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Title: Action on Presentation from the City on the Audit by TAP International titled "City of Santa Clara Tourism Improvement District - Governance, Internal Controls and Oversight Needed"

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Attachments: 1. Audit submitted by TAP International, 2. Management Letter, 3. Staff Response Matrix, 4. POST MEETING MATERIAL

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

REPORT TO COUNCIL

SUBJECT

Action on Presentation from the City on the Audit by TAP International titled "City of Santa Clara Tourism Improvement District - Governance, Internal Controls and Oversight Needed"

BACKGROUND

In accordance with actions required by state law, the City Council established the Tourism Improvement District (TID) by adoption of Ordinance 1797 in January 2005 to fund activities such as marketing campaigns to attract additional travelers with a focus of booking hotel rooms, tourists, cultural groups, and conventions; print ads in travel publications; outdoor advertising campaign; and fund administrative costs of the program. A TID Advisory Board was also established, at that time, representing the nine participating hotels. The TID Advisory Board prepared Bylaws for the TID.

TAP International was hired by the City to conduct a Performance Audit on the Santa Clara Convention Center (SCCC) and Convention-Visitors Bureau (CVB). As part of the initial data gathering for the Audit, TAP noted that the Santa Clara Chamber of Commerce (Chamber) administered all funds for the TID Advisory Board, in accordance with the TID Bylaws designating the Chamber as the an authorized representative to receive and disburse TID funds as provided for in the TID annual budget. As such, given that the CVB Audit was underway and TID funding had been found to be used for staff bonuses/commissions, TAP International suggested, and the Council approved, an audit of the TID. As the party responsible by the TID Bylaws for fiscal receipt and disbursement of TID funds, the Chamber essentially served as the "Fiscal Agent," where it acted on behalf of another party (City and TID Advisory Board) for performing various financial duties, including the employment of employees to implement the annual program, budget, and independent financial audits.

Based on this recommendation on August 28, 2018, Council approved an Amended and Restated

Agreement with TAP International to include the financial audit of the TID examining the following questions:

1. Have the hotels participating in the TID accurately remitted TID revenue to the City for FY15/16, and FY16/17?
2. Are the expenses of the TID consistent with TID bylaws and policies since FY12/13?
3. What is the nature and extent of any outstanding bills and payables, if any, that have not yet been recorded in the TID's financial system.

As a separate but related matter, staff advised Council on July 16, 2018, that the legal procedures required for the TID to properly levy a \$1.00 per room night fee had not been followed. The public hearing on the August 28, 2018 Council agenda brought the TID back into compliance with State law effective September 1, 2018.

DISCUSSION

This report transmits the Auditor's findings of the above referenced Audit (Attachment 1), summarizes the Audit findings, and provides a staff response to the Audit recommendations and findings.

As a standard audit practice, in late October/early November, the Auditor provided the City, Chamber, and TID Advisory Board with the preliminary audit for review of facts and misstatements and allowed the City, Chamber and TID Advisory Board to provide comments regarding the draft for the Auditor's consideration. Since the Council commissioned the audit, by its own motion and direction, the Auditor will present the report and audit findings to the Council during the November 27, 2018 Council meeting.

On November 12, 2018 the Chamber provided input to the draft Audit that was issued to the City, Chamber, and TID Advisory Board. In response to a statement by TAP in the draft that records were missing for various expenditures and for the entirety of FY 2014/15, the Chamber later produced an entire fiscal year of missing financial records. As a result, the audit notes a limitation in its review because of the gap in records at the time of the audit. Additional review of FY 2014/15 is needed to fully understand the Chamber's fiscal management of the TID funds, particularly since other documents have still not been produced that would substantiate over \$300,000 of expenditures.

Similar to the Convention Center/CVB Audit, the TID audit findings document that the Chamber, as the TID's fiscal agent, mismanaged public funds, did not have appropriate policies in place, and practiced sloppy record keeping. Similarly, the Audit also appropriately confirmed a lack of City oversight, as staff reported in summer 2018. The nature of the audit findings show similar patterns of the Chamber's misuse and mismanagement of public resources as found in the Convention Center/CVB audit and an absence of City oversight and compliance management.

More disturbingly, it appears that the Chamber and/or TID Advisory Board had full knowledge of its financial mismanagement and poor accounting practices of public funds which it did not disclose to the City (Governing Body of the TID). Evidence of documented awareness, within their internal documentation, can be confirmed most recently as of October 25, 2017. Other Management Letters are under review to better determine how long the Chamber and/or TID Advisory Board knew about these deficient fiscal practices that went uncorrected for years. Staff will be requesting additional information related to the Management Letters, and possibly additional Management Letters for past fiscal years, and all related audit papers from fiscal years prior to the audit period. A separate staff report can be produced at a later time.

For example, during review of prior independent financial audit reports that the Chamber had commissioned, the Auditor reviewed the Chamber's FY 2016/17 audited financial statements and Auditor's Management Letter to the TID Advisory Board which had warned that it noted "significant deficiencies" in some internal controls, accounting records frequently could not be located, and supporting receipts for expenditures were not properly maintained by staff (Attachment 2). The Management Letter reinforced the importance that expenditures should have proper supporting documentation and be submitted to substantiate the expenditures. Previous audit recommendations were either partially implemented or not implemented (Pages 26-27 of Attachment 1). 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 of taking corrective action or working with the City to cure this mismanagement, 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 possession of evidence documenting its "significant deficiencies" with respect to financial mismanagement and accounting. This is of serious concern and of significant public interest.

As the fiscal agent, responsible for the financial accounting for the TID, the Chamber was not recently able to locate TID financial records for a 12-month period during the audit review period; all supporting documents associated with \$860,795 in expenses that were paid by the Chamber in Fiscal Year 2014/15 were not located until November 15, 2018 after the draft audit report was issued (Page 7 of Attachment 1). Additionally, nearly 78 percent of sampled expense transactions had

internal control exceptions (Page 17 of Attachment 1). For example, nineteen of 68 sampled expense transactions, valued at \$308,172, had no supporting documentation including credit card charges (Pages 2 and 17 of Attachment 1) and ten transactions valued at \$129,084 was expended without the required signatures.

As noted, neither the Chamber nor TID Advisory Board sought City Council annual approval of its proposed Budget (for public transparency of use of the levied assessments) and/or proper action to continue the assessment. Further, the TID's bylaws indicated that it had been incorporated when in fact it had not. Additionally, the City failed to enforce annual procedures required by both the Chamber and TID Advisory Board to initiate a proposed Budget for the Council's approval and perform required annual actions to continue the levied assessments. As such, the TID did not have collection and spending authority for most of its years; in fact, Fiscal Year 2018/19 is the first year after the establishment of the district that the TID assessment fee charge was formally approved by the City Council and administered in accordance with state law. In spite of TID not having proper authority to collect fees for most years, the TID fees collected were generally accurate.

Further, the Audit found that the Chamber and TID did not adhere to its own discount or subsidies policies, much like the same pattern found in the Convention Center/CVB audit. For example, the TID funded subsidy payments to event sponsors were not consistent with subsidy policies (Page 19 of Attachment 1). Four of the 16 event sponsors received approximately \$59,125 in transportation subsidies even though the TID does not have guidelines in place to offer such subsidies (Page 19 of Attachment 1). Five of the nine organizations are repeat subsidy recipients, raising fairness and equity concerns (given that these funds are publicly levied) about the TID program and whether the TID was using levied assessments to attract and expand users (Page 19 of Attachment 1).

City Actions to TID Audit

City staff reviewed the audit, its findings, and recommendations. Staff concurs with the findings and recommendations. The attached matrix (Attachment 3) identifies the recommendations; the current status of implementation classified as "Not Implemented," "Partially Implemented," and "Implemented;" and steps taken so far for complete and partially implemented recommendations and next steps for the remaining recommendations. Staff will provide quarterly updates on the implementation status of the recommendations.

Table 1: Summary of TID Audit Recommendations (November 2018)

Status	Complete	Partially Implemented	Not Implemented	Total
Number of Audit Recommendations	1	1	7	9

ENVIRONMENTAL REVIEW

The action being considered does not constitute a "project" within the meaning of the California Environmental Act ("CEQA") pursuant to CEQA Guidelines section 15378(b)(4) in that it is a fiscal activity that does not involve any commitment to any specific project which may result in a potential significant impact on the environment.

FISCAL IMPACT

There is no fiscal impact associated with the presentation of the audit other than staff time to transmit the report.

COORDINATION

This report has been coordinated with the Finance Department and 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>> or at the public information desk at any City of Santa Clara public library.

RECOMMENDATION

Action on City Response to Audit titled "City of Santa Clara Tourism Improvement District - Governance, Internal Controls and Oversight Needed"

Reviewed by: Ruth Shikada, Assistant City Manager

Approved by: Deanna J. Santana, City Manager

ATTACHMENTS

1. Audit submitted by TAP International
2. Management Letter
3. Staff Response Matrix