



**DATE:** December 11, 2018

**CATEGORY:** Consent

**DEPT.:** City Auditor

**TITLE:** **City Auditor's Annual Report for Fiscal Year 2017-18**

### **RECOMMENDATION**

Accept and file the City Auditor's Annual Report for Fiscal Year 2017-18.

### **BACKGROUND**

Section 710 of the City Charter, as amended in November 1998, specifies the City Auditor shall be an experienced accountant and shall have the power and perform such duties as may be required by the City Council. The Charter also specifies this position may be combined with any other officer of the City as designated by the City Council.

I was appointed as City Auditor by the City Council in December 2008. Many functions and audits are performed or provided by outside consultants, which are overseen by the City Auditor. Reviews that are performed annually, on a periodic basis, or have been performed in the past include:

- Sales Tax Review
- Property Tax Review
- Lessee Compliance Reviews
- Cash-Handling Reviews
- Transient Occupancy Tax Compliance Audit
- Utility Users Tax Compliance Audit
- Purchasing Card Transactions Review

- Fair Labor Standards Act (FLSA) Compliance Review
- Gatekeeper Time Reporting Review

## ANALYSIS

Based on the Work Plan for Fiscal Year 2017-18, the projects performed are as follows:

- Sales Tax Review
- Property Tax Review
- Cash-Handling Review of Rotating Location
- Lessee Compliance Reviews
- Purchasing Card Transaction Review

These projects are discussed in more detail as follows:

### Sales Tax Review

The City receives sales tax based on the point-of-sale reported by the entities collecting and remitting the sales tax to the California Department of Tax and Fee Administration (CDTFA). The City retains the services of an outside consultant, the HdL Companies (HdL), to provide detailed sales tax information to the City for tracking and budgeting purposes. HdL maintains a database of all companies remitting sales tax to the City, which provides sales tax information (e.g., location, type of business, payment history, etc.). In addition, HdL monitors and identifies that sales tax is being reported to the appropriate agency. During this past fiscal year, HdL also focused on the County pool allocation to ensure the appropriate allocation to cities. For Fiscal Year 2017-18, additional gross sales tax of \$708,000 resulted from HdL identifying 77 sales tax producers reporting incorrectly.

### Property Tax Review

The City also contracts with HdL to provide property tax data. The consultant obtains the electronic property tax data throughout the fiscal year from the County of Santa Clara (County) and HdL utilizes this data to update the database maintained of all parcels located in the City. In addition, HdL produces reports that provide very useful information regarding the status of assessed valuations, significant changes and trends

in the tax base, and changes in property ownership, as well as detailed information on the property tax data. These services are provided in aggregate and separately for the City and the Shoreline Regional Park Community (Shoreline Community).

Annually, the consultant performs the following procedures:

1. Downloads County assessment roll, and reviews and matches current fiscal year roll to prior fiscal year, noting and resolving any discrepancies with the County.
2. Reviews each parcel on the roll and verifies it is correctly assigned to the City or Shoreline Community, and verifies all parcels within City limits are correctly identified to either the City or the Shoreline Community and not a neighboring agency. Resolves any discrepancies with the County.
3. Prepares reports and reviews with City staff on the secured and unsecured property tax base for the City and the Shoreline Community.

For Fiscal Year 2017-18, there were no additional property tax revenues as a result of the property tax review.

### Cash-Handling Review

Annually, I request the external auditor to perform a cash-handling review of the various cash collection locations of the City. During Fiscal Year 2017-18, a review of the Cash Handling for Recreation was conducted by Macias Gini & O'Connell, LLP (MGO) (Attachment 1). The review consisted of inquiry of staff and sample testing of cash receipts for reasonableness and effectiveness of controls. For each cash receipt item selected:

1. The individual transactions were traced to supporting documentation—no exceptions were noted.
2. For cash receipts related to a sale to a customer, verified the fees charged were based on the approved fees per the Fiscal Year 2017-18 Master Fee Schedule—no exceptions were noted.
3. For cash receipts related to donations received, verified it was supported by an agreement or other documents—no exceptions were noted.
4. Verified selected transactions were properly reflected in the daily revenue report generated by ACTIVENet—no exceptions were noted.

5. The total daily cash receipts reconciled to the daily revenue report – no exceptions were noted.

The findings and Recreation Cash Handling procedures are included in Attachment 1.

### Lessee Compliance Reviews

MGO was requested to perform lease compliance procedures on City lessees Michaels at Shoreline (Michaels) and Silicon Shores Corporation (Silicon Shores). The procedures performed are agreed upon by MGO and the City Auditor, and are designed to ascertain the City is receiving revenues in compliance with the lease agreements. The lease agreements for Michaels and Silicon Shores require the lessees to pay a percentage of rent based on gross revenues. MGO reviews the financial records and performs a limited review of internal control of the operators and other analytical and test procedures to verify the accuracy of the rent paid to the City. The tests are designed to ensure all revenues are captured and there is no understatement of revenues reported. MGO was requested to perform the procedures for calendar years 2016 and 2017. A summary of the findings are as follows:

1. Michaels (Attachment 2) – MGO obtained a limited understanding of the internal accounting controls over cash receipts. No exceptions were noted.

The annual sales for the years ended December 31, 2015, 2016, and 2017 were \$1,763,979, \$1,738,056, and \$1,716,619, respectively. The decrease from the year ended December 31, 2015 to 2016 was \$25,923 or 1.5 percent, while the decrease from the year ended December 31, 2016 to 2017 was \$21,437 or 1.2 percent.

For the year ended December 31, 2016 and 2017, the rent amounts recomputed in accordance with the agreement were \$140,244 and \$139,616, which were \$632 and \$2,126 less than the total payments received by the City, respectively. The balances of \$632 and \$2,126 represented overpayments by Michaels. All overpayments of rents by Michaels have been credited to Michaels.

2. Silicon Shores (Attachment 3) – MGO obtained a limited understanding of the internal accounting controls over cash receipts. No exceptions were noted.

The annual sales for the years ended December 31, 2015, 2016, and 2017 were \$3,111,723, \$3,107,360, and \$3,330,728, respectively. The decrease from the year ended December 31, 2015 to 2016 was \$4,363 or 0.1 percent, while the increase from the year ended December 31, 2016 to 2017 was \$223,368 or 7.2 percent.

For the year ended December 31, 2016 and 2017, the annual net sales based on the general ledger were \$3.3 million and \$3.4 million, which are \$228,493 and \$107,317 more than the revenue based on the Federal tax returns, respectively. The difference for 2016 and 2017 are comprised of \$236,737 and \$113,899 of tips received from customers less \$8,244 and \$6,582 of tax basis adjustments for gift card revenues, respectively.

Total rent due to the City for 2016 and 2017 was a total of \$250,136 and \$267,869, respectively. However, the agreement provides for the City to share in the cost of utilities for the restrooms; therefore, net rent due to the City was \$242,836 and \$260,045 for 2016 and 2017, respectively. The underpayments of rent for 2016 and 2017 of \$283 and \$6,179, respectively, was the result of timing differences and have been fully paid by Silicon Shores to the City.

For the tips received, MGO and staff reviewed the lease agreement, which is silent to this revenue category. Staff has proposed this category of revenues be included in the lease renewal with Silicon Shores effective January 1, 2019.

#### Purchasing Card Transaction Review

MGO was requested to perform compliance procedures related to the City's Procurement Card Program. The procedures performed are agreed upon by MGO and the City Auditor, and are designed to test compliance with, and ascertain the effectiveness of, the City's Procurement Card Policy (Policy).

MGO selected a sample of procurement cards issued and transactions, the procedures performed are as follows:

1. Verified the approval for the procurement card by the Department Head and Purchasing Agent – The Procurement Card Request Form was not implemented until March 1, 2018; however, all documentation was submitted and approvals were verified.
2. Verified that Cardholder participated in training and Approving Official have signed the Cardholder Agreement – no exceptions were noted.
3. Verified Cardholder and Approving Officials attended training within every two years as stated in the Policy – Exceptions were noted due to Purchasing staff providing training with the renewal of procurement cards, and the credit card

company changed the expiration of the cards from two to three years. All personnel received training within the three years.

4. Verified statement of account reconciliations are performed by the Cardholder and approved timely by the Approving Official – no exceptions were noted related to Cardholders; however, exceptions were noted whereby Approving Officials were not completing timely reviews.
5. Verified the total monthly purchase amount is within the cardholder's limit – no exceptions were noted.
6. Verified individual transactions were not for inappropriate items, supported by documentation, within the single transaction limit and properly coded in the general ledger – no exceptions were noted.

No inappropriate procurement card transactions or usage occurred during the review period. Staff is modifying the Policy to include the training to occur within the renewal period of the card, currently every three years, and also taking steps to send reminders and identify those Approving Officials that are not completing timely reviews.

### **FISCAL IMPACT**

The City receives revenues from a variety of sources, and it is beneficial to ensure companies are in compliance with regulations and City ordinances in remitting a variety of taxes and revenues. Additional revenues are identified and remitted as a result of the audits performed.

### **CONCLUSION**

This is the last and final City Auditor report that I will be filing. I have provided my retirement notice to you as your City Auditor effective December 29, 2018. It has been my honor to serve as the City Auditor for the past 10 years.

### **ALTERNATIVES**

1. Do not accept and file the City Auditor's Annual Report for Fiscal Year 2017-18.

**PUBLIC NOTICING** – Agenda posting.

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PJK/2/CAM  
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- Attachments:
1. Internal Controls Over Cash Collections
  2. Lessee Compliance Report – Michaels
  3. Lessee Compliance Report – Silicon Shores
  4. Procurement Card Policy