



DATE: December 13, 2016

CATEGORY: Consent

DEPT.: City Auditor

TITLE: **City Auditor's Annual Report for
Fiscal Year 2015-16 and
Work Plan for Fiscal Year 2016-17**

RECOMMENDATION

1. Accept and file the City Auditor's Annual Report for Fiscal Year 2015-16.
2. Approve the City Auditor's Work Plan for Fiscal Year 2016-17 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 2015-16, the projects performed are as follows:

- Sales Tax Review
- Property Tax Review
- Lessee Compliance Reviews
- Cash-Handling Review
- Business License Compliance Review

These projects are discussed in 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 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 2015-16, additional gross sales tax of \$69,990 resulted from HdL identifying 14 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 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 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 Fiscal Year 2015-16, there were no additional property tax revenues as a result of the work by HdL.

Lessee Compliance Reviews

Macias Gini & O'Connell LLC (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 rent based on a percentage of gross revenues. MGO reviews the financial records and performs a limited review of the internal controls 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.

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

Overall, sales for the year ended December 31, 2015 have decreased approximately 3.1 percent over the prior year. No detailed explanation was provided by Michaels.

Total rent due for the year was \$142,318, however, the total amount remitted by Michaels was \$142,597 or \$279 more than owed under the lease agreement. Therefore, \$279 has been remitted to Michaels by the City for the overpayment.

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

Overall, sales for the year ended December 31, 2015 increased 14.6 percent. Café sales increased 21.1 percent, sailing rentals increased 6.0 percent, and retail sales, which make up less than 1.0 percent of total sales, increased 9.7 percent over the prior year. Sailing rentals are closely correlated with the increase in camps and classes.

The auditors compared the annual net sales per the general ledger to Silicon Shores Federal tax return and noted a difference of \$16,853 in gross revenue reported. As previously noted, 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 continues to recognize revenue as gift cards are redeemed; therefore, this type of Tax Basis Adjustment is a matter of a timing difference.

Total rent due to the City was a total of \$254,964. However, the agreement provides for the City to share in the cost of utilities for the public restrooms, thereby net rent due to the City was \$248,552. Silicon Shores has fully paid the \$248,552 rent due to the City.

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 2015-16, a review of the Cash Handling for the Center for the Performing Arts (Center) Box Office was conducted by MGO (Attachment 3). The review consisted of inquiry of staff and sample testing of cash receipts for reasonableness and effectiveness of controls. For each sale transaction item selected:

1. The individual transaction was traced to supporting documentation.
2. The price charged to the customer was compared with the ticket price published on the Center's website and or event brochure.

3. The transaction was verified to be properly reflected in the ticket management system.

No exceptions were noted.

Business License Compliance

The City received approximately \$245,000 of Business License fees for Fiscal Year 2015-16 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 typically \$30, with a maximum amount to \$250 annually and would require a ballot measure and receive a majority vote to amend the fee. After a request for proposal process, I contracted with HdL to perform a compliance review of business licenses in 2015. HdL has over 30 years of experience performing services for local governments.

Using the information provided by the City, HdL matched the City's registered businesses with their extensive sales and property tax databases to create a list of potential businesses requiring a City business license. The approach taken by HdL, as requested by the City, is one of information and education. HdL is providing information and soliciting businesses to comply with the City Code. The review got off to a slow start, but beginning in December 2015, we have been receiving regular remittances from businesses coming into compliance with the City's business license ordinance. During Fiscal Year 2015-16, HdL has been able to bring 34 companies into compliance for a total of \$6,223 and a net remittance to the City of \$4,031.

The compliance work will continue through this next fiscal year. In addition, I have implemented procedures to ensure vendors conducting business with the City for goods and services, through professional services contracts or purchase orders, have a valid business license.

Work Plan for Fiscal Year 2016-17

For Fiscal Year 2016-17, I would recommend the following:

- Sales tax and property tax reviews.
- Cash-Handling review of rotating locations.

- Transient Occupancy Tax compliance review.
- Continuation of the Business Licenses compliance review.
- Purchasing Card Transaction Review

I am proposing the Property and Sales tax reviews continue to be performed as they are part of a broader scope of services provided to the City. I also propose to continue a review of a cash-handling site and the business license compliance review. In addition, for Fiscal Year 2016-17, I propose to conduct the Transient Occupancy Tax compliance and the Purchasing Card Transaction review, if staffing and resources permit. Funds for these two latter items were requested and approved in the adopted budget.

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 2015-16.
2. Do not approve the City Auditor's Work Plan for Fiscal Year 2016-17 as recommended and propose additional or different projects.

PUBLIC NOTICING – Agenda posting.

Prepared by:

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City Auditor

PJK/7/CAM
546-12-13-16CR-E

- Attachment:
1. Independent Accountant's Report on Michaels at Shoreline
 2. Independent Accountant's Report on Silicon Shores Corporation
 3. Independent Accountant's Report over Cash Collections