

DATE ISSUED: April 15, 2005

REPORT NO. 05-074

ATTENTION: The Committee on Rules, Finance and Intergovernmental Relations
Agenda of April 20, 2005

SUBJECT: Special Promotional Programs, Social Services Programs and City
Agencies – Contract Administration and Monitoring

SUMMARY

<u>Issue</u>	Should the Mayor and City Council adopt the City Manager's recommendations on the administration and monitoring of all organizations receiving City funds, approve amendments to applicable Council Policies, and make changes effective in Fiscal Year 2005?
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<u>Manager's Recommendation</u>	Adopt the recommendations with regard to monitoring of City-funded organizations.
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<u>Other Recommendations</u>	None.
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<u>Fiscal Impact</u>	None.
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BACKGROUND

On February 4, 2004, the City Manager presented to the Rules Committee recommendations for increased clarity and control on the manner in which City funds could be expended by outside organizations or City agencies, as well as additional disclosure requirements. Alternatives to those recommendations were also provided. The motion by the Rules Committee directed the City Manager to do the following:

1. Explore the alternatives regarding [funding for/reimbursing] lodging and meals after meeting with the organizations affected;
2. Explore lowering the \$1 million Transient Occupancy Tax or Community Development

- Block Grant [disclosure requirements] threshold amount; and
3. Analyze, in consultation with the City Auditor, the outside auditing function and the processes for reviewing City-funded organizations' performance.

Pursuant to the Rules Committee's motion, the Financial Management Department extended an invitation to stakeholder organizations to discuss potential spending parameters. The City met with representatives from ConVis, Economic Development Corporation, San Diego Film Commission, North ConVis, and the Commission for Arts and Culture. These meetings were very constructive and useful in the development of policy revision recommendations affecting organizations receiving City funding.

The recommendations below have been modified based on the above motion and the meetings held with stakeholders; the audit function is also discussed below.

In addition to proposing changes related to better define appropriate and allowable expenditure of City funds, this report also proposes additional, administrative changes to Council Policy 100-03 to improve contract administration procedures and practices, as well as to remove unnecessary portions of the policy.

DISCUSSION

Under the provisions of Council Policy 100-03, all recipients of Transient Occupancy Tax (TOT) funding are required to provide annual reports on how they spend City funds. Additionally, in the 1990s, the City Council and City Manager, pursuant to Council Policy 100-03, arranged for an annual audit of all TOT recipients of \$35,000 or more. The required year-end financial audit and statement of compliance must be completed by a Certified Public Accountant (CPA) to assure that TOT recipients have expended City of San Diego funding in accordance with their respective agreements. These financial reports are provided to the Department responsible for administering the TOT contract. The City of San Diego's Auditor and Comptroller's Office periodically reviews the administering Department's records to confirm that organizations are providing the required reports to the City per the Council Policy. The City also retains the right to perform a separate audit, independent of the CPA audit, should it choose to do so.

Council Policy 100-03 currently contains certain prohibitions on the use of TOT funds for specified purposes. The recommendations in this report are intended to broaden the disclosure requirements of City-funded organizations, as well as to extend these requirements beyond TOT funding to include all organizations receiving City of San Diego funding.

Current Audit Requirements

TOT Recipients (governed by Council Policy 100-03)

- \$35,000 received or greater: year-end financial audit and statement of compliance completed by CPA.

Community Development Block Grant (CDBG) Recipients (governed by Council Policy 700-02)

- \$35,000 received or greater: year-end financial statement audit and statement of compliance completed by CPA.
- \$500,000 received or greater: single audit must be performed by CPA.

City Agencies (governed by individual agreements)

- Year-end financial statement audit performed by a CPA.

During a financial statement audit, a CPA provides assurance of the fair presentation of the information in the financial statements prepared in conformity with Generally Accepted Accounting Principles. Since the purpose of a financial audit is to provide an opinion on the fair presentation of financial information, it may not detect inappropriate expenditures of City resources such as expensive travel or alcoholic beverages, or whether or not the organization has complied with all provisions of the applicable Council Policy.

A compliance audit and a statement of compliance are intended to provide assurance that an organization has abided by the terms of the City's agreement and policies regarding the receipt of those funds. A compliance audit may detect inappropriate expenditures that are prohibited in the agreement or policies regarding the receipt of those funds. The City Auditor's Office and Financial Management have the option to review these organizations for compliance.

RECOMMENDATIONS

Given that the areas that elicit the highest degree of concern pertain to salaries and wages, including executive salary packages, and expenses related to travel, meals, lodging and entertainment, the following recommendations for additional requirements for not only TOT-funded organizations, but also for any organization or agency receiving City funds, are put before the Mayor and City Council for their consideration. The intent of these recommendations is not to hamper the affected organizations' ability to perform the core functions for which they receive funding; rather, it is to provide these organizations with parameters within which City funds may appropriately be used, thereby ensuring the responsible and effective utilization of public funds for these activities. It is also recommended that these changes become retroactively effective for Fiscal Year 2005.

Transient Occupancy Tax-Funded Organizations

1. Amend Council Policy 100-03, "Transient Occupancy Tax" (See Attachment "A"), Attachment B, Section B, number 3, to read: "City funds may not be used for alcoholic beverages. In addition, City funds may not be used for travel, meals, lodging, or entertainment expenses, except as otherwise may be provided. Waivers to this provision will be considered for expenditures within the Economic Development Program categories. Organizations receiving waivers may use City funds for travel, meals, or lodging within the following parameters:
 - a. Travel – when use of public air carrier transport is required in order to perform the contractual scope of services to the City, City funds may be applied toward the equivalent of coach airfare only. City funds may not be applied toward any upgrades.
 - b. Meals – when provision of meals is required in order to perform the contractual

scope of services to the City, City funds may be applied toward a maximum of \$50 per day per person for meals (excluding sales tax and a maximum 15% gratuity, which are also eligible expenses). This daily maximum of \$50 is further limited by meal, as follows: \$10, \$15, and \$25 are the maximum City funds that can be applied toward breakfast, lunch, and dinner, respectively, per person. If alcoholic beverages are consumed with meals, they may not be paid for with City funds. In the event that meals are provided to individuals who are not members of the funded organization within the scope of a business development meeting, documentation containing the purpose of the meeting, the benefit to the City, and a list of attendees must be provided to the City in order for City funding to be utilized.

- c. Lodging – when out-of-town lodging is required in order to perform the contractual scope of services to the City, City funds may be applied toward the equivalent of the cost of a standard room in a business class hotel, or toward the conference rates of the host hotel when attending a conference.
- d. Sponsorships – the City acknowledges the business requirement of event sponsorships by promotional organizations in order to market San Diego as a convention destination in a highly competitive market. The primary objective of a funded organization’s participation in such events is to gain exposure for San Diego and secure access to important decision makers representing prominent convention groups. Financial sponsorship of such events is an acceptable application of City funds. If alcoholic beverages are consumed during event sponsorships, they may not be paid for with City funds.”

It is important to note that some organizations, such as the San Diego Film Commission or those organizations under the Commission for Arts & Culture, already disallow travel as an eligible expenditure for TOT reimbursement and will continue to do so.

- 2. Amend Council Policy 100-03, “Transient Occupancy Tax”, Attachment B, Section G, adding a new number 1, to read: “Any organization receiving \$500,000 or more of TOT funding, when that funding represents more than 10 percent of the organization’s annual budget, must include in their applications salary and wage ranges for each of their job classifications, including actual executive salaries and benefits packages applicable for the contract period, during the annual budget process each fiscal year. Organizations receiving less than \$500,000 annually may voluntarily comply with these disclosure requirements.”

The language establishing the reporting requirement threshold at greater than 10 percent of an organization’s annual budget is included to preclude the need for organizations to comply with these reporting requirements when City funding does not comprise a significant portion of their overall funding.

Community Development Block Grant-Funded Organizations

- 3. Amend Council Policy 700-02, “Community Development Block Grant Program” (See Attachment “B”), adding item number 8 to read: “With the exception of City departments

or agencies, which are governed by the City's Administrative Regulations on meals and travel, CDBG funds may not be used for travel, meals, lodging, or entertainment expenses for administrative purposes. However, certain of these types of expenses may be pre-approved by the City when they are part of the core purpose of a program, such as a shelter, nutrition program, at-risk youth program, or other eligible program. CDBG funds may not be used for alcoholic beverages under any circumstances." [NOTE: CDBG recipients do not have a business need to use City funding for travel, meals, or lodging except as noted; the parameters for such use, as provided for TOT recipients, are therefore not required for CDBG recipients.]

4. Amend Council Policy 700-02, "Community Development Block Grant Program", adding item number 9 to read: "Any organization receiving \$500,000 or more of funding from the City of San Diego, when that funding represents more than 10 percent of the organization's annual budget, must include in their applications salary and wage ranges for each of their job classifications, including actual executive salaries and benefits packages applicable for the contract period, during the annual budget process each fiscal year. Organizations receiving less than \$500,000 annually may voluntarily comply with these disclosure requirements."

Additional modifications are recommended to Council Policy 700-02 to memorialize audit requirements. In so doing, it is recommended that the threshold for the requirement of a year-end financial statement audit by a CPA be raised to \$75,000. As described in the section on administrative revisions to Council Policy 100-03, this is still more rigorous than what is called for in the State's new Nonprofit Integrity Act, and is therefore considered a sufficient lower threshold for this requirement.

The addition of the following sections to Council Policy 700-02 would clearly define audit requirements of CDBG recipients:

5. Amend Council Policy 700-02, "Community Development Block Grant Program", adding item number 10 to read: Financial disclosure information shall be required of all funding recipients receiving \$10,000 or more in City funds. Organizations receiving funding shall provide the Contract Administrator, each year, copies of true, accurate and complete financial disclosure documentation evidencing the financial status of the organization's last complete fiscal year within ninety (90) days of the end of that fiscal year.

All organizations receiving funding in the amount of \$10,000 or more shall submit the following documents:

- a) A statement of the expenditure of City funds by program to be identified in the same expenditure classifications as contained in the final budget and compared with the budgeted amounts.
- b) A statement of revenues and expenditures and a balance sheet of all funds received by the organization.

If City funding is \$75,000 or greater, audited financial statements, including

items a and b above, must be prepared in accordance with generally accepted accounting principles (GAAP) and audited by an independent Certified Public Accountant, in accordance with generally accepted auditing standards (GAAS) and submitted to the Contract Administrator within one hundred-fifty (150) days of the end of that fiscal year. The Contract Administrator may grant extensions of up to thirty (30) days to these deadlines when deemed necessary, upon written request by the funded organization.”

6. Amend Council Policy 700-02, “Community Development Block Grant Program”, adding item number 11 to read: “Contractors shall ensure that Single Audits are completed within one hundred eighty (180) days of the termination of the contract period. For contractors completing audits by calendar year rather than fiscal year, audits shall be completed within one hundred eighty (180) days of December 31st. Individual projects funded by the City of San Diego must be clearly identified in the audit reports, as well as the dollar amount allocated to the project by the City. In accordance with the Single Audit Act of 1984 pertaining to recipients of Federal funds, all contractors who expend \$500,000 or more (or the current Federal threshold) in total Federal funding from all sources in a year shall have an annual single audit conducted in accordance with Federal Office of Management and Budget (OMB) Circulars A-110, and A-133. Contractors shall provide the City with a copy of the single audit within fifteen (15) days of receiving the report.”
7. Amend Council Policy 700-02, “Community Development Block Grant Program”, adding item number 12 to read: “An organization receiving funding support will permit the City to inspect all books and records at any time and to perform or require audits the City reasonably desires. City shall periodically monitor records of contracting organizations.”

City of San Diego Agencies and Organizational Subdivisions

8. Seek amendments to the operating agreements for all City of San Diego agencies and organizational subdivisions to include the following:
 - a. During each annual budget process, each agency must submit salary and wage ranges for each of their job classifications, including actual executive salaries and benefits packages.
 - b. During each annual budget process, each agency must submit to the City Manager’s Office the agency’s policies on travel, meals, lodging, and entertainment expenses.
 - c. In January of each year, each agency shall submit to the City Manager’s Office the actual expenditures for travel, meals, lodging, and entertainment for the last completed fiscal year.
 - d. City funds may not be used for the purchase of alcoholic beverages.

The City of San Diego agencies and organizational subdivisions include Centre City Development Corporation, Convention Center Corporation, San Diego Data Processing

Corporation, San Diego Housing Commission, and the Southeastern Economic Development Corporation.

Council Policy 100-03 – Administrative Revisions

Several revisions included in the draft revised policy (Attachment “A”) are required updates due to title changes, clarifications, or other mechanical changes. These are found in Sections 4 and 5 of the Policy, Attachment A and Attachment B, Sections A.6., B.6., D and H.

Modifications to the Policy

Several modifications are proposed that will enhance the City’s ability to monitor contracts and use of funds, in addition to allowing reasonable opportunities for contracting organizations to comply with City requirements.

Section 3: The Executive Director of the Commission for Arts and Culture is not the appropriate point of contact for all categories of funding or for decision-making with regard to appropriate subcategories outside of the Commission for Arts and Culture’s funding categories. In practice, each category has (an) administrator(s) that serve as point(s) of contact and work cooperatively amongst the categories to enhance consistency of application of Council Policy 100-03. The City Manager recommends removing the requirement that the Executive Director of the Commission serve as a Single Point of Contact.

Attachment A: Currently, Attachment A is inaccurate and does not represent the actual TOT application process. It is proposed that text descriptions in the Policy, Section 4 are adequate representations of the TOT application and funding process. Attachment A is proposed to be eliminated.

Attachment B. Section F.: This new section is added to enhance the City’s ability to enforce performance requirements and objectives. Performance reports submitted at the end of the fiscal year allow the City to evaluate the effectiveness of City funding and to make recommendations for future funding. Additionally, the City Manager recommends that the Statement of Compliance with the terms of the City’s agreement be completed by an executive officer of the organization, rather than as part of the audited financial statements, as the Statement of Compliance speaks more to the completion of performance and reporting requirements.

Attachment B. Section G.: In this section, the City Manager recommends modified requirements for audited financial statements. Under new requirements, financial disclosure will only be required by organizations receiving \$10,000 or more in City funds. Currently, all funding recipients must submit financial disclosure, regardless of amount of funding. In addition, financials audited by a Certified Public Accountant (CPA) will only be required of organizations receiving \$75,000 (currently \$35,000) or more in City funds. This new requirement is still more rigorous than requirements in the State’s new Nonprofit Integrity Act, which calls for organizations with gross revenues over \$2 million to conduct an annual audit by a

CPA. Organizations receiving \$75,000 in City funds in any of the categories, and some organizations receiving funds in excess of \$75,000, do not have gross revenues of \$2 million or more. The City Manager recommends that the City maintain a reasonable threshold for requiring audited financial statements by increasing that threshold to \$75,000.

In addition, nonprofit organizations have found it increasingly difficult to comply with the City's timeline requiring submission of audited financials within 90 days of the end of the fiscal year. The new requirements of the Sarbanes-Oxley Act of 2002 and similar factors in the audit services industry have made the 90 day requirement onerous if not impossible for many organizations. The Manager recommends extension of the timeline for groups requiring audited financials to 150 days, and allowing the Contract Administrator the authority to extend the deadline an additional 30 days, if necessary.

CONCLUSION

Council Policy 100-03 has sound provisions for ensuring the accountability of recipients of City of San Diego TOT funding. However, given the City's obligation to its citizens in ensuring the responsible use of City funds, as well as heightened sensitivity to activities or spending practices that are perceived as extravagant or excessive, it is felt that the additional clarity and level of disclosure afforded by the recommended revisions to Council Policies 100-03 and 700-02, and the extension of these requirements to organizations receiving other forms of City funding, is not only warranted but essential. It is also felt that the recommended administrative revisions to Council Policy 100-03 will aid City staff in administering the application process and contract compliance, as well as setting more appropriate parameters for document submittal time frames and audit thresholds.

Respectfully submitted,

Mary Vattimo
Financial Management Director

Approved: Lisa Irvine
Deputy City Manager

Attachments: [Attachment "A", Draft revised Council Policy 100-03](#)
 [Attachment "B", Draft revised Council Policy 700-02](#)