

The Honorable James K. Hahn
The Honorable Rockard J. Delgadillo
The Honorable Members of the City Council
page two

These audits further raise questions about the City's responsibility and ability to oversee and monitor the services provided through BIDs. The City Clerk, on behalf of the City is responsible for ensuring that services are provided and terms of the contract are met. My audits show that they have not been given the authority or the tools to discharge that responsibility efficiently and effectively.

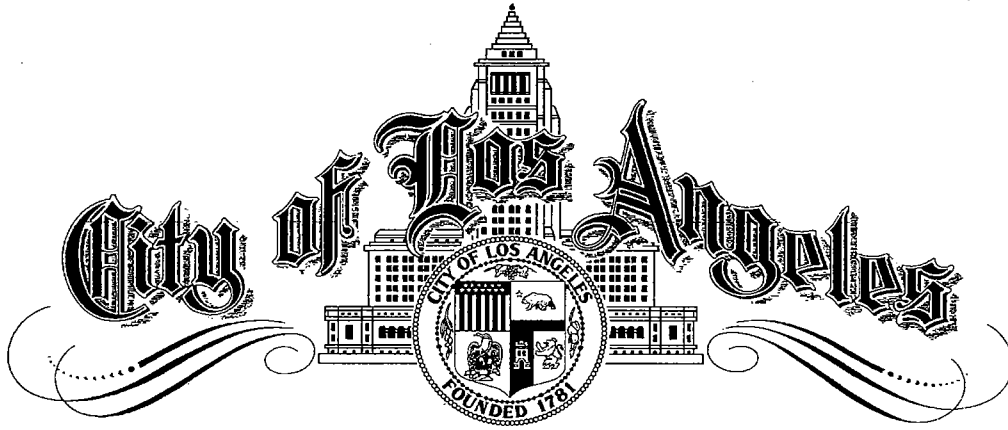
First and foremost, the executive directors and boards that manage the City's BIDS have a fiduciary responsibility to ensure that services are delivered in a timely and cost effective way. These audits reveal problems with the manner in which the executive directors and boards are meeting this basic standard so integral to the success of Business Improvement Districts.

BIDs can be an effective way to empower local businesses to enhance the quality of their community . The management and oversight of these districts are important issues that we as City elected leaders must review and improve .

Sincerely,

A handwritten signature in black ink that reads "Laura N. Chick". The signature is written in a cursive, flowing style.

LAURA N. CHICK
City Controller



OFFICE OF
CONTROLLER

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July 6, 2004

Mr. J. Michael Carey
City Clerk
200 N. Spring St., Room 360
Los Angeles, CA 90012

Dear Mr. Carey,

Enclosed are two audit reports pertaining to Business Improvement Districts entitled "Contract Compliance Audit of the Westwood Village Community Alliance, Inc. (C-99914)" and "Contract Compliance Audit of the Central City East Association (C-97899)."

Drafts of these two audit reports were provided to your office on April 29, 2004, and May 12, 2004, respectively. An exit conference was subsequently held on May 25, 2004, wherein the findings and recommendations in the two reports were discussed with you and your staff. Your responses before and during the exit conference were evaluated and considered prior to finalizing both reports.


Please review the final audit reports and advise the Controller's Office within 30 days of the date of this report on actions taken to implement the recommendations.

Mr. J. Michael Carey
City Clerk
July 6, 2004
Page 2 of 2

If you have any questions or comments, please contact Farid Saffar, Director of Auditing, at (213) 978-7392.

Sincerely,

LAURA N. CHICK, CITY CONTROLLER

By:  CPA

For Marcus Allen
Chief Deputy Controller

Enclosure

cc: Honorable James K. Hahn, Mayor
Honorable Members of the City Council
Honorable Rockard J. Delgadillo, City Attorney
Timothy B. McOsker, Chief of Staff, Office of the Mayor
Carmel Sella, Deputy Mayor
William T. Fujioka, City Administrative Officer
Ronald F. Deaton, Chief Legislative Analyst
Antoinette Christovale, Director of Finance
Independent City Auditors



**City of Los Angeles
Office of the Controller**

**Contract Compliance Audit
of the Central City East Association
(C-97899)**

July 6, 2004

**Laura N. Chick
City Controller**

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CONTRACT COMPLIANCE AUDIT OF CENTRAL CITY EAST ASSOCIATION (C-97899)

EXECUTIVE SUMMARY

The City Controller's Internal Audit Division completed a contract compliance audit of the Central City East Association of Los Angeles (CCEA), a California nonprofit corporation that administered the Los Angeles Downtown Industrial District (LADID) Business Improvement District. The primary objectives of this audit were to determine whether the CCEA complied satisfactorily with the significant provisions of the contract and to evaluate the adequacy of the City Clerk's oversight of the contract. The scope of the audit covered the contract period from January 1, 2000, through December 31, 2002.

Background

In December 1998, the City entered into an agreement with the CCEA to administer the LADID. The agreement stipulates that the CCEA shall be fully responsible for developing, implementing, directing and operating the LADID programs, as described in the Management District Plan. In addition, the CCEA is also responsible for submitting required reports, such as Annual Reports, quarterly reports and financial statements to the City. The City Clerk, as the City's Business Improvement District program coordinator, was to administer the agreement with the CCEA. As such, the City Clerk was responsible for enforcing contractual provisions and maintaining fiscal oversight over the activities of the CCEA. The term of the agreement was from December 1, 1998, through March 31, 2004.

A Business Improvement District (BID) is a geographically defined area within a municipality, in which services, activities and programs are supplied and paid for through special assessments charged to all members within the BID. Two state laws authorize the establishment of BIDs: The Parking and Business Improvement Area Law of 1989 (California Streets and Highways Code Section 36500 et seq) allows for the creation of merchant-based BIDs, and the Property and Business Improvement District Law of 1994 (California Streets and Highways Code Section 36600 et seq) allows for the creation of property-based BIDs. The operation of a merchant-based BID is supported by assessments collected from business owners in the BID, while a property-based BID's operation is supported by assessments collected from property owners in the BID. As of May 2003, there were 31 active BIDs citywide and 20 more BIDs in various stages of formation.

The LADID, a property-based BID, was established on August 5, 1998. The Management District Plan of the LADID stated the services and activities to be provided to the property owners in the BID as follows: maintenance, security, and image enhancement (marketing).

The CCEA received approximately \$3.2 million in assessment revenue during the three fiscal years 2000 through 2002. In August 2003, the City Council approved a new contract with the CCEA to administer the LADID covering the period January 1, 2004 through December 31, 2009.

Summary of Audit Results

The CCEA generally complied with the key provisions of the contract with the City of Los Angeles, such as submission of quarterly activity reports to the City Clerk, issuance of quarterly newsletters, conducting annual public meeting, and maintaining an updated assessment records of the property owners of the LADID. Also, the CCEA provided programs, such as maintenance, security, marketing, and other services, as called for in its Management District Plan, in accordance with allowable budget specified in the contract. However, the CCEA did not submit Annual Reports and financial statements in a timely manner to the City Clerk.

In general, the CCEA maintained adequate accountability over its receipts and disbursements, and timely financial information was provided to its management and the Board. However, we noted some control weaknesses over payroll, contract with a service provider, bank reconciliations, and travel expenses.

The lack of formal written guidelines to BIDs may have contributed to the above-mentioned issues. We believe that, as part of its responsibilities as BID coordinator, the City Clerk should have provided guidelines to all BIDs to assist them in complying with the terms of the contract.

Compliance with Significant Provisions of the Contract

The City Clerk's records disclosed that the CCEA was late in submitting its Annual Reports and financial statements. Also, the Annual Report did not contain all the required information in accordance with Section 36633 of the California Streets and Highways Code, as required by the contract. For fiscal years 2000, 2001, and 2002, the CCEA submitted Annual Reports late by seven, five, and six months, respectively. For the same three fiscal years, the CCEA also submitted financial statements late, ranging from a few days to almost one month past the due date.

The City Clerk did not take action when the submitted Annual Reports did not contain the operation and financial plan, as required by the contract. According to the City Clerk, they developed and implemented a new monitoring process at the end of 2002.

Without the financial information in the Annual Reports and financial statements, the City Clerk could not make a timely, adequate operational and financial analysis of the program activities for the LADID. A comparative analysis of budgeted and actual revenue and expenses at the end of each program year is necessary for the City Clerk to identify necessary changes, if any, to the following year's program activities and budget in a timely manner.

Monitoring Oversight and Administrative Controls

During our review, we noted that the CCEA did not maintain a current service contract and some accounting documents, such as payroll documents, bank reconciliations, and travel expense statements, to fully support costs incurred in relation to LADID operations. Although our audit did not disclose expenses unrelated to the services to be provided by LADID, the lack of adequate documentation for expenditures incurred could lead to undetected errors and possible loss of funds.

The fieldwork for this audit was conducted from June 6, 2003, through October 31, 2003, and was performed in accordance with Generally Accepted Government Auditing Standards.

TABLE OF RECOMMENDATIONS

RECOMMENDATIONS	PAGE REFERENCE
<p>The City Clerk stated that they have implemented the majority of the recommendations enumerated in Section I. We encourage the City Clerk to continue to fully implement our recommendations.</p> <p><u>Section I Compliance with the Significant Provisions of the Contract</u></p> <p>We recommend that the City Clerk:</p> <ol style="list-style-type: none"> 1. Ensure that the CCEA comply with the requirements of the contract by submitting the Annual Report and the financial statements on time, with the required information, such as future plan, included in the Annual Report. 2. Review and analyze the Annual Reports and financial statements submitted by the CCEA to determine compliance with the contract provisions pertaining to the proper use of assessment funds, budget allocations/changes, and future financial and operating plans. 3. Consider modifying the contract terms with the CCEA, such as the due date for the required reports, if the due dates are not reasonable. <p><u>Section II Monitoring Oversight and Administrative Controls</u></p> <p>We recommend that the City Clerk ensure that the CCEA:</p> <ol style="list-style-type: none"> 1. Maintain payroll documents, such as employment agreement, to validate salaries and benefits of employees. 2. Maintain written agreements with contractual employees as to the type of services to be provided and the rate of compensation to be paid by the CCEA. 3. Maintain Board approval documents for other compensation, such as bonuses. 4. Maintain a current, enforceable written contract with the service providers, so that compliance with contract provisions, such as CCEA's signing of contractor's employees' time cards, can be enforced. 5. Resolve bank reconciling items that were outstanding for more than one year; thereafter, resolve all bank reconciling items in a timely manner. 6. Prepare monthly bank account reconciliation and maintain documentation to support validation and supervisory review. 7. Require the Executive Director and other employees who travel to prepare travel expense reports within 30 days after completion of the travel. 8. Maintain a schedule of expenses allocable between the LADID and the Toy District, indicating percent of allocation, in order to properly monitor shared expenses. 	<p>Pg 12</p> <p>Pg 16-17</p>

TABLE OF RECOMMENDATIONS

RECOMMENDATIONS	PAGE REFERENCE
<p>9. Reimburse the LADID from the Toy District's funds for its share of the unallocated CPA fees that were paid for the preparation of the financial statements.</p> <p>We recommend that the City Clerk:</p> <p>10. Provide guidelines to all BIDs regarding basic internal controls, including but not limited to, maintaining:</p> <ul style="list-style-type: none"> • Necessary payroll documents (such as employment agreements, time sheets, and others) for employees' compensation and bonuses. • Current contract with service providers and subcontractors. • Monthly bank account reconciliation statements. • Travel expense reports for employees. <p>11. Ensure that adequate controls are developed and properly implemented to safeguard and prevent possible misuse of funds among BIDs.</p>	

INTRODUCTION AND BACKGROUND

In 1994, Governor Pete Wilson signed AB 3754, California Streets and Highways Code (State Code) Section 36600 et seq., establishing the Property and Business Improvement District Law of 1994. This state law created a mechanism for property owners to join forces and improve their commercial districts through the formation of Business Improvement District (BID).

A BID is a geographically defined area within a municipality, in which services, activities and programs are supplied and paid for through special assessments charged to all members within the BID.

Generally, the County of Los Angeles collects the assessments through property tax bills and remits the funds to the Office of the City Clerk. As the assessment funds collected in a given BID cannot legally be spent outside of that BID, the City creates a trust fund for each BID, with funds periodically released to support operations of the BID.

The City of Los Angeles entered into a contract with a nonprofit corporation, which is designated as the agent responsible for procuring the improvements and providing services to the BID. The contracted nonprofit corporation is obligated to provide the City with financial reports, disclosing financial and program activities associated with the use of the assessment funds.

Los Angeles Downtown Industrial Business Improvement District (LADID)

The City of Los Angeles established the LADID by the adoption of City Ordinance 172155 (Council File 96-1281) on August 5, 1998. Said ordinance authorized the annual levy of a special assessment upon the various parcels of real property located within the BID to support supplemental activities and services provided to property owners located within the BID.



The LADID is a manufacturing and wholesale area, comprised of mostly seafood, produce and food services, as well as garment and printing businesses. The types of businesses in the district vary greatly from high-end office furniture manufacturing to shrimp processing.

Geographically, the LADID is centrally located in the eastern end of downtown Los Angeles, covering part of Council Districts 9 and 14. Supplemental services were delivered in approximately a 35-block area, bounded by 4th Street on the north, Alameda Street on the east, 8th

Street on the south, and San Pedro on the west. Two separate benefit zones, Zone 1 and Zone 2, were created because of the scope and nature of the LADID and services to be provided. Zone 2 properties are large properties that require services on perimeter streets while Zone 1 properties are smaller properties that require more maintenance and security services because Zone 1 covers more streets.

The signed written petition of property owners located within the BID initiated the ballot process to form the LADID. The ballot included a copy of the Management District Plan, which contained the following:

- A map of the BID
- The boundaries of the BID
- The main programs, activities and services to be provided
- Proposed annual budgets
- Proposed sources of financing including assessments to be levied and their calculations
- Time and manner of collecting the assessments
- Specific number of years that assessments will be levied
- List of properties, by assessor's parcel number, to be assessed.

LADID's Management District Plan was approved by the City Council when the LADID was established.

Central City East Association (CCEA)

The CCEA is a nonprofit organization, exempt from federal income taxes under Section 501(c) 6 of the Internal Revenue Code. The CCEA, incorporated in 1986, has taken a leadership role to revitalize the downtown industrial area. The CCEA's mission is to protect investments in the area and provide a clean, safe, and friendly business and industrial core area.

The City signed a five-year contract with the CCEA for developing, implementing, directing and operating the LADID programs, as described in the Management District Plan. The key contract provisions required CCEA to: submit annual financial statements, program and budget reports, such as annual report and quarterly reports to the City Clerk on specified dates; obtain and administer subcontracts necessary in providing the LADID with the required improvements and activities; maintain an ongoing liaison relationship with the community by organizing and conducting one annual public meeting, issuing a quarterly newsletter and conducting other events and activities that involve members of the LADID; maintain a current and updated assessment records; and implement the LADID programs within the specified budget amounts and within the allowable limit for budget allocation changes. The contract period is December 1, 1998, to March 31, 2004.

The CCEA also administers the Toy District. The CCEA is governed by its Board of Directors, made up of thirteen members who meet on a monthly basis to discuss

financial matters and operational issues of the two districts. The CCEA's operating expenses are allocated between the Toy District and LADID.

The CCEA has three full-time personnel: the Executive Director, the Operations Manager, and a Receptionist. Two contractual employees, a bookkeeper and a marketing-newsletter staff person, assist the full-time personnel.

Until 2003, responsibility for the timely preparation of Annual Reports and financial statements rested with the LADID's Advisory Board appointed by the City Council. However, effective January 2004, this function was transferred to the "owner's association" (the CCEA Board of Directors) per § 36614.5 of the State Code when the LADID was renewed for a six-year term.

The reported revenues and expenditures of the CCEA for the LADID are shown in Table 1.

Table 1:

Reported Revenues and Expenditures

	FY 2000	FY 2001	FY 2002
Revenue			
Property Assessment	\$1,001,731	\$1,089,289	\$1,096,617
Interest Income	22,014	22,033	10,797
Other Income	0	0	3,911
Total Revenues	\$1,023,745	\$1,111,322	\$1,111,325
Expenses			
Security Services	\$592,202	\$637,029	\$593,627
Maintenance Services	164,476	234,998	221,938
Administration	219,247	239,361	267,166
Total Expenses	\$975,925	\$1,111,388	\$1,082,731
Increase (Decrease) in Net Assets	<u>\$47,820</u>	<u>(\$66)</u>*	<u>\$28,594</u>

Source: CCEA's unaudited financial statements for the LADID submitted to the City Clerk.

One of the responsibilities of the CCEA, as specified in the contract, was to implement each program within the specified budget amount and within the allowable limit for budget allocation changes.

Office of the City Clerk

The following are the responsibilities of the City Clerk, as the City's BID program coordinator, as stated in the contract with the CCEA:

1. Effect the timely collection of the annual assessment.

* During fiscal year 2001, expenses for maintenance services exceeded the original budget, but the excess expenses were within 10% of the total budget, which was allowed by the contract.

2. Coordinate the collection of the annual assessment through an Interagency Agreement with the County of Los Angeles, and through other means, including direct billing, as the City Clerk deems appropriate.
3. Provide general assistance, clarification, or information to the CCEA, the assessed parties, and the public at large.
4. Maintain a continual liaison with the CCEA, including the coordination of services from various City departments.
5. Authorize supplemental assessments, adjusted assessments, assessment exemptions, reductions or refunds, to be issued by the County of Los Angeles.
6. Direct the disbursement of assessment funds to be made by the City Controller to the CCEA.
7. Perform other related administrative, analytical, clerical, financial, technical or public relations tasks, as mutually agreed to by the City Clerk and the CCEA.

During the audit period, the City Clerk directed the disbursement of assessments to the CCEA through the City Controller. The Special Assessments Section of the City Clerk is staffed by the following personnel: one Senior Management Analyst supervising three Management Analysts, three Office Engineer Technicians, and three clerical staff. The BID program of the City Clerk had an operating budget of approximately \$1.4 million for the fiscal year 2002-2003.

The City Clerk had developed comprehensive guidelines and started to implement the following procedures as of December 2002:

- Begin a no-exception policy for all BIDs for meeting all contract requirements before funds are disbursed.
- Use checklists to monitor a BID's compliance with requirements.
- Compare quarterly reports submitted by all BIDs with Management District Plans to determine compliance.
- Hold funds until contract requirements have been met by the BIDs.
- Conduct presentations to all the BIDs. In September 2002 and January 2003, the City Clerk conducted presentations for BID Board of Directors in the City. Presentations included information regarding submission of quarterly and annual reports and the disbursement of funds.

These procedures partially addressed our audit recommendations.

Objectives and Scope

The objectives of this audit were:

- To determine if the CCEA has complied with all significant provisions of the agreement.

- To evaluate the adequacy of contract monitoring oversight and administrative controls over the agreement.
- To evaluate the reasonableness of services performed and propriety of expenditures by the CCEA.

Scope Limitation

The scope of our audit was limited by our inability to review the CCEA's bylaws. The CCEA and the City Clerk did not provide us a copy of the CCEA bylaws even after we had repeatedly requested them for a copy. We were not able to determine specific responsibilities of the CCEA Board of Directors, which include hiring practices and setting salaries and bonuses of the CCEA employees and contractual employees.

The audit scope included contract oversight practices in the Office of the City Clerk and management controls at the CCEA for the period from January 2000 to December 2002.

Audit Techniques and Methodology

In order to achieve the audit objectives, we performed the following audit procedures:

- Interviewed key personnel within the Office of the City Clerk and the CCEA.
- Reviewed significant provisions of the contract, as well as other pertinent information related to the contract, to identify key performance or compliance provisions, such as submission of required financial statements and Annual Reports.
- Reviewed City Council files and pertinent provisions of the California Streets and Highways Code.
- Reviewed and evaluated the City Clerk's management policies, procedures, and contract monitoring controls over the agreement to ensure that contractual provisions were fully enforced.
- Evaluated the adequacy and accuracy of collection and remittance practices of the Special Assessments Unit in the City Clerk, as they relate to the CCEA.
- Assessed the accuracy of additional sources of revenue (sale of signage, interest on investment, etc.) for the CCEA.
- Analyzed all categories of expenses and budgeted amounts, as shown in the Management District Plan, against actual amounts, as presented in the financial statements prepared by the CCEA's independent Certified Public Accountant.
- Tested a sample of invoices and reviewed allocation of the CCEA's operating expenses between LADID and Toy District.
- Reviewed the minutes of meetings of the Board of Directors to become familiar with various issues and work done by the CCEA.
- Reviewed a member survey report prepared by a consultant to assess the level of satisfaction with the services provided by the CCEA.
- Reviewed contracts entered into by the CCEA with the security and maintenance service providers.
- Conducted a physical observation of the LADID area.

AUDIT FINDINGS

The audit concluded that the CCEA generally complied with the key contract provisions and maintained adequate internal controls to account for receipts and disbursements. However, the City Clerk needs to improve their monitoring over the BID operations, such as providing formal written guidelines and training to all BIDs.

The CCEA submitted quarterly activity reports to the City Clerk and issued quarterly newsletters, as required by the contract. The CCEA also provided services and activities such as security, maintenance and marketing services as stated in the management district plan through subcontractors. The CCEA held annual public meetings to keep in touch with the property owners of the LADID. In addition, the CCEA prepared and submitted to the City Clerk annual assessment data and maintained an updated assessment records, as required by the contract.

Our audit revealed weaknesses in the following areas:

Section I. Compliance with Significant Provisions of the Contract

The CCEA submitted Annual Reports and financial statements late to the City Clerk. The City Clerk did not ensure that the CCEA submitted the required Annual reports and financial statements in a timely manner, as required in the contract.

Finding: The CCEA did not submit its Annual Reports and financial statements on time.

We noted that the CCEA was always late in submitting its Annual Reports and financial statements to the City Clerk. For fiscal years 2000, 2001, and 2002, the CCEA submitted the Annual Reports late by seven, five, and six months past the due date, respectively. For the three fiscal years, the CCEA also submitted financial statements late, ranging from a few days to almost a month past the due date.

In addition, the Annual Reports submitted by the CCEA did not include the future financial and operating plans, as required by the contract. The City Clerk did not take action when the submitted Annual Reports did not contain all the information required by State Code § 36633¹, as referred to in the contract, such as improvements and activities to be provided for the following year and the estimated cost of providing these improvements.

¹ This Section of the California Streets and Highways Code was applicable when the contract was signed on February 11, 1999. Then, on July 1, 2001, this section has been amended and renumbered to Section 36650 by Stats. 2001, c.88 (A.B.1021), § 5), which requires the owner's association [CCEA] instead of the Advisory Board to prepare the Annual Report. The current section explicitly stated "The owner's association's first report shall be due after the first year of operation of the district."

The City Clerk stated that the Annual Reports and financial statements submitted by the CCEA were reviewed to determine their compliance with the contract terms and the management district plan. However, there was no documentation to show that they reviewed or analyzed the Annual Reports and financial statements submitted by the CCEA.

Section 2.2.A of the contract required the CCEA to submit Annual Reports on or before December 1 of each year of operation, except for the first year, during which the approved Management District Plan is to be considered as the approved Annual Report. The contract further required that the Annual Report should be prepared in accordance with Section 36633² of the State Code and should contain all items required by that section.

Section 2.3 of the contract also required that financial statements covering each fiscal year, compiled or prepared by a Certified Public Accountant, are to be submitted to the City Clerk by March 31 of the following year.

According to the City Clerk, the CCEA once requested an extension of the deadline for the submission of Annual Reports. Late submission then became a practice, but the City Clerk did not call the attention of the CCEA. Also, the City Clerk stated that the submission of the Annual Report by December 1 of each year was too early because the LADID's fiscal year ends on December 31. The CCEA's Executive Director stated

² Section (§) 36633 of the California Streets and Highways Code

- (a) The advisory board shall cause to be prepared a report for each fiscal year for which assessments are to be levied and collected to pay the costs of the improvements and activities in the report. The report [Annual Report] may propose changes, including, but not limited to, the boundaries of the property and business improvement district or any benefit zones within the district, the basis and method of levying the assessments, and any changes in the classification of property, if a classification is used.
- (b) The report shall be filed with the City Clerk and shall refer to the property and business improvement district [BID] by name, specify the fiscal year to which the report applies, and with respect to that fiscal year, shall contain all of the following information:
 - (1) Any proposed changes in the boundaries of the property and business improvement district or in any benefits zones within the district.
 - (2) The improvements and activities to be provided for that fiscal year.
 - (3) An estimate of the cost of providing the improvements and the activities for that fiscal year.
 - (4) The method and basis of levying the assessment in sufficient detail to allow each real property owner to estimate the amount of the assessment to be levied against his or her property for that fiscal year.
 - (5) The amount of any surplus or deficit revenues to be carried over from a previous fiscal year.
 - (6) The amount of any contributions to be made from sources other than assessments levied pursuant to this part.
- (c) The City Council may approve the report as filed by the Advisory Board or may modify any particular contained in the report and approve it as modified. Any modification shall be made pursuant to Section 36640 and 36641.

NOTE: As of July 2001, § 36650 was added by Statute 2001, Chapter 88 [Assembly Bill (A.B.) 1021], § 7 to amend §§ 36633 that changed the responsibility of report preparation from the BID's advisory board to the nonprofit organization or owner's association.

The same statute added §§ 36635 and 36636, § 5 to amend §§36640 and 36641.

§ 36640 The advisory board may, at any time, request that the City Council modify the management district plan...

§ 36641 (a) Upon the written request of the advisory board, the City Council may modify the management district plan by adopting a resolution after holding hearings on the proposed modification...

that six other BIDs that have the same timely submission problem, have discussed with the City Clerk to have the City Council change the deadline for the submission of the Annual Report from December to April or May of the following year.

Due to the late submission of the required reports by the CCEA, the City Clerk was not able to perform the financial and program analysis of the CCEA and to recommend or take any necessary actions in a timely manner. Furthermore, Annual Reports were not submitted to the City Council in a timely manner, as required in the State Code.

Recommendations:

We recommend that the City Clerk:

1. Ensure that the CCEA comply with the requirements of the contract by submitting the Annual Report and the financial statements on time, with the required information, such as future plan, included in the Annual Report.
2. Review and analyze the Annual Reports and financial statements submitted by the CCEA to determine compliance with the contract provisions pertaining to the proper use of assessment funds, budget allocations/changes, and future financial and operating plans.
3. Consider modifying the contract terms with the CCEA, such as the due date for the required reports, if the due dates are not reasonable.

Section II. Monitoring Oversight and Administrative Controls

The CCEA maintained adequate accountability over its receipts and disbursements. However, we noted some control weaknesses over payroll, contract with a service provider, bank reconciliations, travel expenses, and the allocation of the CCEA's operating expenses. We believe that the lack of formal written guidelines to BIDs may have contributed to these conditions.

Finding No. 1: The CCEA lacked documentation to support employees' compensation.

The CCEA has no documentation, like an employment agreement, to support employees' compensation. The CCEA maintained personnel records, such as personal data sheets and job descriptions. However, no documents were available to validate the salary and benefits of its three employees: an executive director, an operations manager and a receptionist. Also, the receptionist, an hourly employee who started in January 2003, did not fill out timesheets to support hours worked.

The CCEA has two contractual employees who provide bookkeeping services and newsletter design and layout. The bookkeeper was paid an hourly rate of \$25, while the newsletter staff was paid an hourly rate of \$15. However, the CCEA has no documentation that showed agreement with contractual employees as to the type of services to be provided and the rate of compensation to be paid.

We also noted that there was no documentation for Board approval of bonuses amounting to \$9,055, which included \$5,000 for the executive director, \$250 for the operations manager, and the rest for the CCEA's contractual employees and service providers' employees. According to the Board Treasurer, the bonus was approved in the Board meeting. However, the bonus approval was not recorded in the minutes of the Board meeting. The Executive Director stated that the bonus amounts were considered in the budget and was included in the payroll expense. However, the payroll expense had no breakdown by line item to verify if the bonus amounts were included.

Despite our repeated requests, neither the CCEA nor the City Clerk was able to provide a copy of the CCEA's bylaws so that we can determine the Board's responsibilities as to hiring practices and setting up of salaries and bonuses of CCEA employees and contractual employees.

We believe that adequate documentation should be maintained to support and validate salaries and benefits, including bonus amounts paid to employees. Such procedures will ensure that employees are paid correctly and in accordance with the terms of the hiring documents.

Finding No. 2: The CCEA has no current contract with the maintenance service provider.

The CCEA has no current contract with the maintenance service provider. Although the original contract expired in April 2000, the contractor continued to provide maintenance services for the LADID, and the CCEA continued to pay them for their services. The CCEA paid the maintenance contractor approximately \$122,000, \$178,000, and \$165,000 in calendar years 2000, 2001 and 2002, respectively, for maintenance services provided to the LADID.

The Executive Director stated that the annual letters to the maintenance contractor amending the wage rates served as a renewal of the contract. She further stated that a request for proposal (RFP) for a new contract starting January 1, 2004, was in process.

The letters amending the wage rates may have modified the rates but did not renew the contract term. Without a current contract, the CCEA may lack the necessary documentation to enforce the terms agreed to by the contractor. In addition, the lack of a current contract may not protect the CCEA in the event that the contractor does not provide the required services.

The contract with the maintenance service provider required that the CCEA staff reviews hours worked by each employee of the maintenance contractor on a weekly basis by signing each employee time card. The initialed time card served as authorization of payment for actual hours worked by the maintenance contractor's employees.

Considering that the expired contract provisions are still applicable, the CCEA did not enforce its provision pertaining to the signing of the contractor's employees' time cards. The CCEA representative did not sign the time cards of the maintenance contractor's employees for approval of actual hours worked, as required by the contract. Instead, the CCEA asked the maintenance contractor's supervisor to sign the contractor's employees' time cards.

Finding No. 3: The CCEA needs to improve internal controls over bank account reconciliations, accounting for travel expenses and allocation of the CCEA's operating expenses.

The CCEA needs to strengthen its internal controls over certain aspects of its financial operations in order to safeguard its assets and to ensure that the LADID funds are spent appropriately and in a prudent way. We noted weaknesses in the following areas:

Bank Account Reconciliation

The CCEA did not maintain monthly bank account reconciliation to support their review and analysis of the bank account transactions and balances. However, the CCEA prepared and documented year-end bank account reconciliation. According to the bookkeeper, she prepared but did not keep hardcopies of the monthly bank account reconciliations.

Our review of the year-end bank reconciliation for 2002 showed three reconciling items that had been outstanding for over a year as of October 31, 2003. By the end of our fieldwork, the CCEA had not provided us any documentation of the nature or resolution of these items.

Good internal control dictates that monthly bank account reconciliation statements should be maintained for review purposes and audit trail. A bank account reconciliation statement is an aid to determine cleared and outstanding transactions, as well as errors between the books and the bank records. Without proper documentation of monthly bank account reconciliation, there is no assurance that bank transactions were properly reviewed and validated.

Travel Expenses

The CCEA did not require its Executive Director to prepare travel expense reports to account for her travel expenses, which were charged to the CCEA's credit card.

Allocation of Professional Fees

The CCEA bookkeeper did not allocate 50% of the CPA fees of \$4,500 to the Toy District for fiscal year 2002. The CPA prepared financial reports for both the LADID and the Toy District. We believe that proper allocation of expenses between the two organizations is necessary to accurately capture actual costs chargeable to each BID.

The CCEA Management was unaware of the need to prepare monthly bank account reconciliations or the need for travel expense reports. We were informed that the bookkeeper overlooked the allocation of CPA fees for fiscal year 2002. However, she stated that she allocated the CPA fees for fiscal years 2000 and 2001.

Recommendations:

We recommend that the City Clerk ensure that the CCEA:

1. Maintain payroll documents, such as employment agreement, to validate salaries and benefits of employees.
2. Maintain written agreements with contractual employees as to the type of services to be provided and the rate of compensation to be paid by the CCEA.
3. Maintain Board approval documents for other compensation, such as bonuses.
4. Maintain a current, enforceable written contract with the service providers, so that compliance with contract provisions, such as CCEA's signing of contractor's employees' time cards, can be enforced.
5. Resolve bank reconciling items that were outstanding for more than one year; thereafter, resolve all bank reconciling items in a timely manner.
6. Prepare monthly bank account reconciliation and maintain documentation to support validation and supervisory review.
7. Require the Executive Director and other employees who travel to prepare travel expense reports within 30 days after completion of the travel.
8. Maintain a schedule of expenses allocable between the LADID and the Toy District, indicating percent of allocation, in order to properly monitor shared expenses.
9. Reimburse the LADID from the Toy District's funds for its share of the unallocated CPA fees that were paid for the preparation of the financial statements.

We recommend that the City Clerk:

10. Provide guidelines to all BIDs regarding basic internal controls, including but not limited to maintaining:

- Necessary payroll documents (such as employment agreements, time sheets, and others) for employees' compensation and bonuses.
 - Current contract with service providers and subcontractors.
 - Monthly bank account reconciliation statements.
 - Travel expense reports for employees.
11. Ensure that adequate controls are developed and properly implemented to safeguard and prevent possible misuse of funds among BIDs.

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A draft audit report was provided to the Office of the City Clerk on May 12, 2004. An exit conference was conducted on May 25, 2004, at which time the audit staff discussed the findings and recommendations in the draft audit report with the City Clerk and his staff. The City Clerk stated that the recommendations enumerated in Section II are policy issues, which were the responsibility of the BID and their Board of Directors, and not the responsibility of the City Clerk. The City Clerk's response during the exit conference was evaluated and considered prior to finalizing the report.

Respectfully submitted,



Amalia Robles
Internal Auditor



Teresita Bautista, CGFM
Internal Auditor



Mike Lee, CPA, CIA
Chief Auditor



Farid Saffar, CPA
Director of Auditing

October 31, 2003

**OFFICE OF THE CONTROLLER
CONTRACT COMPLIANCE AUDIT OF THE CENTRAL CITY EAST
ASSOCIATION (C-97899)**

Ranking of Recommendations

Section	Summary Description of Findings	Ranking Code	Recommendations
1.	<p><u>Compliance with Significant Provisions of the Contract</u></p> <p>The Central City East Association (CCEA) did not submit its Annual Reports and financial statements on time.</p>	<p align="center">U</p> <p align="center">N</p> <p align="center">U</p>	<p>We recommend that the City Clerk:</p> <ol style="list-style-type: none"> 1. Ensure that the CCEA comply with the requirements of the contract by submitting the Annual Report and the financial statements on time, with the required information, such as future plan, included in the Annual Report. 2. Review and analyze the Annual Reports and financial statements submitted by the CCEA to determine compliance with the contract provisions pertaining to the proper use of assessment funds, budget allocations/changes, and future financial and operating plans. 3. Consider modifying the contract terms with the CCEA, such as the due date for the required reports, if the due dates are not reasonable.
2.	<p><u>Monitoring Oversight and Administrative Controls</u></p> <ul style="list-style-type: none"> • The CCEA lacked documentation to support employees' compensation. • The CCEA has no current contract with the maintenance service provider. • The CCEA needs to improve internal controls over bank account reconciliation, accounting for travel expenses and allocation of the CCEA's operating expenses. 	<p align="center">U</p> <p align="center">U</p> <p align="center">U</p> <p align="center">N</p> <p align="center">N</p>	<p>We recommend that the City Clerk ensure that the CCEA:</p> <ol style="list-style-type: none"> 1. Maintain payroll documents, such as employment agreement, to validate salaries and benefits of employees. 2. Maintain written agreements with contractual employees as to the type of services to be provided and the rate of compensation to be paid by the CCEA. 3. Maintain Board approval documents for other compensation, such as bonuses. 4. Maintain a current, enforceable written contract with the service providers, so that compliance with contract provisions, such as CCEA's signing of contractor's employees' time cards, can be enforced. 5. Resolve bank reconciling items that were outstanding for more than one year; thereafter, resolve all bank reconciling items in a timely manner.

Section	Summary Description of Findings	Ranking Code	Recommendations
		N	6. Prepare monthly bank account reconciliation and maintain documentation to support validation and supervisory review.
		N	7. Require the Executive Director and other employees who travel to prepare travel expense reports within 30 days after completion of the travel.
		N	8. Maintain a schedule of expenses allocable between the LADID and the Toy District, indicating percent of allocation, in order to properly monitor shared expenses.
		N	9. Reimburse the LADID from the Toy District's funds for its share of the unallocated CPA fees that were paid for the preparation of the financial statements.
		N	We recommend that the City Clerk:
		N	10. Provide guidelines to all BIDs regarding basic internal controls, including but not limited to, maintaining: <ul style="list-style-type: none"> • Necessary payroll documents (such as employment agreements, time sheets, and others) for employees' compensation and bonuses. • Current contract with service providers and subcontractors. • Monthly bank account reconciliation statements. • Travel expense reports for employees.
		N	11. Ensure that adequate controls are developed and properly implemented to safeguard and prevent possible misuse of funds among BIDs.

Description of Recommendation Ranking Codes

U - Urgent - The recommendation pertains to a serious or materially significant audit finding or control weakness. Due to the seriousness or significance of the matter, immediate management attention and appropriate corrective action is warranted.

N - Necessary - The recommendation pertains to a moderately significant or potentially serious audit finding or control weakness. Reasonably prompt corrective action should be taken by management to address the matter. Recommendation should be implemented no later than six months.

D - Desirable - The recommendation pertains to an audit finding or control weakness of relatively minor significance or concern. The timing of any corrective action is left to management's discretion.

N/A - Not Applicable