locally, But Reporting Would Need to Be Improved

Local government financial information systems can produce accurate and reliable information on lodging tax revenues and expenditures. However, the lodging tax reporting format developed by Commerce does not clearly account for all expenditures from lodging tax accounts. A clear reporting format would need to specifically identify:

- Total lodging tax revenue;
- Total expenditures from lodging tax accounts; and
- Expenditures by category for:
  - jurisdiction events, facilities, and tourism promotion;
  - nonprofit organizations promoting and advertising tourism; and
  - nonprofit organizations to operate events and facilities.

A state-level organization would need to be assigned responsibility of monitoring reporting compliance, following up with non-reporting jurisdictions, and assessing reported financial information.

Information on Tourist Volume Could Be Collected but Would Require Oversight and Review

Although information on the number of tourists and lodging stays does not fully measure economic impact, this information can serve as an indicator of impact. However, greater oversight would be needed to monitor reporting compliance and review reports for completeness and consistency of tourist and lodging information reported. Commerce's consultant has provided local jurisdictions with guidance on different approaches to collect information on tourist volume. Overseeing this data collection would require sufficient knowledge of local events to assess the quality of the tourist volume and lodging stay information for those individual events. That task might be more appropriately assigned to local entities such as the lodging tax advisory committee required by law in most jurisdictions.

Assessing Economic Impact Can be Costly

If the Legislature wants to measure the full economic impact of lodging tax funds used to support nonprofit organizations' events and facilities, the sponsoring organizations would need to obtain information on spending by the tourists participating in those events and visiting facilities. As noted previously, obtaining the information to accurately measure the economic impact of tourism expenditures can be costly. For many small nonprofit events and facilities, the cost to conduct a valid economic impact study could potentially use up a large portion of the lodging tax revenue the nonprofit received.

In determining whether to continue the expanded authorization for use of lodging tax funds and considering what information to require local jurisdictions to report, the Legislature may want to consider two important caveats identified in this review:

- The available financial data shows that use of lodging tax revenues to support nonprofit events and facilities accounts for a small proportion of total lodging tax expenditures (8 percent), and
- There would be costs and burdens associated with improved data collection and oversight, particularly collecting reliable information on tourist spending.

Appendix 1 – Scope and Objectives

USE OF LODGING TAXES

PRE-AUDIT SCOPE & OBJECTIVES

STATE OF WASHINGTON

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Why a JLARC Study of Use of Lodging Taxes?

SSB 5647 enacted in 2007 directs the Joint Legislative Audit and Review Committee to report on the economic impact of expenditures made by local jurisdictions in support of nonprofit festivals, events, and facilities. The JLARC report is due in September 2012.

Background

Local jurisdictions in Washington may levy sales tax on lodging of less than one month duration. In 2010 local revenue from sale on lodging totaled $65.4 million. Prior to 2007, statute limited the use of these revenues to activities and facilities in which local jurisdictions had ownership interest or to tourism promotion activities. SSB 5647 enacted in 2007 allowed local jurisdictions to use lodging tax revenue to support certain nonprofit organizations' events and facilities. The legislation also required localities to report their use of lodging tax revenue to the Department of Commerce.

Pre-Audit Scope and Objectives

JLARC will follow its established pre-audit procedures to gain an understanding of:

1. Statutory requirements governing use of lodging tax revenues,
2. Reporting requirements and procedures established pursuant to SSB 5647,
3. Financial information to document local jurisdiction use of lodging tax revenue,
4. Information on tourism and lodging stays reported by local jurisdictions, and
5. Methodologies for evaluating the economic impact of tourism.

APPENDIX 2 – AGENCY RESPONSES

- Department of Commerce

Note: JLARC also requested a response from the Office of Financial Management (OFM). OFM responded that they did not have comments on this report.

STATE OF WASHINGTON
DEPARTMENT OF COMMERCE
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April 18, 2012

Mr. Keenan Konopaski
Legislative Auditor
Joint Legislative Audit and Review Committee
PO Box 40910
Olympia, WA 98504-0910

RE: Lodging Tax Revenues: About 8 Percent of Funds Sponsor Nonprofit Events and Facilities, but Information is Inadequate to Estimate Economic Impact

Dear Mr. Konopaski:

Thank you for the opportunity to comment on the above-referenced report.

For years, the Department of Commerce (Commerce) was home to the Washington State Tourism Office. When the Legislature decided to expand the local use of the lodging tax it was natural they would ask Commerce to become involved. The report is correct in its description of Commerce's implementation of the bill. Commerce staff utilized an existing relationship with a nationally recognized expert to develop a reporting form and instructions for local governments to use when fulfilling their obligations according to the statute. Commerce staff provided all of this within existing resources; no additional funds were appropriated to Commerce for this work.

Additional information collection, as suggested by the report, could be added with minimal effort, and we agree that information would help create greater detail into the impact of these events. Unfortunately this will continue to be an inexact exercise. In order to truly gauge impact event organizers must deploy interviewers and perform analysis that, as the report states, would cost far more than the event received in funding from the lodging tax (estimated \$4,000 - \$10,000 per event).

Commerce worked with the state local government associations to disseminate the form and instructions to local jurisdictions, but without resources and further complicated by the closure of the Washington State Tourism office last year, Commerce could not follow up with individual jurisdictions to ensure reporting compliance. The statute does not give Commerce authority or responsibility to enforce compliance.

Mr. Keenan Konopaski
April 18, 2012
Page 2

We agree with the report's conclusion that a state-level organization would need to be assigned responsibility of monitoring reporting compliance, following up with non-reporting jurisdictions and assessing reported financial information. We also agree that, should the Legislature wish to more fully understand the impact of these events, data collection and oversight will be costly.

Sincerely,

Rogers Weed
Director

cc: Nick Demerice, Legislative Director
John Thomas, Internal Auditor