Sonoma County

Auditor-Controller-Treasurer-Tax Collector

Internal Audit Report

Internal Audit:
Sonoma County General Services Department Veteran's Buildings Concession Agreements

For the Period
September 1, 2012 through June 30, 2016

Engagement No: 4030
Report Date: October 26, 2016

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Executive Summary

Per request from the Sonoma County General Services Department Head, the Internal Audit Division of the Sonoma County Auditor-Controller-Treasurer-Tax Collector's Office (ACTTC) performed an audit of the Veteran's Building Concession Agreements for Santa Rosa, Petaluma and Cotati (the Agreements) related to revenues and expenses reported to the General Services Department for the period September 1, 2012 to June 30, 2016 and determined that:

- There were no major exceptions noted during testing for both revenue and expenses.

- Even though all expenses tested were in accordance with the contract, there were two minor observations made relating to the expense categories of maintenance and other. In our estimate, these exceptions impact no more than 10% of the total expenditures:
    - For certain type of expenses we were unable to determine which Veteran's buildings they related to because there was no such indication on the invoices
    - Two full time employees who have access to multiple credit cards (Bank of America Visa, Home Depot and Cash & Carry) can purchase and approve their own transactions. The risk here would be unauthorized payments.

- There are multiple factors contributing to United Camps, Conferences and Retreats' (UCCR) operating losses.

- Higher than anticipated free use (based on 827 free room use in the first ten months of operation) accounted for approximately $95,680 of the total net loss of $275,527 (excluding bad debt expense for $2.5K) for the period between the fiscal year 2013/14 and 2015/16. Approximately $43,221 of the total net loss for the period was due to increase in variable unit cost attributable to increased free use.

- We conclude, based on our work, the operating loss of $307,061 (excluding bad debt expense) reported by UCCR for the period September 1, 2012 through June 30, 2016 is not materially misstated (see page 5).

Introduction and Background

Introduction

ACTTC completed an audit of the revenue and expenses relating to the activities covered by the Agreements as reported by UCCR to the General Services Department for the period September 1, 2012 through June 30, 2016. We also performed an analysis of higher than anticipated free use of the buildings during the period between the fiscal year 2012/14 and 2015/16 (see page 6). We conducted our audit in accordance with the *International Standards for the Professional Practice of Internal Auditing (Standards)*. These Standards require that we identify, analyze, evaluate, and document sufficient information and evidence to achieve our audit objectives. We believe that the evidence obtained provides a reasonable basis for the results, observations, and recommendations contained in our report.

The purpose of this audit report is to furnish management independent and objective analyses, recommendations, and other information concerning the activities reviewed. The audit report is a tool to help management identify and implement improvements.

Background

The General Services Department has a contract with UCCR, to manage County owned Veteran's Buildings located in Santa Rosa, Cotati and Petaluma. Under the contract, UCCR receives a percentage of gross revenues as concession fees and is required to pay the first $500 of each expenditure transaction.

The contract requires the County to maintain an operating account and deposit in it the initial operating capital. The County is also required to deposit additional funds, if deficits are expected. The County is allowed to make withdrawals from the operating fund if there is a surplus beyond the amount needed to fund operations.

UCCR is required to submit an annual budget to the County for approval.

During the period covered by the audit, the operating account was not maintained and the operating budgets were not prepared and approved as required by the contract. UCCR claims that the building operations incurred approximately $307,061 in loss over fiscal year 2012/13 to 2015/16. If the operating account, as required by the contract, had been maintained there would have been a deficit that the County would have had to eliminate. UCCR claims that it advanced its own funds to cover the loss and that, as provided by the contract, the County must reimburse UCCR.

Objectives and Scope

Objectives

The objectives of this audit were to determine whether:

1. UCCR has a system of controls designed to reduce the risk of non-compliance with the Agreements related to revenue and expenses reported to the General Services Department.

2. The operating losses reported by UCCR were primarily the result of higher than anticipated building usage by organizations exempt from paying rent.

Scope

The audit covered the period September 1, 2012 through June 30, 2016. In order to achieve the above objectives we performed the following:

- Gained an understanding of the UCCR system of internal controls over the accounting and reporting of revenue and expenditures covered by the Agreements.
- Performed analytical procedures over revenue and expenditures and investigate unusual variances.
- Performed limited test of details over revenue and expenditure transactions based on unusual variances identified in #2 above. Randomly selected and tested a sample of revenue and expenditure transactions to confirm that the amounts reported by UCCR are complete, accurate and valid. Expenditure testing to include verification that the costs were incurred solely at County owned facilities and in accordance with the contract.
- Interviewed UCCR staff and reviewed related UCCR records necessary to determine the extent to which the operating losses reported to the County were the result of building usage by organizations exempt from paying rent.

Results

<u>Objective #1:</u> **UCCR has a system of controls designed to reduce the risk of non-compliance with the Agreements related to revenue and expenses reported to the General Services Department.**

We determined that there were adequate controls over the revenue and expense process within UCCR. We performed walkthroughs of both processes and documented the process and the controls that are in place.

<u>Revenue</u>

We performed a walkthrough of the event booking and revenue recording process and conclude that the risk that events will be booked and not be recorded is low.

We judgmentally selected events from the Santa Rosa, Petaluma and Cotati Veteran's Buildings for the fiscal years 13/14, 14/15 and 15/16 and performed the following tests:

1. Traced booked events per executed rental contracts to revenues recorded in UCCR's books (QuickBooks). We noted no exceptions.
2. Traced revenue recorded in QuickBooks to executed contracts and noted no exceptions.

<u>Expenses</u>

We performed a walkthrough of the payroll, employee benefits, insurance, utilities and maintenance expenditure requests, approval and payment processes and noted that the risk of unauthorized expenditures for all categories were low with the exception of one. The functions relating to the requesting of, and authorizing payment for maintenance expenditures were not adequately segregated. Maintenance expenditures however constitute only between 10-15% of the total expenditure.

While all expenses tested were in accordance with the contract, we noted the following exceptions. In our estimate, these exceptions impact no more than 10% of the total expenditures.

1. For certain type of expenses we are unable to determine which Veteran's buildings they related to because there was no such indication.
2. Two full time employees who have access to multiple credit cards (Bank of America Visa, Home Depot and Cash & Carry) can purchase and approve their own transactions.

Results

The chart below represents the breakdown of the expenses for the Veteran's buildings.

Fiscal Year	FY 12/13		FY 13/14		FY 14/15		FY 15/16		
Description	Amount	% of Total Expenses	Amount	% of Total Expenses	Amount	% of Total Expenses	Amount	% of Total Expenses	Total
Revenue	**372,739**		**494,489**		**502,426**		**540,295**		**1,909,949**
Expenses:									
Payroll	202,070	50%	298,721	51%	316,091	54%	367,472	57%	
Employee Benefits	42,986	11%	62,813	11%	61,993	11%	61,205	10%	
Utilities	67,878	17%	81,527	14%	79,880	14%	86,114	13%	
Insurance	22,083	5%	25,064	4%	23,786	4%	25,491	4%	
Maintenance	44,614	11%	90,205	15%	71,036	12%	61,596	10%	
Other	24,642	6%	31,744	5%	29,556	5%	38,443	6%	
Total Expenses	**404,273**	**100%**	**590,074**	**100%**	**582,342**	**100%**	**640,321**	**100%**	**2,217,010**
Net Income/(Loss)	**(31,534)**		**(95,585)**		**(79,916)**		**(100,026)**		**(307,061)**

The table above is not adjusted for the first $500 of each expenditure that UCCR is required to pay per the contract. FY 14/15 expenses excluded bad debt expense for $2.5K.

Objective #2: **The operating losses reported by UCCR were primarily the result of higher than anticipated building usage by organizations exempt from paying rent.**

Based on our audit, free use of the facilities make up approximately 39% of the total rooms rented.

There are a number of factors in addition to free use by Veterans that contributed to the operating loss as discussed below:

- **UCCR may have difficulty marketing the facilities because they are not updated**. Per UCCR, because the buildings are old and do not have air conditioning, it is difficult to attract renters.

- **Some Veteran group users may not be entitled to free use of the facilities**. According to UCCR management, some Veteran groups are not disclosing the amounts they charge non-veterans by classifying amounts collected as donation rather than admission fee.

  Per Exhibit C of the contract, Veteran groups that charges entrance fees are not entitled to free use of facilities.

- **Rental rates have not been increased over the past four years whereas costs have gone up**. Some employees received pay increases over the audit period of approximately 3%. Had rent rates been increased at least by this increase in payroll cost, the operating loss over the audit period would have been lower.
- **UCCR may not be utilizing its parking lot in a manner that maximizes revenue.** Currently, the parking lot is operated by the Fairgrounds under an arrangement where UCCR receives 50% of the net income. By taking over operations, UCCR could retain 100% of the net income incurring

a marginal amount in operating cost. According to UCCR management, net income could be increased by approximately $35k per year. It is recognized that this would amount to an equivalent loss in income to the Fairgrounds.

We also performed an analysis of the operating cost to determine the impact of increase in free use on the total cost to determine the portion of the cost attributable to free use, thus contributing to the net loss. We disregarded fixed cost as by its nature it should not vary as usage increases. The schedule below documents our analysis. We assumed the anticipated free use was the actual free use in the first year of operation.

UCCR
Variable Cost Analysis
Fiscal Year 2013/14 to 2015/16

	FY 12/13	FY 13/14	FY 14/15	FY 15/16	Total
Variable Operating Costs					
Payroll (excluding benefits)	57,636	132,787	164,104	166,584	521,111
Benefits	9,367	21,870	24,279	22,533	78,049
Utilities	67,878	81,527	79,880	86,114	315,399
Maintenance	44,614	90,205	71,036	61,596	267,451
Other	24,642	31,745	32,104	38,443	126,934
Total variable cost	**$ 204,137**	**$ 358,134**	**$ 371,403**	**$ 375,270**	**1,308,944**
Rooms rented					
Community Use	1,763	1641	1,469	1,383	6,256
Free Use	827	1109	1,053	1,055	4,044
	2,590	**2,750**	**2,522**	**2,438**	**10,300**
Variable cost per event	$ 79	$ 130	$ 147	$ 154	$ 127
Actual free use variable cost	$ 65,333	$ 144,170	$ 154,791	$ 162,470	526,764
Expected free use variable cost	$ 65,333	$ 107,510	$ 107,510	$ 107,510	387,863
Variance	**$ -**	**$ 36,660**	**$ 47,281**	**$ 54,960**	**$ 138,901**
Increase in free use (actual vs. expected)		282	226	228	736
Variance due to increase in free use		$ 36,660	$ 29,380	$ 29,640	$ 95,680
Variance due to increase in variable unit cost		$ -	$ 17,901	$ 25,320	$ 43,221
		$ 36,660	**$ 47,281**	**$ 54,960**	**$ 138,901**

Results and Staff Acknowledgement

Results

The following assumptions have been made to arrive at total variance of $138,901:

1. UCCR management used the number of rooms used for free in the first ten months (827) to set the expected number of rooms to be provided for free in all of the following years.
2. Expected variable cost per event was actual variable cost for the first full year (FY 2013/14) of operations ($130)
3. Benefits cost were added per UCCR management's request although it remained largely fixed throughout the three years.
4. We didn't perform cost study to determine if part of utilities and maintenance cost can be classified as fixed cost. We included all utilities and maintenance cost as variable cost.
5. We arrived at the variable payroll and benefits costs by excluding such costs relating to full-time employees and those involved in booking events as they are not event driven. UCCR agreed with the methodology.
6. We utilized the actual variable cost per room rented for the first full year (FY 2013/14) of operation to determine the cost of higher than expected free usage. The first fiscal year includes only 10 month of operations. Given that the actual variable unit costs were $79, $130, $147 and $154 for each of the years FY12/13 to FY 15/16, the first year's variable cost does not appear to represent expected unit cost for fiscal years 2013/14 through 2015/16.

Staff Acknowledgement

We would like to thank General Services Department Management and staff for their helpfulness and cooperation in conducting this audit. If you have any further questions regarding this report, please contact the auditor-in-charge, Olga Gray at (707) 565-8303.