FOLLOW-UP REPORT
Department of Excise and Licenses and Department of Finance – Treasury Division
Short-Term Rental Enforcement
December 2018

Office of the Auditor
Audit Services Division
City and County of Denver

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December 6, 2018

AUDITOR'S REPORT

In keeping with generally accepted government auditing standards and the Audit Services Division's policy, as authorized by D.R.M.C. § 20-276, our Division has a responsibility to monitor and follow up on audit recommendations to ensure audit findings are being addressed through appropriate corrective action and to aid us in planning future audits.

In our follow-up effort for the Short-Term Rental Enforcement audit issued December 14, 2017, we determined the Department of Excise and Licenses (Excise and Licenses) and the Department of Finance – Treasury Division (Treasury) have taken action towards implementing some of the recommendations made in the audit report. Despite Excise and License and Treasury’s efforts, auditors determined the risk associated with the audit team’s initial findings has not been fully mitigated. As a result, the Division may revisit these risk areas in future audits to ensure appropriate corrective action is taken.

For your reference, this report includes a highlights page that provides background and summary information on the original audit and the completed follow-up effort. Following the highlights page is a detailed implementation status update for each recommendation. Although we did not update the status of recommendations that Excise and Licenses disagreed with, these recommendations are included in the status update section as a reference.

This concludes audit follow-up work related to this audit. I would like to express our sincere appreciation to Excise and Licenses and Treasury personnel who assisted us throughout the audit and follow-up process. If you have any questions, please feel free to contact me at 720-913-5000 or LaKeshia Allen Horner, Internal Audit Supervisor, at 720-913-5085.

Denver Auditor’s Office

[Signature]

Timothy M. O’Brien, CPA
Auditor
Short-Term Rental Enforcement
December 2018

Follow-up Status
The Department of Excise and Licenses (Excise and Licenses) and the Department of Finance – Treasury Division (Treasury) have fully or partially implemented five of the six recommendations agreed to in the December 2017 audit report. Excise and Licenses disagreed with two recommendations.

Objective
The objective of the audit was to assess the efficacy of Excise and Licenses’ and Treasury’s administrative processes and procedures for enforcing short-term rental regulations, including ensuring adherence to licensing requirements and collecting the City’s Lodger’s Tax.

Background
Short-term rentals (STRs), also called rentals by owner or vacation home rentals, are private residences leased to private parties to provide lodging for short-term stays.

In July 2016, the City and County of Denver authorized the operation of STRs in primary residences for a period of less than 30 days. To operate lawfully in the City, STR hosts are required to obtain a business license from Excise and Licenses. In addition, STR hosts are required to collect and remit Lodger’s Tax and other applicable taxes to Treasury.

Highlights from Original Audit

Licensing and Enforcement – Excise and Licenses needed to improve its current licensing and enforcement activities through better alignment with the law, departmental rules, regulations, and accurate licensing data. Discrepancies between licensing and enforcement rules, regulations, and the law could lead to public confusion and perception of inequity and might put the City at risk for legal action. Also, data that were incomplete, inaccurate, or invalid could hamper Excise and Licenses’ ability to develop, analyze, and use quality information to assess the effectiveness of its enforcement efforts.

Program Evaluation – Excise and Licenses had developed a Short-Term Rental Strategic Enforcement Plan but lacked a systematic approach for collecting and analyzing agency data to determine the effectiveness of STR enforcement efforts. Without a systematic approach for developing, collecting, and analyzing information about STR enforcement efforts, Excise and Licenses may be missing opportunities to strengthen its ability to ensure the safe, efficient, and responsible operation of short-term rentals within the City.

Contracting Process – Excise and Licenses’ process for selecting a compliance software service provider did not fully adhere to the City’s competitive selection processes or best practices, which could place Excise and Licenses at risk for not selecting the most cost-effective option for the best value.

Tax Compliance – Gaps in Treasury’s Lodger’s Tax validation procedures for Lodger’s Tax identification numbers could adversely impact compliance with the City’s tax laws and impede the division’s ability to ensure that all persons holding an STR license are paying all applicable taxes.

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RECOMMENDATION STATUS OF IMPLEMENTATION

FINDING: The City Cannot Fully Assess the Effectiveness of its Short-Term Rental Processes and Procedures for Licensing and Enforcement

Recommendation

1.1 Compliance with Applicable Laws – The Director of Excise and Licenses should evaluate current and future Department of Excise and Licenses short-term rental licensing and enforcement policies and procedures to ensure compliance with the Denver Revised Municipal Code and other applicable laws, including those related to proof of possession, insurance coverage, processes for issuance and denial, and administrative citations.

Status: Partially Implemented (Original target date for completion: March 2018)

Agency Action

Excise and Licenses evaluated its policies and procedures related to proof of possession, insurance coverage, processes for issuance and denial, and administrative citations to ensure compliance with the Denver Revised Municipal Code (D.R.M.C.). Excise and Licenses’ evaluation of its policies and procedures resulted in the following changes:

- **Proof of Possession** – Excise and Licenses modified its online application process for short-term rental licenses to require, at the time of application, evidence of ownership or written permission from the property owner to operate a short-term rental—referred to as “proof of possession.” To ensure accuracy and completeness, the department also revised its internal process for reviewing applications to require the review of proof of possession documentation.

- **Insurance Coverage** – To better understand practices for accepting insurance acquired by short-term rental hosts, Excise and Licenses reviewed insurance requirements in other municipalities and examined coverage offered through online short-term rental service providers. Based on the information gathered, Excise and Licenses drafted rules for short-term rental insurance, which document the department’s practices for accepting insurance—including setting liability limits for insurance provided through online platforms. Excise and Licenses also worked with the Short-Term Rental Advisory Committee to obtain guidance and recommendations on rules for the proposed insurance requirement.

- **Administrative Citations** – Excise and Licenses revised the content of its administration citations for short-term rentals to include the approximate time the violation was observed and the signature of the enforcement official, as is required by City ordinance. The department also revised administrative citations to specify that persons served with a citation can file a written notice of appeal within 10 calendar days after the date they were served, as opposed to the 14 days previously printed on the citation.

Although Excise and Licenses has taken several important steps toward aligning its processes for short-term rental licensing with applicable laws, the department has not addressed several components of the recommendation. For example, despite having developed draft rules for insurance requirements, Excise and Licenses has not finalized those proposed rules. Department officials estimate the rules will be finalized and formally adopted before the end of 2018, following a public hearing.
For administrative citations, Excise and Licenses has continued its practice of sending all citations by certified mail without first attempting to deliver the citation to the property that is the subject of the violation. As noted in original audit report, the D.R.M.C. states that an Excise and Licenses enforcement official should deliver an administrative citation to the responsible party at the site of the violation or at the responsible party’s business or personal address. If the enforcement official is unable to issue the administrative citation directly to the responsible party, then—in addition to posting the citation to the site of the violation—the department is required to send the citation to the responsible party by first-class mail. Excise and License officials stated that, after consulting with the City Attorney’s Office, they determined personal service of administrative citations is not required and that mailing citations constitutes sufficient service. Moreover, Excise and Licenses has continued to accept signatures on certified mail receipts with the assumption the signature is that of the responsible party—contrary to a D.R.M.C. requirement that the department must have the signature of the responsible party on the citation itself.

Finally, Excise and Licenses has not established a process for preventing the issuance of short-term rental licenses in violation of City ordinance. Specifically, the D.R.M.C. prohibits Excise and Licenses from issuing a license to an applicant who has overdue fines, assessments, or fees owed to the City. Additionally, City ordinance prohibits the department from issuing a license to an applicant who has outstanding warrants for arrest in any municipality. However, Excise and Licenses has continued its practice of allowing short-term rental license applicants to attest that these requirements have been met during the online application process—as opposed to verifying that these requirements have been met in advance of issuing a license. Officials maintain that the department can deny an application for a short-term rental license or revoke an existing license, should officials become aware that an applicant or license holder is in violation of these prohibitions.

**Recommendation**

1.2 **Rules and Regulations** – The Director of Excise and Licenses should review and update all Department of Excise and Licenses rules and regulations to reflect current short-term rental enforcement practices, including those rules and regulations related to administrative citations.

**Status: Disagree**

**Agency Action**

No action taken.

**Recommendation**

1.3 **Performance Evaluation** – The Director of Excise and Licenses should develop and implement an approach for evaluating the effectiveness of its STR enforcement strategies and tactics, including a suite of measures to assess the efficiency and effectiveness of enforcement processes.

**Status: Partially Implemented (Original target date for completion: Ongoing)**

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1 D.R.M.C., §33-53 and §32-11 (6).
Agency Action

Excise and Licenses continues to use its Short-Term Rental Enforcement Plan, which outlines four main strategies and tactics for short-term rental enforcement, as shown in Table 1.

**TABLE 1. Short-Term Rental Strategic Enforcement Plan Mission, Strategies, and Tactics**

<table>
<thead>
<tr>
<th>Mission</th>
</tr>
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<tbody>
<tr>
<td>Ensure the safe, efficient, and responsible operation of short-term rentals within the City and County of Denver.</td>
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<table>
<thead>
<tr>
<th>Strategies and Tactics</th>
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<tbody>
<tr>
<td><strong>Strategy 1: Community Engagement</strong></td>
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<tr>
<td>• Provide “town hall” forums to heighten public awareness and seek input; provide a critical stakeholder (industry and host) forum for education on licensing requirements and enforcement; solicit community and stakeholder feedback and make adjustments as needed; establish and launch media campaign to notify and inform the public of the requirements</td>
</tr>
<tr>
<td><strong>Strategy 2: Ease of Compliance</strong></td>
</tr>
<tr>
<td>• Collaborate with internal City and County of Denver partners to establish core requirements; leverage existing enterprise applications to minimize implementation risks; deliver compliance tools in a medium familiar to core constituency; and develop resources to aid the community in complying with regulations</td>
</tr>
<tr>
<td><strong>Strategy 3: Compliance Monitoring and Enforcement</strong></td>
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<tr>
<td>• Determine method to identify and track scofflaw STRs; identify resources and mechanism to implement monitoring; coordinate with Peak team to ensure process efficiency; and utilize existing tools to facilitate compliance (reminders, notices of violation, and administrative citations)</td>
</tr>
<tr>
<td><strong>Strategy 4: Complaint Investigation Monitoring and Enforcement</strong></td>
</tr>
<tr>
<td>• Determine method to identify and track operator complaints; identify method for tracking licensed operators violating established requirements; utilize existing tools to facilitate compliance (reminders, notices of violation, postings, administrative citations); and coordinate with the City Attorney’s Office, provide evidence for City Attorney’s Office determination to show cause for revocation</td>
</tr>
</tbody>
</table>

Source: City and County of Denver Department of Excise and Licenses.

Note:

Excise and Licenses has identified some measures for monitoring short-term rental enforcement and compliance. For example, consistent with its Strategy 3, Excise and Licenses relies on several measures to gauge compliance with the department’s licensing requirements and enforcement. Specifically, Excise and Licenses monitors the number of advertisements for short-term rental properties, the number of licenses issued, and the compliance rate—which is the percentage of unique short-term rentals that comply with licensing requirements. To assess the effectiveness of its enforcement efforts, the department measures the number of violation notices and of administrative citations issued and analyzes the success rates for subsequent enforcement actions. Lastly, consistent with Strategy 4, Excise and Licenses analyzes data on short-term rental complaints to monitor both the number and the nature of complaints.

However, as stated in the original report, Excise and Licenses has not identified specific measures or methods for assessing the effectiveness of all strategies and tactics outlined in its enforcement plan. For
Strategy 2, the department has not specified measures or methods for assessing how well these compliance tools are helping them address customer service and overall compliance. Similarly, Excise and Licenses has not developed a way to determine whether its efforts to help the community comply with STR regulations are effective.

Recommendation

1.4 **Neighborhood Impact** – The Director of Excise and Licenses should develop and implement an approach for tracking and analyzing data to evaluate the impact of short-term rentals on the City’s neighborhoods, including the effect of STRs on housing affordability.

**Status: Disagree**

**Agency Action**

No action taken.

Recommendation

1.5 **Data Reliability** – The Director of Excise and Licenses should improve the reliability and quality of short-term rental enforcement data by developing policies and procedures to ensure that the data collected is complete, accurate, and valid.

**Status: Implemented (Original target date for completion: Ongoing)**

**Agency Action**

In response to our recommendation, Excise and Licenses updated both its application review policies and procedures and its information system controls to improve the reliability and quality of data on short-term rental enforcement. For example, Excise and Licenses’ Short-Term Rental Application Guide now includes a quality-control checklist containing procedures for verifying information to prevent (a) multiple licenses being issued to the same applicant, (b) hosts from operating short-term rentals in properties other than a primary residence, (c) applicants from using invalid government-issued identification, and (d) duplicate entries from license renewals. Also, Excise and Licenses worked with both Treasury and the City’s Technology Services to enable real-time verification of Lodger’s Tax account numbers when registering or renewing business licenses. This is meant to ensure short-term rental hosts have obtained a valid Lodger’s Tax number, as is required by ordinance.
Recommendation

1.6 **Contracting Practices** – For future procurement of short-term rental enforcement software services, the Director of Excise and Licenses should adhere to the requirements outlined in Executive Order No. 8B to ensure that the City selects the most cost-effective option for the best value.²

**Status: Not Implemented (Original target date for completion: November 2017)**

**Agency Action**

In the original audit, we found that Excise and Licenses’ procurement of compliance monitoring and enforcement software services did not fully align with the City’s contracting policies for competitive selection as outlined in Executive Order No. 8B. Specifically, we found that Excise and Licenses had not:

- Requested bids from at least three responsible parties;
- Obtained bids in a manner that would achieve maximum competition; nor
- Obtained written responses from all competing bidders.

In its formal response to the audit, Excise and Licenses stated that it had consulted with the Department of General Services – Purchasing Division and the City Attorney’s Office to procure enforcement software services for 2018, in accordance with the competitive selection requirements outlined in Executive Order No. 8B. Excise and Licenses also stated that the department would ensure greater documentation of vendor selection.

However, upon reviewing Excise and Licenses’ procurement documentation, we found that Excise and Licenses did not use a competitive bidding process to procure compliance and enforcement software services. Rather, the department opted to amend its existing contract—including an expansion of services—with Host Compliance, which is the current vendor.³ Therefore, the recommendation was not implemented, as Executive Order No. 8B applies to the competitive selection process.

Though Excise and Licenses did not use a competitive bidding process, department officials stated that they met with Host Compliance and two additional service providers to discuss compliance monitoring and enforcement services before amending the existing contract. However, Excise and Licenses did not provide documentation that summarized the issues discussed or the results of the conversations. Meanwhile, Excise and Licenses obtained written proposals from the two additional service providers, which contained descriptions of the services offered and corresponding pricing information. However, despite being awarded the amended contract, Host Compliance did not submit a written proposal containing details about its available services—including those not provided under the existing contract—but instead provided a general listing of pricing information and services available.

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² Executive Order No. 8B states every department and agency should (a) document the department’s method for soliciting bidders; (b) request bids from at least three responsible bidders or proposers or inform potential bidders or proposers of an invitation to bid “in a manner that will achieve maximum competition” to the City; and (c) require written responses from all interested parties.

³ Excise and Licenses’ previous contract with Host Compliance was for a term of one year and expired on December 31, 2017.
alternatives. When considering alternatives, the Director should also consider mission threats and dependencies on other programs.

Status: Partially Implemented (Original target date for completion: November 2017)

Agency Action

Excise and Licenses officials documented the department’s business case analysis for procuring a short-term rental enforcement software vendor in an email to the department’s executive director, dated December 2017. Consistent with leading practices, the analysis identified and compared the quantifiable and non-quantifiable costs and benefits associated with the bids presented—including factors such as operational effectiveness and suitability of the available alternatives.

However, as discussed in the original report, the U.S. Government Accountability Office (GAO) provides valuable guidance on business case analysis, in its publication titled, “GAO Cost Estimating and Assessment Guide.” Among other things, the guidance states that business case analyses should be balanced and should not be developed to support a pre-determined solution. Furthermore, GAO guidance states that business case analyses should be rigorous enough that independent auditors can review it and clearly understand why an alternative was chosen.4

As previously noted under Recommendation 1.6), Host Compliance did not submit a written proposal or other documentation containing detailed descriptions of the available services. The absence of this information prevents independent parties from having the facts and supporting details required to understand the extent to which each provider’s services address Excise and Licenses’ compliance and enforcement strategies.

Recommendation

1.8 Lodger’s Tax Validation – The Treasurer should improve the Treasury Division’s data validation policies and procedures to ensure that all persons holding an short-term business license have obtained a Lodger’s Tax license and identification number and are paying all applicable taxes.

Status: Implemented (Original target date for completion: November 2017)

Agency Action

Treasury worked with Excise and Licenses and the City’s Technology Services to enable real-time verification of Lodger’s Tax account numbers through the online application process for short-term rentals—which helps to ensure short-term rental hosts have obtained a valid Lodger’s Tax number, as is required by ordinance.

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CONCLUSION

While the Departments of Excise and Licenses and Finance - Treasury Division have made progress towards implementation of the agreed-upon recommendations made in the Short-Term Rental Enforcement Audit Report, one recommendation was not implemented. Despite Excise and Licenses’ efforts, auditors determined the risks associated with the audit team’s initial findings have not been fully mitigated. These risks include compliance with applicable laws, approaches for evaluating the effectiveness of its short-term rental enforcement strategies and tactics, and contracting practices. As a result, the Audit Services Division may revisit these risk areas in future audits to ensure appropriate corrective action is taken.

On behalf of the citizens of the City and County of Denver, we thank staff and leadership from Excise and Licenses for their cooperation during our follow-up effort and their dedicated public service.
Office of the Auditor

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