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Date	Ver.	Action By	Action	Result
11/27/2018	1	Council and Authorities Concurrent Meeting	Approved	Pass

## REPORT TO COUNCIL

### SUBJECT

Action on the City's Response to the Performance Audit "Santa Clara Convention Center and Convention-Visitors Bureau: Restructuring Operations Can Strengthen Accountability, Performance and Revenue" and Analysis of the Chamber's Response

### BACKGROUND

On May 22, 2018, by Council direction, the City hired TAP International to complete a performance audit of the Santa Clara Convention Center (SCCC) and Convention-Visitors Bureau (CVB). On September 18, 2018, TAP International presented its audit scope, audit findings, and recommendations (Attachment 1) in its report, "Santa Clara Convention Center and Convention-Visitors Bureau: Restructuring Operations Can Strengthen Accountability, Performance and Revenue" (Audit).

The Audit found that the fiscal health of the SCCC and CVB is good when evaluated separately, but that the City could strengthen the financial performance of both entities when evaluated together. The CVB and SCCC also received high customer satisfaction scores by users. The Audit also revealed serious failures to manage public assets with appropriate stewardship, accountability and transparency by the Contractor (Santa Clara Chamber of Commerce, referred to as the Contractor in the Audit and "Chamber" in this staff report).

Additional key findings include: problematic accounting practices of public funds by the Chamber; Chamber's apparent misuse of government assets; improper payment of commissions and bonuses without proper disclosure or transparency, which need further review; potential improper actions

relative to the Santa Clara Chamber of Commerce's Political Action Committee (SCCCPAC); unmanaged conflicts of interests by Chamber staff and Board; and, City's improper oversight of contracts for the SCCC and CVB.

On September 18, 2018, the Council directed the City Manager to issue a 180-day notice to terminate the Convention Center Management Agreement, while simultaneously engaging in a competitive procurement process for the management and operation of the Convention Center and take necessary actions to stabilize its operations and to minimize further impact to public resources and assets. On October 9, the Council approved a procurement strategy for a contract award to manage the Convention Center and related sales and marketing services as well as procurement process integrity and conflict of interest guidelines. These guidelines provide a fair opportunity to participants through a competitive process for the award of the future management contract. At the same meeting, the Chamber announced that it had posted to its website a document entitled "Santa Clara Chamber of Commerce Response to Audit Findings and Concerns with City Actions" (Chamber Response) (Attachment 2). Response from both TAP International (#18-699) and City staff (Discussion section below) are provided on the November 27, 2018 Council agenda.

## **DISCUSSION**

This section of the report provides response to the City Council on the City actions taken to address this Audit, as well as response to the Chamber's response to the Audit. Key to the Audit report is continued demonstration by the Chamber of its absence of basic working knowledge of management of public contracts, governance and authority, conflicts of interest, and the management of public assets and resources (that differ significantly from private sector practices). Equally absent was the City's dedicated oversight and management of these contracts to ensure the public's interest with dutifully managing this public assets and properly monitoring these contracts.

## ***CITY ACTIONS TO SCCC/CVB AUDIT***

### ***(1) City Implementation of Audit Recommendations***

**Audit Recommendations & Tracking** --Staff reviewed the 26 audit recommendations and developed an audit implementation plan matrix (Attachment 3). This plan lists the audit recommendations and the standard designation for the status of the recommendations such as Complete, Partially Complete and Not Implemented. The audit matrix is a conventional tool to track progress. Table 1 summarizes the current status of the recommendations grouped by RFP Related, Future Management Contract, and City Action Related.

**Table 1: Summary of Audit Recommendations Status - November 2018**

	<b>RFP Related</b>	<b>Future Management Contract</b>	<b>City Action Related</b>	<b>Total</b>
Complete	0	0	3	3
Partially Complete	11	0	0	11
Not Implemented	0	10	2	12
<b>Total</b>	<b>11</b>	<b>10</b>	<b>5</b>	<b>26</b>

Table 1 shows that 21 of 26 audit recommendations relate to the Request for Proposals (11

recommendations) or new operator contract (10 recommendations). These recommendations are intended to address the structural insufficiency of the current contracts. The audit recommendations categorized as “City Action Related” pertain to City actions required to address internal controls (Recommendation 2.G and 2.T), staff assignment for effective contract oversight (Recommendation 2.K), referral of audit findings to other public agencies (e.g., IRS and FPPC) (Recommendation 3), and CVB contract close-out activities (Recommendation 4).

**City Staffing and Oversight** -- Council has approved resources for staff to implement the SCCC audit and manage the new contracts (e.g., 1.0 FTE Assistant to the City Manager and 0.5 FTE Office Specialist III position). Recruitment is underway and the funding source is the SCCC and, possibly, the TID (see TID Audit regarding City responsibilities).

**Referral of Audit Findings to State and Federal Agencies** -- The Audit found that there were several instances in which referrals to other agencies should be made for possible investigations, specifically state and federal agencies. Based on the Audit recommendation, the City Attorney and City Manager referred the matters to the Internal Revenue Service (IRS) and California Fair Political Practices Commission (FPPC) (Attachments 4 and 5). On October 9, 2018, the FPPC provided a response and the matter is now with the District Attorney for review (Attachment 6).

**CVB Contract Close-out Activities** - At Council’s direction, the City Manager executed an amendment to the TAP International’s contract to provide: (1) Financial analysis and review of revenue and cost allocation by the Chamber of Commerce for the Convention-Visitors Bureau (CVB); (2) Reconciliation of the American Express credit card statements to review allocation of CVB-generated expenses; and, (3) Other contract close-out activities to ensure that all invoices submitted to the City contained proper support and that expenses were allowable and reasonable under the CVB contract. (City staff has reviewed allocation of expenses from Chamber credit card statements to either CVB or Convention Center accounts since May 2018.)

## ***CITY COMMENTS ON CHAMBER’S SCCC/CVB AUDIT RESPONSE***

### ***(1) Public Sector Governance***

Staff’s analysis of the Chamber Response revealed a significant lack of understanding of several basic governance and contract principles, particularly with a public agency, which together form the root cause of the numerous inaccuracies and misstatements in the Chamber Response. These basic principles include: public sector governance and authority; distinction between public sector vs. private sector conventional business practices; budget, contracting, oversight, and contract authority; and, auditing standards and purpose.

City of Santa Clara Charter and Municipal Code provide that the City Council shall formulate policy and establish rules and regulations for the governing of the City through ordinances, resolutions and oral motions or orders duly passed and entered in the official minutes of its meetings. The City Manager, as the chief executive officer, is responsible to the Council for the proper administration of all affairs of the City and to that end, has the authority, among other items: 1) to prepare the budget annually for Council approval and manage its implementation upon adoption and 2) make investigations into the affairs of this City, or any department or division thereof, or any contract, or the proper performance of any obligation to the City.

All actions taken by the City staff regarding the Convention Center and CVB have been consistent with the City Council direction/strategic pillars, Charter authorities, existing Chamber contracts, and professional standards/ethics. The Chamber Response does not recognize that through its two public contracts for the SCCC and CVB, it is bound and responsible to the City's governing body, common public sector regulations and contract practices, and non-profit/tax exempt corporation fiduciary responsibilities. The fact that the Chamber's Response does not acknowledge these responsibilities, illustrates its inability to have correctly managed these contracted services where it sees itself as responsible to the public and City Council for the transparent and responsible use of these public resources. It is unfortunate for both the Chamber and City that the conditions went unrecognized for several decades, costing both the inappropriate expenditures of public funds, persistent mismanagement of a public asset, and an unstable relationship between both governing bodies, e.g., Chamber Board and City Council.

**City Communications** -- As one of its strategic pillars, Council adopted "Enhance Community Engagement and Transparency." Consistent with the Council's policy objective, open and frequent communication with the community has been an active effort of the Administration and has been embraced by the City Council and community. Open communication with the Santa Clara community regarding City issues and events has been promoted through the City Manager bi-weekly blog; robust launch of MySantaClara customer relations management system; regular press releases; more frequent social media posting of public services and activities; and, multiple open letters to the community on City matters. Chamber Response states its belief that the City misused its authority by inappropriately communicating on this matter as an attempt to harm the Chamber is simply not true.

It should not be a surprise, or unwelcomed, that the City would want to be transparent about matters surrounding SCCC and CVB given the magnitude of findings that both confirm the shortcomings of management by the Chamber and City. Further, as both the City Council's directions and actions of specific City Councilmembers were mischaracterized by the Chamber and local media, press releases and letters were mailed to increase the reach of the accurate communication to clarify the City's position. The City has always had, and will always maintain, the right to communicate broadly to the Santa Clara community and it is completely responsible and appropriate for the City to correctly communicate the City's position for the public purpose which the actions support. The investment of approximately \$7,000 per mailing to communicate to the Santa Clara community is appropriate to support the principle of an open and transparent government- these actions were neither political, harmful, nor fraudulent.

**Public Sector vs. Private Sector Practices** -- The Chamber Response reflects a lack of basic understanding about the differences between public sector and private sector business practices and governance, as well as a misunderstanding of its duty as a tax-exempt nonprofit. While the Chamber explains its actions of fee waivers, discounts and compensation bonuses as conventional practices in the industry, it fails to acknowledge that it is not a private sector provider/operator in this industry, rather a non-profit/tax exempt management company of a public facility using 100% of public funds through a public contract. As such, the Chamber is bound to conventional public sector practices required to manage public contracts, resources, and assets in a transparent manner where the Chamber is directly responsible to the City Council (which holds the ultimate fiduciary responsibility of these contracts, the public funds, and the public asset).

Moreover, it is not at all clear that a nonprofit corporation can legally provide undisclosed fee waivers, discounts, and compensation bonuses, as part of a private sector business practice, when these types of remuneration go to Boardmembers and their friends and family. No matter how these

practices are viewed, the Chamber had a fiduciary obligation to be transparent in its management and to ensure that no self-dealing took place; Chamber staff's booking the SCCC; and, to establish proper protocols for these disclosures to the City Council.

Given that the City's General Fund was the backstop for operational financial shortcomings, the Chamber should have been transparent about how its business practices impacted the larger public good and adhered strictly to its own discount/fee waiver policies-which the Audit found it did not. Had the Chamber properly managed these discounts and fee waivers, it would have (1) established a transparent process and established a segregated fund to issue and track discounts and subsidies so that public reports could be issued as part of required quarterly reports and (2) adhered to its own facility discount policy of 20 percent on rental charges. Figure 27 on page 39 of the Audit summarizes fee discounts in the amount of \$16.1 million granted during the audit period (FY 2011-2012 to FY 2017-2018 [April]), which constitute about 45% of the total gross facility charges in the amount of \$36 million. The Audit described that 53.6% of all bookings were discounted (Page 39 of Attachment 1). The Audit confirmed that the Chamber did not adhere to its own policy for issuing discounts and/or waivers. The Chamber Response attempts to express that the City doesn't understand the industry, but incorrectly uses a private sector methodology while completely out of compliance with its own policy, as its explanation to justify its lack of transparency in compliance with proper public sector contracts.

**Public Sector Budget Appropriation** -- As the governing body, decision of the Council are made at Council meetings by majority vote and only such action binds the City (unless expressly delegated to the City Manager by a formal action of the City Council or City Charter). It is a well-known fact that individual members of the City Council do not have authority to bind the City on funding, contracts, or other matters. In the private sector, there may be more authority granted to individuals to make these fiscal and policy commitments, but that is not the case in local government. To argue that Mayor Gillmor and Councilmember Davis "authorized" a nearly tripling of the Chamber's Management Fee, from a flat fee of \$50,000 in FY 2015/16 to 2% of gross revenue or \$136,699 in FY 2016/17, as described in Chamber internal emails, demonstrates a lack of understanding of the authority of individual Councilmembers and public sector governance. Councilmembers engaging in any discussion with the Chamber do not constitute a binding action of the City Council. The City Council is only authorized to take action when properly noticed topics, consistent with the Brown Act, are publicly presented at a City Council meeting and by an affirmative majority vote. This is the only way the City Council can act on behalf of the City. The Chamber Response shows a misunderstanding of public sector governance and how the City Council takes action.

Further, there was no authority for: the Chamber to insert an increase in its budget for a Management Fee based on conversation with two Councilmembers; authority for the City staff to process increased payments; or, to leave the matter undisclosed when the City Council was presented with a revised budget for SCCC operations. As such, the Chamber Response asserts that the City Council approved the increase is wrong, because it was not properly disclosed to and publicly approved by the City Council. Further, a budget appropriation does not legally bind the City. Budget appropriations reflect expenditure plans and limits, but do not authorize the City Manager to expend funds absent proper contracts or delegated authority. For example, if the City Council approves a project budget for a dog park, it does not authorize the City Manager to execute agreements to construct the dog park.

The City Manager must publicly and competitively procure contractual services and seek Council approval to (1) enter into a contract and (2) appropriate funds or disclose the availability of funds for

the specific contract purpose. It is a fact that neither actions took place with respect to the Management Fee increase (e.g., contract to issue payments); the Chamber cannot claim that an undisclosed budget increase appropriation and discussions with the Mayor and one Councilmember constitutes proper approval. In fact, the Mayor and Councilmember disagree with the Chamber's characterization of those meetings.

**Public Sector Contracting & Existing Legal Obligations** -- The Chamber Response also reveals a lack of understanding about contract scope and proper management of scope obligations. The Chamber held two public contracts, one to manage the SCCC and another in support of CVB activities. Each of these public contracts contains legal obligations for the Chamber to fulfill, yet the Chamber Response illustrates a lack of knowledge of their contractual requirements and legal relationship to these contracts.

For example, the City's contract with the Chamber provided funds for CVB services. The City did not hire CVB employees and they were/are employees of the Chamber-any statement by the Chamber, its Boardmembers, or local media that the City terminated CVB employees is simply not true. The Chamber took action to terminate their employees, before the date for which the City provided transition funding and before the Chamber could implement its own transition plan to comply with the SCCC contract obligations. This action reflects poorly on the Chamber because it could not meet its legal reporting requirements to the City Council, relative to the requirements for the SCCC contract, as demonstrated in its incomplete 4<sup>th</sup> quarter SCCC Performance Report and statement that it cannot sustain booking/marketing activity for the SCCC.

The CVB contract had been structured as a one-year contract requiring renewal annually. Council's consideration of the contract was discretionary, meaning Council could have chosen to approve or deny the funding request during any given year. In June 2018, the Council chose to allow the CVB contract to expire without a replacement contract for FY18/19. As with any other business that experiences a loss of revenue, it was up to the Chamber to establish a contingency plan for its needs, as well as determine how to best manage its own organization in response to the loss of funding. Nevertheless, understanding the potential human impact of the Council's decision, Council authorized payment of an amount equal to 60 days of salaries for CVB employees in order to provide some continuity and for the close-out transition for the Chamber and its employees with respect to CVB activities. The Council also authorized the City Manager to move funding for some employees to the SCCC contract for the purpose of maintaining compliance with the SCCC public contract. The Council's action did not change the status of the existing SCCC contractual legal requirements on the part of the Chamber. However, the Chamber's action revealed the following contract confusion:

- There were two companion contracts: 1) annual CVB contract and 2) Convention Center Management Agreement. The CVB contract included convention center sales and marketing as a core part of its scope of services. The scope of services under the SCCC Management Agreement provides that the Chamber would "market, advertise, and promote the convention center..." for the purpose of booking. The SCCC maintains some booking activity, as confirmed in the Audit.
- The expiration of the CVB contract did not modify the scope of services required under the SCCC Management Agreement. As explained at the July 16 and August 21 Council meetings, staff could not enter into an Agreement with a third party to provide these same services, because the Chamber (through the SCCC Management Agreement) was already contractually required to provide these same services. Despite the fact that the City Council and City

Manager authorized funding for some employees to be transferred over to the SCCC, it does not appear that any effort was made which impaired the Chamber's ability to uphold its legal obligations outlined in the SCCC Management Agreement. Had the Chamber better understood the Council's actions, it could have engaged in more meaningful conversations to transfer some of its CVB employees to the SCCC Management Agreement for proper and stable transition: instead the Chamber took broad action to destabilize the SCCC, terminate TID funded employees, and close out the CVB without proper actions.

- The Chamber Response correctly points out that the City (through Assistant City Manager Ruth Shikada) advised the Chamber that there was not an expectation that CVB services, under the CVB contract, continue to be provided beyond the expiration of the contract. However, the Chamber in error used this communication to relieve itself of SCCC contractual obligations requiring the Chamber to "market, advertise, and promote the convention center..." for the purpose of booking. The Chamber's lack of understanding of its existing SCCC contract obligation and, use of this direction to attempt to establish contradictory direction from the City, illustrates that the Chamber does not understand its contractual obligations under the SCCC Management Agreement and, through its own actions, created a much higher level of chaos within its organization and for its employees. In fact, on several occasions both public and private, the Chamber/Convention Center was advised by City staff that the Chamber could transfer some employees to the SCCC operations to sustain booking and other services (per SCCC Management Agreement), but the Chamber took no action to maintain these functions through its SCCC Management Agreement and at its own peril.
- The City made a payment to the Chamber consistent with Council direction (payment of 60 days of salaries) prior to the expiration of the CVB contract. The Chamber's broad sweeping actions to terminate TID employees jeopardized its TID "Fiscal Agent" obligations of the TID, unnecessarily. In fact, given that the TID employees were funded by non-CVB funds, for which the City Council has taken no action, the City advised the Chamber that it could move fundings for transfer of employees to the Convention Center Management Agreement for the purpose of continuity and sustainment of TID obligations. The Chamber, on its own, terminated its TID funded employees which further rendered itself unable to continue the services and obligations as Fiscal Agent of the TID. The Chamber's overly broad actions to terminate its employees (without regard to its legal obligations under the SCCC contract, CVB contract and Council transition action, and TID fiscal agent obligations), without regard to the Council's offer to fund some employees moving to the SCCC contract, has placed itself in a position where it is no longer able to fulfill its contractual obligations that still exist and, therefore, negatively impacting future bookings of events at the Convention Center and hotel room bookings within the TID and the City as described publicly by TID representatives. These actions demonstrate the Chamber's inability to distinguish its legal obligations for the various public agreements or obligations that it holds/held (e.g., CVB, TID fiscal agent, and SCCC operations).
- Since the Management Agreement requires marketing, advertising and promotion of SCCC, and the SCCC Management Agreement is still valid, there is a legal obligations that some form of these services are and will continue to be provided. CVB files were transferred by City staff to the SCCC staff after CVB offices closed. Since the Chamber remained the responsible entity for marketing, advertising and promotion of SCCC, it would have seemed prudent that after the Chamber made a decision to release CVB employees from employment, a transition of records and work effort between its own internal staff would have occurred in order to execute the organization's continuing responsibilities under the SCCC Management

Agreement. However, the City had to initiate this transfer of documents for the Chamber for the continuance of SCCC required services. This further illustrates the lack of knowledge on the part of the Chamber of its legal obligations within the existing management contract, but demonstrates how it removed itself of SCCC oversight when the CVB contract expired.

**Chamber Contract Authority** - The SCCC operates under an agreement between the City of Santa Clara and the Chamber. The 1984 Management Agreement only provides the Chamber with authority to operate the SCCC and to enter into agreements for operations. Particularly, the SCCC Management Agreement does not vest any property rights from the City of Santa Clara to the Chamber as part of operations, nor does it allow the Chamber to convey the City's property rights or part of the facility to a third party. Therefore the Chamber was not authorized to enter into leases for space at the Convention Center. Only the City Council, acting as the owner for City property, can authorize a transfer of the City's property rights. There was a complete absence of recognition by the Chamber when it allowed the Convention Center staff (who had no legal authority to bind the Chamber or City in such lease agreement) to a lease agreement with UPS. As the UPS Lease Agreement was not authorized by the City, there is not a legal relationship between the City, Chamber, and a third party for the UPS store in the SCCC-a public facility. Chamber Response does not reflect an understanding of two core contracting principles: 1) there was no contract authority for the Chamber, or SCCC operations, to enter into a Lease Agreement that binds the City of Santa Clara and 2) without a valid Lease Agreement that only the City Council can approve, there were never any legitimate rights to transfer from the previous UPS tenant to a new UPS tenant (the Chamber Boardmember). The absence of the Chamber's understanding of its contractual limits and obligations through the SCCC Management Agreement to operate the SCCC illustrates how several of these actions could have occurred.

**Business and Industry Oversight** -- Management of a publicly owned Convention Center and the public funds involved, requires an understanding of the public sector obligations and practices, as well as industry practices and business trends. The Chamber Response establishes that it does not understand the requirements to manage a public facility or funds and, instead, depends on "hand shake" deals as an explanation/justification for management shortcomings and oversight.

The Chamber was responsible for management oversight of the SCCC and CVB, which should have included business practices and models to maximize revenue and independence from the General Fund, versus dependence on the General Fund for operations and capital projects. The City requested, and the Chamber provided, one year of its Board meeting minutes to understand and substantiate the Board's extent of oversight at its regular meetings. A review of the minutes shows a shallow oversight role of the SCCC and CVB, both by way of oversight of operations and its review of business and industry practices and trends. The weaknesses in the model, identified by both Jones Lang LaSalle, a consultant company, and the Audit were never reflected in the Chamber meeting minutes and, in fact, its minutes show no focus/diligence on strategies to improve performance through critical analysis of their existing practices and industry trends. Had the Chamber conducted such evaluations, it would have discovered the Audit's finding of internal conflict between the CVB multi-day bookings and Convention Center one-day booking practices that disadvantaged the multi-day bookings over one-day bookings, as a loss of hotel bookings and potential greater revenue generation. The fact that the Chamber, as part of its management oversight of SCCC and CVB operations, did not recognize its own internal operational flaws and internal conflicts with bookings, illustrates its significant gaps in managing these services.

## **(2) Conflicts of Interests**



The Chamber Response also demonstrated disturbing and unmanaged conflicts of interests; however, it positively acknowledges the Chamber's recent admission of efforts to implement conflict of interest training for its organization. The Chamber demonstrates a need for training, management of its "real" and/or "perceived" conflicts, and corrective action for inaccurately filing of its IRS Form 990: Exempt from Income Tax with respect to its maintenance of a conflict of interest policy.

Apart from the Audit, and as directed by the City Council, staff's analysis found that the Chamber filed IRS Form 990 inaccurately by declaring under penalty of perjury for multiple years that it did not maintain a conflict of interest policy, when it affirmatively confirmed with the City, and produced such policy, that it did maintain a Conflict of Interest Policy. The likeliness that the Chamber did not manage conflicts of interest is more credible, as reflected in the actions of the Board and the significant delay in producing conflicts of interest documents when requested by the City (most of which were executed by Board members during the period of time for which the request was outstanding).

For example, the Chamber, through its own Conflict of Interest policy, holds itself to a threshold standard of avoiding a "perception" of a conflict of interest, let alone a "real" conflict. The Chamber Response incorrectly defends its actions regarding the findings of conflicts in the Audit, in that the Chamber did not meet its own standards to avoid even the "perception" of a conflict, nor did it correctly disclose the perception/real conflict to the "appropriate level of authority" which is the City Council given that the conflicts arise from certain Boardmember's inappropriate use of public assets and/or resources. The City Council is the appropriate authority because the Board is the governing body of the Chamber activities and it responsible for the implementation of the SCCC and CVB publicly funded contracts. The Chamber's Conflict of Interest Policy clearly states:

A conflict of interest exists when officers, board members or staff has a direct or indirect business, professional or personal situation or relationship that may influence or be perceived to influence the judgment or action of the officer, Board Member or staff when servicing the Santa Clara Chamber of Commerce & Convention-Visitors Bureau...***All real or perceived conflict of interest will be disclosed to the appropriate level of authority necessary*** for consideration, resolution and direction. [emphasis added]

The Chamber Response explains that there were no conflicts of interest when Mr. Miles Barber, owner of the Santa Clara Weekly and Boardmember of the Chamber, had the CVB marketing staff advertise in his local publication. The Chamber Response uses various irrelevant reasons to explain away the real conflict and focuses on the CVB's intentions to advertise for the purpose of booking the SCCC, e.g., targeting local corporations, decline of media publications, seasoned marketing staff making decisions, under market pricing by Mr. Barber. The Chamber Response also states the absence of a conflict as it was approved by various chain of command levels within the Chamber (e.g., CEO/President, Board Chair, and CVB Supervisor).

The explanation illustrates the Chamber's complete lack of knowledge of how to manage and avoid conflicts of interest, which do not take into consideration the intention of individual's actions to offset a violation. According to the Chamber Response, neither Mr. Barber declined to profit from CVB funds when approached for advertisements, which he should have done to avoid a "real" and "perception" of an economic interest resulting from profits to his personal business while concurrently holding a Boardmember role. If Mr. Barber had upheld the Chamber's Conflict of Interest Policy, he should have declined the CVB's request to advertise in the Santa Clara Weekly to prevent even the

“perception” of a conflict of interest-- the threshold established in the Chamber’s own policy. He did not.

More disturbing is that the Chamber explains the properness of its actions by stating that the transaction between the CVB and Mr. Barber were reviewed and approved at various levels within the Chamber, e.g., CEO/President, Board Chair, and CVB Supervisor. This chain of command review and approval by the Chamber does not remedy or establish that there was no conflict; to make this matter worse, it does show that the “real” and “perception” of a conflict was not detected at multiple levels within the Chamber organization to prevent it from occurring, which instead of it serving as a correction to the conflict of interest, demonstrates a complete failure at all levels within the Chamber to uphold the Chamber’s Conflict of Interest Policy and prevent violations of it. This is disturbing because the Boardmember did not decline the advertising and profits and the Chamber staff did not detect the conflict.

In addition to its internal failures to prevent this conflict of interest, when the City did inquire about these events, the Chamber failed to provide a consistent response to the economic advantage afforded Mr. Barber through these violations. The Chamber has provided three responses to the actual value of publicly funded economic benefit that Mr. Barber received from these violations, for example:

- in June 26, 2018, Mr. Kasper stated at the City Council meeting that Mr. Barber charged “fair market price” for the advertisement suggesting that there was no conflict because the CVB received no discounted pricing,
- at that same meeting, the City Manager referenced Mr. Kasper’s correspondence which stated that Mr. Barber had provided the advertisement at a 30% discount from normal pricing after which Mr. Kasper acknowledged the correction that the price offered for CVB advertising was not “fair market price”, and
- the October 2018 Chamber response provides a third explanation that “the Santa Clara Weekly offered 6 full-page color advertisements to the CVB for an under market price of \$5,000 (each).” Appendix L to the Chamber Response provides an email from the Santa Clara Weekly sales manager which states that the quoted rates are at a “big discount”. The pricing for six ads quoted at \$4,284 each amounts to a total package cost of \$25,704 from the CVB to the Santa Clara Weekly.

Putting aside the multiple versions from the Chamber, disclosure to the City should have occurred consistent with the Chamber’s Conflict of Interest requirements, which states, “All real or perceived conflicts of interest will be disclosed to the **appropriate level of authority** necessary for consideration, resolution and direction.” The Chamber’s failure to understand how it created a completely avoidable conflict of interest and, once created, its failure to report it consistent with its own policy supports staff’s concern about the Chamber’s ability to manage conflicts. Further, it was only at the City’s inquiry about the Chamber’s conflict of interest policy and its practices of compliance, did the Chamber produce documents dated largely between February - May 2018, which did not satisfy proof that the Chamber actively managed conflicts or its Conflict of Interest Policy.

Similarly, the Chamber also failed to uphold its Conflict of Interest Policy when it allowed for a Boardmember to operate a UPS Store in the Convention Center, without any effort to manage the “perception” of a conflict of interest or disclose it to the City-the owner of the facility. The Chamber

focuses its response on an existing lease agreement between the Convention Center and the UPS Store and an invalid agreement provision that speaks to the transferability of the franchisee to another operator (e.g., a Chamber Boardmember), without any regard to the Chamber's lack of authority to lease out space (see earlier discussion under Public Sector Governance). This example, unfortunately, is much broader than the conflict of interest, because the:

1. SCCC Management Agreement does not authorize the Chamber to lease public facility space, which the Chamber erroneously allowed without any approval or disclosure to the City-the owner,
2. Chamber allowed a Boardmember to move in to the space and operate a private business without any disclosure to the City, the owner, per its Conflict of Interest Policy which states, "All real or perceived conflicts of interest will be disclosed to the **appropriate level of authority** necessary for consideration, resolution and direction." Had the Chamber disclosed this Lease Agreement, the Council could have approved it or advised the Chamber that it would not approve a lease agreement, thus avoiding the Conflict of Interest leading to a Boardmember occupying the space, and
3. To complicate the matter, the Chamber allowed a Boardmember to move into the space without proper completion of required legal paperwork, which had the Chamber done so, the inappropriateness of the action to lease out public space would have been detected (and corrected) and saving the Boardmember of the expectation to provide business at the SCCC under the UPS lease agreement and avoiding personal expenditure of his own funds. When the City inquired about the status of this matter, the SCCC General Manager stated that no transfer agreement had been executed to allow the Board member to operate, despite the fact that he has been operating at the UPS Store at the SCCC. Given the absence of City Council action to enter into a lease agreement with UPS Store to operate in the SCCC, City provided notice that any lease agreements, or transfers, should remain unexecuted until further notice.

Had the Chamber performed its obligations under the SCCC Management Agreement appropriately, it would have sought City approval to lease out public space, managed a competitive process with transparent and equal access to all vendors seeking to operate a private business in a public facility, and worked with the City to enter into a legally binding agreement for space in a publicly owned facility. The Chamber allowed for a "real" and "perception" of a conflict of interest to develop by authorizing the Boardmember to move into a public facility to operate his private business. The above illustrates the Chamber's lack of knowledge of operating a publicly owned facility, adhering to its own Conflict of Interest Policy, and its contractual obligations to the City as it managed a publicly owned facility using public funds. The Chamber Response does not address these issues in its response which cause concern.

### **(3) *Tourism Improvement District Audit***

As the fiscal agent, the Chamber Response also shows a lack of understanding of basic governance of the Tourism Improvement District (TID), a levied assessment approved by the City Council in accordance with state law. While the TID Advisory Board has bylaws, the TID is not a legal entity authorized to conduct business in the State of California: in fact, the TID is solely an advisory body that provides input on how to implement the funds collected through approved levied assessment action and recommend a budget outlining an expenditure plan to achieve the mission for which the funds are collected. The TID has no contracting authority and its recommended expenditures must adhere to the City Council approved budget, according to state law, and administered appropriately

by its Fiscal Agent (Chamber). As discussed at the August 28 Council meeting, although the TID was established in 2005, the TID has not enacted assessments in a manner consistent with State Law since 2006. The funds collected by the TID are public administered funds, not Chamber or hotel funds, and can only be used for limited purposes designated by state law and articulated in a Council approved Ordinance. The Council authorized and directed a performance audit of the TID on August 28, 2018.

The presentation of the audit and its findings is a separate item on the November 27, 2018 Council meeting agenda; however, related to the Convention Center audit by both its commingling of funds with CVB activity and as a reinforcement of the pattern of fiscal mismanagement by the Chamber.

The TID Audit makes similar findings of the Chamber management practices with respect to mismanagement of public funds, poor accounting practices, and lack of adherence to policy for which to apply fee discounts or waivers, and substantial expenditures that have no supporting documentation. Of concern is that the Chamber currently holds a \$600,000 TID Reserve for the City which it has not released, despite the fact that the TID Advisory Board took action to release it as Fiscal Agent. The audits of the Chamber's management of the Convention Center, CVB, and TID all reinforce the finding that the Chamber did not manage public facilities or funds properly and did not understand its legal obligations of how to manage public funds.

Additionally, the Chamber's assertion that the City directed the TID Advisory Board to stop conducting business with the Chamber is a complete misunderstanding of the TID Advisory Board's authority. The TID Advisory Board exists only by the City Council action to approve its creation and authority to levy revenue for a specific purpose. The levied funds are submitted to the City, who in turn distributes the funds to the TID Advisory Board's Fiscal Agent for implementing the Council approved budget and expenditure plan. The Chamber's role as Fiscal Agent was responsible for the proper expenditure of funds, per the budget and expenditure plans, and both the City and Fiscal Agent were responsible for complying with state laws. The TID is a business activity of the City, permissible under state law and for specific purpose, for which the City serves as the governing body annually authorizing the levied assessments, budget approval, expenditure authorization, and authority to continue with its activity. The City acted appropriately when advising the TID Advisory Body of the City's concern regarding the Chamber's fiscal mismanagement of public funds, as proven true in the TID Audit which demonstrated additional fiscal mismanagement by the Chamber as Fiscal Agent. The City has full authority to inquire of the TID Advisory Body about its Fiscal Agent and how it is managing levied public funds under the City Council's authority.

Last, while working on this Audit and the TID Audit, City staff received a copy of the Chamber's TID Management Letter which reinforced the importance of proper fiscal management and accounting. Specifically, the October 25, 2017 Management Letter (Chamber Commissioned Independent Financial Audit by Johanson & Yau, Accountancy Corporation) states:

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as discussed below, ***we identified certain deficiencies in internal control that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.***

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency or a combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the Organization's financial statements will not be prevented, or detected and corrected, on a timely basis.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. ***We consider the deficiencies in Santa Clara Tourism Improvement District's internal control presented on page 2 of this letter to be significant deficiencies. [Emphasis Added]***

While the Chamber has denied adamantly its poor fiscal controls and management of public contracts or funds, the Chamber's own internal documentation by their commissioned professional accountants to produce independent financial audits of its financial statements serve as evidence that they were made aware of their "significant deficiencies" with managing public funds (e.g., TID funds). Instead, the Chamber has taken a different route by attempting to discredit TAP International, City staff, and/or assign the City's intent as political motivation. The Chamber should have been more transparent with the City Council, City staff, and public of its own evidence documenting its "significant deficiencies" with respect to financial mismanagement and accounting.

#### **(4) Obligations to Report: Preliminary Observations & Staff Findings**

Performance auditing is an important part of the accountability process because it provides an independent view on the extent to which government officials are faithfully, efficiently, and effectively carrying out their responsibilities. As a public agency, the City is expected to uphold itself to high standard regarding disclosure of information to ensure transparency and accountability and earn the public's trust. Auditors of governmental entities hold themselves to similar standards.

The Chamber Response takes issue with both the Auditor and City staff for its public disclosures of preliminary audit observations and staff's research findings. In fact, the Chamber has publicly criticized the City for disclosing preliminary audit observations and staff findings in advance of the final audit report, characterizing such actions as politically motivated or unprofessional. The Chamber's position further demonstrate that it completely misunderstands the role of audit, governance, Council direction to staff and follow-up reporting, and how critical these matters are with respect to the use of a public facility and resources. Suggesting that the Auditor or City staff are politically motivated, while convenient for the Chamber to use as an explanation during an election and during their own political activities, is an illustration of how unprepared the Chamber is to manage a public facility. An Auditor and City staff always maintains the right to report directly to the City Council on its activities with respect to implementing City Council action.

In July 2018, City staff explained in writing of the requirements to release preliminary observations by the Auditor, as well as staff findings, the Chamber finds other attributions to explain simple City Council direction and professional standards. In fact, the July 2018 memo specifically quotes the Auditor's purpose for releasing the preliminary observations, ***"when there is preliminary evidence of potential fraud, waste or abuse, it is an audit requirement to immediately report it to the client (the City). The Chamber/CVB and CC providing discounts to Chamber members at the Convention Center, including full discounts to the Chamber and other entities that use***

***Convention Center facilities triggered this requirement.”***

Specifically, auditing standards used by TAP and other government auditors are documented in the *United States Government Accountability Office Government Auditing Standards*, also known as the “Yellow Book”. The Yellow Book is used by auditors of government entities, entities that receive government awards, and other audit organizations performing Yellow Book audits. The Yellow Book outlines the requirements for audit reports, professional qualifications for auditors, and audit organization quality control. Auditors of federal, state, and local government programs use these standards to perform their audits and produce their reports. Yellow Book Section 6.78 provides that:

Auditors report deficiencies in internal control, fraud, noncompliance with provisions of laws, regulations, contracts, or grant agreements, or abuse. **For some matters, early communication to those charged with governance or management may be important because of their relative significance and the urgency for corrective follow-up action.** Further, when a control deficiency results in noncompliance with provisions of laws, regulations, contracts or grant agreements, or abuse, early communication is important to allow management to take prompt corrective action to prevent further noncompliance.

Yellow Book Section 6.49 also provides that “Determining the form, content, and frequency of the communication is a matter of professional judgment, although written communication is preferred.” As stated in the July 17, 2018 Informational Memo to Council, TAP International was required to inform the City Council, via the City Manager, of its preliminary audit findings per professional standards. TAP’s report on preliminary observations included:

- Chamber members were provided discounts for use of the Convention Center without an established City policy or City approval
- Free use of the Convention Center by Chamber and others without an established City policy or City approval

In fact, prior to the public disclosure of the above preliminary audit findings, the Council was presented in Closed Session with additional Auditor preliminary observations, but the Auditor worked with City staff to establish how to provide disclosure in public session. Disclosure of these preliminary observations led to the change in the SCCC’s practices regarding free or discounted use for public presentation at the City Council meeting. Additionally, disclosure of staff’s findings resulted in changed practices of the Convention Center’s access to the City’s general checking account and established greater due diligence for disbursement of public funds.

The Chamber Response objects to the information provided in the Audit and its findings. The Auditor made multiple requests for information, both at a staff level and by City Council, and provided the Chamber with a draft copy of the audit for review and correction of facts. According to TAP International, the Chamber requested many changes and had full access to the information in the Audit. As articulated in the Yellow Book, the charge of an Auditor is to conduct high-quality engagements with competence, integrity, objectivity, and independence. Changes in the audit were made when appropriate documentation supporting the change was submitted by the requestor (e.g., Chamber). To preserve the independence and integrity of the Auditor and Audit itself, requested changes modifying interpretation and or presentation of information without supporting documentation were not made. The Chamber was never denied time to review the Audit in draft or final form, and the Chamber attempted to characterize the postponement of the report to the City Council as a political effort in complete disregard to the Auditor’s unavailability resulting from a

personal matter.

The Chamber Response also takes issue with the Administration's disclosure and reporting of the preliminary observations and execution of actions recommended in the audit report. Again, the Chamber lacks an understanding of public sector governance and practices. With the Council's policy decision to commission an audit, the Council became the client of the auditor and the City Manager had to report preliminary audit observations to the City Council, as well as report Council directed research and related findings on the part of staff. The City's actions appropriately support the principles of transparency and openness, as well as the authority of the City Council to initiate an Audit and to receive updates of the audit per professional standards.

The Chamber was well aware of the City's request for IRS Form 990s and Conflict of Interest forms and that the City staff evaluation was underway, by several requests for this information over weeks or months which were discussed publicly and even requested by Councilmember Davis at a City Council meeting. There is not another forum, other than a City Council meeting, to report the staff findings based on our review or the Auditor's preliminary observations. The Chamber's attempts to characterize staff's actions as unprofessional or politically motivated on the part of TAP International or City staff are simply a meritless attempt to deflect attention from its own misdeeds. These audits at City Council direction were an exercise in fiscal responsibility over public funds and assets; TAP International was adhering to its professional ethics/practices in providing its preliminary research and observations. Ultimately, the public is entitled to know what is going on with its money and property. City staff should not be faulted for being too transparent or too early in reporting on serious risks to the City.

### **ENVIRONMENTAL REVIEW**

The action being considered does not constitute a "project" within the meaning of the California Environmental Quality Act ("CEQA") pursuant to CEQA Guidelines section 15378(a) as it has no potential for resulting in either a direct physical change in the environment, or a reasonably foreseeable indirect physical change in the environment.

### **FISCAL IMPACT**

There is no additional cost to the City associated with this report other than staff time and expense.

### **COORDINATION**

This report has been coordinated with the City Attorney's Office.

### **PUBLIC CONTACT**

Public contact was made by posting the Council agenda on the City's official-notice bulletin board outside City Hall Council Chambers. A complete agenda packet is available on the City's website and in the City Clerk's Office at least 72 hours prior to a Regular Meeting and 24 hours prior to a Special Meeting. A hard copy of any agenda report may be requested by contacting the City Clerk's Office at (408) 615-2220, email [clerk@santaclaraca.gov](mailto:clerk@santaclaraca.gov) <<mailto:clerk@santaclaraca.gov>> or at the public information desk at any City of Santa Clara public library.

### **RECOMMENDATION**

Action on 1) the City's Response to and 2) Analysis of the Chamber's Response related to the Performance Audit "Santa Clara Convention Center and Convention-Visitors Bureau: Restructuring Operations Can Strengthen Accountability, Performance and Revenue"

Reviewed by: Ruth Shikada, Assistant City Manager  
Approved by: Deanna R. Santana, City Manager

**ATTACHMENTS**

1. Performance Audit by TAP International on September 18, 2018
2. Santa Clara Chamber of Commerce Response to Audit Findings and Concerns with City Actions
3. Audit Implementation Plan Matrix
4. Chamber Conflict of Interest Policy
5. IRS Referral
6. City letter to FPPC
7. FPPC response letter to City