



DATE: December 2, 2014

CATEGORY: Consent

DEPT.: City Auditor

TITLE: **City Auditor's Annual Report for Fiscal Year 2013-14 and Work Plan for Fiscal Year 2014-15**

RECOMMENDATION

1. Accept and file the City Auditor's Annual Report for Fiscal Year 2013-14.
2. Approve the City Auditor's Work Plan for Fiscal Year 2014-15 as recommended.

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 2013-14, the projects performed are as follows:

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

These projects are discussed in detail as follows:

Utility Users Tax (UUT) Compliance Audit

The City's UUT rate is 3.0 percent of telecommunication services billed in Mountain View that are taxable in accordance with the Mountain View City Code. As you are aware, the voters approved an amendment to the City's UUT Ordinance on the November 2010 ballot. The amended ordinance did not change the rate of the UUT, but clarified and expanded the base the UUT is applicable to. After passage of the ballot measure, the City provided information and notified telecommunication service providers of the changes to the ordinance. The effective date of the change was March 1, 2011.

Jim Thompson of Tax Compliance Services (TCS) was contracted to perform the UUT compliance audit. The audit was anticipated to take 12 to 18 months to complete; it

commenced in July 2012 and was completed in February 2014. Procedures performed included:

1. Assist the City in notifying each telecommunications service provider of the upcoming review and requesting data to be reviewed.
2. Communicate with telecommunications service provider and answer questions.
3. Test the revenue records for consistency with the returns filed with the City.
4. Analyze data and document any findings, including any tax, interest, and penalties that are owed.
5. Assist the City with collection efforts.
6. Inform the City on status of issues related to UUT.

Initial letters were sent to 183 providers on July 30, 2012, with 84 follow-up letters sent on September 21, 2012 to those that had not responded. We worked very closely with the City Attorney's Office on this audit and, although a subpoena is not required, subsequently, a total of 66 subpoenas were issued through May 2013 requesting data.

The final results of the audit are as follows:

Compliant	35.0 percent
No Further Action	24.0 percent
Assessments/Findings	<u>41.0 percent</u>
Total	<u>100.0 percent</u>

No further action are companies that are out of business or we determined there were no taxable services provided. After significant communications between the City and one company, they agreed to remit \$1.1 million for back UUT and to continue to report UUT in compliance with the ordinance on an ongoing basis. In total, \$1.3 million has been received by the City as a result of the UUT audit. In addition, it is anticipated the City will receive additional annual UUT remittances in compliance with the ordinance of \$650,000.

Although the compliance audit has been officially completed, the City has continued to receive inquiries from companies with regard to the City's UUT ordinance and compliance.

Transient Occupancy Tax (TOT) Compliance Audit

In accordance with Chapter 33 of the City Code, hotels and motels (hotels) collect and remit the City's TOT of 10.0 percent of the room rate. For Fiscal Year 2013-14, the City received \$5.6 million in TOT revenue.

Major procedures performed during the audit are as follows:

1. Contact hotels to be audited, request records be provided, and schedule date for on-site audit.
2. Collect City records for taxes paid and forms submitted by hotels.
3. Meet with hotel management to discuss record keeping, internal controls, cash-handling practices, reconciliations, application of room charges to amounts paid, application of TOT to other items included with room charge, treatment of free or promotional rooms provided, and exemptions to the TOT.
4. Audit selected sample and trace daily transaction records to bank deposits.
5. Verify TOT rate of 10.0 percent is accurately applied, collected, and remitted to the City.
6. Discuss audit findings with hotel management and the amount of additional tax due, if any.
7. Perform additional procedures as necessary based on results of audit test and findings.

There are 29 hotels located in Mountain View that were selected for audit during Fiscal Year 2013-14. Tax Compliance Services (TCS) was contracted to perform this audit. The findings are as follows:

No Findings	19
Closed	5
Findings	<u>5</u>
Total	<u>29</u>

A total of 19 hotels or 65.5 percent were audited with no findings or found to be in compliance. An additional five hotels have closed and there were five hotels with underreporting or exemption errors that resulted in an additional \$2,642 of taxes received by the City.

When these audits were first initiated, several discrepancies were noted and the City recovered a significant amount of revenue. The cycle of the audit has varied over the years and the recoveries have been reduced due to improved accounting and reporting compliance by the hotels. However, it is recommended to continue to audit the hotels on a periodic basis to ensure compliance.

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 State Board of Equalization (SBOE). The City retains the services of an outside consultant, the HdL Companies (HdL), that provides detailed sales tax information to the City for tracking and budgeting purposes. HdL also provides sales tax information based on location and type of business, and monitors and identifies that sales tax is being reported to the appropriate agency. For Fiscal Year 2013-14, additional sales tax of \$138,800 resulted from HdL identifying 10 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 from the County of Santa Clara (County) and 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, the former Revitalization Authority (Authority), 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, Authority, or Shoreline Community, and verifies all parcels within City limits are

correctly identified to one of the City entities 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 each City agency.

For the 2013-14 fiscal year, there were no additional property tax revenues as a result of the work by HdL.

Lessee Compliance Reviews

Maze & Associates (Maze), the City's external auditors, was requested to perform lease compliance procedures on City lessees:

- Michaels at Shoreline (Michaels)
- Silicon Shores Corporation (Silicon Shores)
- Children's Creative Learning Center (CCLC)

The procedures performed are agreed upon by Maze 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. Maze 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. For CCLC, a fixed flat operating fee is deducted from revenue and CCLC is entitled to a management fee of 6.0 percent of revenues after deducting operating expenses.

- Michaels (Attachment 1) – The auditors obtained a limited understanding of the internal accounting controls over cash receipts. No items were noted that would indicate a weakness in internal accounting controls over cash receipts.

Overall, sales for the year ended December 31, 2013 have increased approximately 3.1 percent over the prior year. This may be interpreted as a sign of economic recovery compared to an increase in sales for 2012 of 0.4 percent and decrease in sales for 2011 of 1.9 percent. Banquet sales increased 4.4 percent over the previous year, lower than the increase in 2012 of 6.8 percent. However, café sales and

window sales have increased 1.7 percent and 5.8 percent, respectively, over the previous year, compared to the decrease in 2012 of 4.7 percent and 9.0 percent, respectively.

Total rent due for the year was \$144,745, 3.1 percent higher than the prior year. The total amount collected was \$144,799; therefore, \$54 was due Michaels and has been paid by the City.

- Silicon Shores (Attachment 2) – The auditors obtained a limited understanding of the internal accounting controls over cash receipts. No items were noted that would indicate a weakness in internal accounting controls over cash receipts.

The auditors noted a difference of \$10,557 in gross revenue reported on the corporate tax returns compared to the unaudited income statement provided to the City for 2013. As reported in the two previous reports, this is due to an IRS regulation beginning in 2011 that requires revenues for unredeemed gift cards over 12 months old be reported. Since the gift cards do not expire and remain a liability, Silicon Shores will continue to recognize revenue as gift cards are redeemed; therefore, this type of tax basis adjustment is excluded from the rent calculation.

Overall, net sales for the year ended December 31, 2013 increased 18.6 percent. Net café sales increased 12.5 percent, sailing rentals increased 29.1 percent, and retail sales, which make up less than 1.0 percent of total sales, increased 10.1 percent over the prior year. Rental sales are closely correlated with camps and classes and the increase in overall classes can be attributed to the investment in a new marketing strategy and advertising campaign. There has also been an increased demand for facility-related events.

Total net rent due to the City increased 20.4 percent for a total of \$200,981. Silicon Shores paid \$203,113, an overpayment of \$2,132. The City has paid this amount to Silicon Shores.

- Children's Creative Learning Center (Attachment 3) – The auditors performed procedures to ascertain the validity of the Net Surplus reported by CCLC and the Management Fee. The period for review of July 1, 2011 to February 14, 2014 covered the two prior fiscal years and the partial fiscal year until termination. No exceptions were noted with the exception of the Management Fee calculation for Fiscal Year 2011-12 and Fiscal Year 2012-13. For Fiscal Year 2011-12, there was a deficiency in Net Surplus for the 6.0 percent Management Fee. The lease provides

the deficit Management Fee can be carried over to the next fiscal year. In the following Fiscal Year 2012-13, the Net Surplus was insufficient to recoup the prior fiscal year deficit by \$346. Since the deficit can only be carried over to the next fiscal year and the Net Surplus was insufficient for the entire deficit, no additional funds are due to CCLC. For the final partial fiscal year, it was noted a Net Surplus was due to the City as of February 14, 2014 of \$36,535. This amount has subsequently been paid by CCLC to the City.

Cash-Handling Review

Periodically, I request Maze to perform a cash-handling review of the various cash collection locations of the City. During Fiscal Year 2013-14, I requested a review be performed of the Police Department (Police) and Fire and Environmental Protection Division (Fire) cash-handling operations (Attachment 4). The review consisted of inquiry of staff and sample testing of cash receipts. The findings noted are as follows:

- Police

1. Voided transactions are not reviewed or approved by someone other than the cashier.

Department response—Police will review procedures and incorporate a review and approval by a second individual when possible. However, there are times when there is only one employee on duty.

2. Billing for false alarm billed by a third-party administrator (TPA) are not reviewed and monitored by Police and due to the implementation of a new Computer Aided Dispatch (CAD) system, false alarm fees were unable to be invoiced during the period reviewed.

Department response—Police has reconnected with the CAD system and the TPA is processing the fees. Police will review the false alarm program process.

3. Credit balances for false alarm billings are not followed up in a timely manner by the TPA. It was noted as of March 3, 2014, there was approximately \$15,000 that had not been refunded to customers since 2010.

Department response—Police will review the false alarm program and process for following up on credit balances.

4. Checks received via mail are placed in a mail bin until processed and not endorsed immediately.

Department response—Police will review the process for checks received in the mail and determine if there is a better workflow possible. This has not been an issue to date.

- Fire

1. All invoices for Hazardous Materials (HazMat) Permits are created through a separate FileMaker system that is not integrated with the City's general ledger. The FileMaker system is reconciled with the general ledger on an annual basis and discrepancies are not followed up timely.

Department response—HazMat invoices are only produced annually. Fire is researching an alternative to the City's billing of HazMat Permits through Santa Clara County. If this is not implemented, Fire staff will work with staff of the Finance and Administrative Services Department (FASD) to transfer the invoicing and collection process to FASD.

2. Receipts are not prenumbered; the permit issued serves as the customer's receipt.

Department response—The issuance of a "current" permit serves as the customer's receipt of payment. Additionally, each business is assigned a unique Facility Identification number. As such, this number serves as a receipt number.

Work Plan for Fiscal Year 2014-15

- I would recommend the sales tax and property tax reviews continue to be performed as it is part of a broader scope of services provided to the City.
- The new operator agreement for the Child-Care Center with Community Gatepath provides for a minimum fee be paid to the City of \$201,084 annually. All financial risk and reward is borne by Community Gatepath, therefore no future compliance review is anticipated for the Child-Care Center operator.

- A review of Business Licenses is an area I am recommending be performed. The City received approximately \$268,000 of Business License fees for Fiscal Year 2013-14 in accordance with Chapter 18 of the City Code. This amount does not fluctuate significantly from year to year. The fee is a nominal amount of \$30 to \$100 annually and would require a ballot measure and receive a majority vote to amend the fee. However, it would be beneficial to ensure that new businesses, as well as current businesses, are complying with the ordinance.

FISCAL IMPACT

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

ALTERNATIVES

1. Do not accept and file the City Auditor's Annual Report for Fiscal Year 2013-14.
2. Do not approve the City Auditor's Work Plan for Fiscal Year 2014-15 as recommended and propose additional or different projects.

PUBLIC NOTICING – Agenda posting.

Prepared by:

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City Auditor

PJK/3/CAM
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- Attachments:
1. Michaels at Shoreline Agreed Upon Procedures Report
 2. Silicon Shores Corporation Agreed Upon Procedures Report
 3. Children's Creative Learning Center Agreed Upon Procedures Report
 4. Cash Collections of the Police Department and Fire Department's Fire and Environmental Protection Division Review