



City of Norfolk

TO: Honorable Council Members FROM: John H. Sanderlin, Jr., City Auditor JHS

DATE: December 21, 2015 SUBJECT: CFAE - Scope Promotions Accounts

Please find attached our final audit report on the Cultural Facilities, Arts and Entertainment (CFAE) – Scope Promotions Accounts. Should you have any questions please feel free to contact me at 664-4045.

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**Audit of the Cultural
Facilities, Arts and
Entertainment –
Scope Promotions Accounts**



**City of Norfolk
Office of the City Auditor**

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Audit Report No. 16-1R

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Executive Summary

Certain characteristics or operational constraints are found in the entertainment industry which typically do not exist in the processes of other businesses. For example, show promoters may require full accounting and complete settlement immediately following the event, which could be in the middle of the night or on weekends or holidays, and may require such settlement be paid in cash. On this premise, as part of the entertainment industry, Cultural Facilities, Arts and Entertainment (CFAE) faces unique challenges and operates very differently than other departments. Another example of differing business need and practice is the discretion CFAE management has in the process of negotiating the terms of agreements with show promoters. Acknowledging the need for industry-specific practices, some flexibility must be permitted to allow CFAE management, using its skill and experience, to work to obtain the best results in the interest of Norfolk citizens.

Independence of action and this need for flexibility increases the necessity for strong internal controls. These controls can provide for efficient and effective use of assets and

clarity, uniformity and timeliness of reporting activity results. Accordingly as part of our FY14 Audit Work Plan and continued into FY15, we conducted an audit with the objective being the determination of the effectiveness of management controls of the Scope Promotions Accounts. For many CFAE-provided entertainment and public service venue events, revenue is received in the Scope Promotions bank accounts and the expenditures supporting these events are paid from these accounts which were created pursuant to the provisions of state code and city ordinance.¹ CFAE has discretion in the management of these accounts and funds for which its personnel use a separate accounting system (QuickBooks) which functions outside the City’s financial accounting system.²

In our departmental audit report of CFAE which we issued in March 2014, we described certain aspects of the Scope Promotions Accounts which came to our attention and we determined that the operation of these accounts was sufficiently important to warrant a separate review. During this audit, in addition to performing a more detailed review of expenditures, we followed-up on our prior findings and observations and, while understanding that a relatively short period of time transpired since the departmental report was issued, we observed that few promotions accounts processes had changed.

With our audit covering the period of fiscal year 2014, we found that a total of \$10,660,588 (excluding transfers among promotions accounts) was disbursed from the

¹ Revenues received in and disbursements made from the Scope Promotions Accounts are not part of annual budget appropriations.

² The City uses AMS Advantage financial system software for financial management and reporting.



six promotions accounts during fiscal year 2014³. The total of the reconciled June 30, 2014 account balances was \$1,124,774. In reviewing these disbursements, our audit findings indicate several opportunities exist for better alignment of CFAE Scope Promotions Accounts processes with those of the City to meet the public expectation and need for accountability and transparency. In summary, we recommended CFAE management:

- Establish procedures for the determination of appropriate promotion account expenditures and update and monitor policies and procedures accordingly
- Develop policies and procedures for the operation of the promotions accounts to incorporate internal controls comparable to those used in the City's AMS financial system
- Enhance internal control by ensuring the adequacy of management participation, oversight and documentation in its disbursement processes
- Establish policies and procedures for the management of the net event revenue remittance process to ensure timeliness and consistency
- Review CFAE contracts to verify compliance with contract terms
- Consult with the City Purchasing Agent and City Attorney's office and review and address the appropriateness of the security services arrangement
- Implement the outstanding management actions from the previous audit report

We met with CFAE management on October 12, 2015 and reviewed the results of our audit. Management concurred with our conclusions and recommendations and provided its responses which are included in this report. The audit was conducted by Assistant City Auditors Tim Haycox and Barbara Reeves under the direction of City Auditor John Sanderlin. We appreciate the courtesies and cooperation extended to us during the audit by the department. We look forward to CFAE's continued success and support of the Norfolk and greater Hampton Roads community by providing valued entertainment venues and events.

Background

CFAE provides entertainment and public service venue events to the City of Norfolk and the Hampton Roads region. Such events may occur one time, several times over a short period of time or be regularly scheduled events occurring on a periodic basis. For the majority of these events, fees are paid by attendees and revenue is received by CFAE and third party ticket-sellers.

In the interest of promoting public assembly facilities as venues for public entertainment services, Virginia State Code Section 15.2-1129 provides for the establishment and funding of a special or revolving account from which funds may be expended for this purpose. To facilitate this, in 1977 Norfolk City Council appropriated funds in the amount of \$100,000 to be under the separate control and management of CFAE. Several bank accounts, serving separate entertainment venues, have since been created for this purpose, disbursing funds for event promotion and production and receiving event revenue. CFAE has sole discretion in the management of these accounts which essentially function as revolving fund accounts. At this time there are six promotions accounts.

³ In addition to the financial activity of the promotions accounts, CFAE receives, as do other city departments, annual appropriations from the general fund (for CFAE in the amount of \$6.59 million for FY14) to support its operations and these

are accounted for through the City's AMS financial accounting system.



1. Scope Promotions (checking)
2. Attucks Promotions (checking)
3. Scope Promotions (savings)
4. Broadway (checking)
5. Selden (checking)
6. Special Events (checking)

Objective, Scope, and Methodology

Our overall audit objective was to determine the effectiveness of management controls over the Scope Promotions Accounts. Our audit covered fiscal year 2014. In achieving our objective, we placed our emphasis on reviewing expenditures since our analysis of FY14 activity in the Scope Promotions bank accounts disclosed that there was \$10 million in disbursement transactions and CFAE's management of these accounts is independent of the City's financial accounting system controls and processes.

We conducted tests of records and performed other audit procedures as we deemed necessary. We requested policies and procedures and Promotions Accounts budgets. We reviewed the original audit report of the CFAE department issued March 2014 for findings and recommendations regarding the promotions accounts and requested documentation to support the progress made on each recommendation. We reviewed bank statements, check copies, invoices, vouchers, and other applicable documents. Additionally, we performed the following to accomplish the audit objective:

- Interviewed the CFAE staff to gather an understanding of processes in place to support how transactions were performed.
- Tested a sample of disbursement transactions which was randomly drawn from the Scope Promotions account and judgmentally selected from the Attucks, Selden and Special Events accounts

We conducted this performance audit in

accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Conclusion

State and City Code permit autonomy to CFAE in the use of promotions accounts to carry out its mission. While the ability to conduct independent business activities is necessary, it must be performed within the context of the City's need for accountability and transparency, both of which are supported by an effective system of internal control.

Internal control is defined as a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting and compliance⁴. Effective internal control is essential to a business entity's success.

The financial system of the City of Norfolk includes a number of well-designed and implemented internal control features. These controls provide for 1) the adherence to policies and procedures 2) the reporting of financial results and 3) the safeguarding of assets.

Our audit findings present several opportunities for strengthening CFAE's management control system to meet public expectation for accountability and transparency and are presented below.

Findings

A. Event-Related Expenditures

We found expenditures from the Scope

⁴ Internal Control – Integrated Framework – Executive Summary, COSO, May 2013



Promotions Accounts which were not directly or indirectly related to events or event promotion. Virginia State Code Section 15.2-1129 provides for the establishment and funding of a special or revolving account from which funds may be expended for promoting public assembly facilities as venues for public entertainment services. Accordingly, any expenditure or disbursement that is not related to the promotion or support of events would possibly not be consistent with this code section.

During the review, we characterized three types of expenditures in the Scope Promotions Accounts:

1. Directly-related to events – Expenditures directly attributable to events and their promotion such as show settlements, payments of show-related expenses, event advertising, materials and supplies purchased to support a particular event
2. Indirectly-related to events – Expenditures related to events but not directly identifiable to specific events such as acquisition of event production equipment, job advertising for the box office manager position, payment of electric utility costs, travel to and from and attendance at show and award conferences and payments to contract employees for support functions such as custodial operations, engineering and marketing
3. Unrelated to events – Expenditures used to pay for a CFAE activity but not related to event promotion or production such as employee appreciation events, parties for retirees, coffee for the office, and travel, lodging and job vacancy listing for MacArthur Memorial director candidate

We attribute the possible noncompliance with State Code to the fact that currently, there is no policy or guidance (City or departmental) to specify the types of expenditures that are approved for the CFAE promotions accounts. As a result, expenditures from these accounts

have broadened in purpose beyond being directly or indirectly related to events which presents financial reporting and budgetary control implications.

Recommendation #1: We recommend that CFAE, in conjunction with the Department of Finance, establish a policy for the determination of appropriate promotion account expenditures and update and monitor policies and procedures accordingly.

Management Response:

Concur. We will work with Finance to develop a comprehensive listing of expenditures that are regularly paid out of Scope Promotions. This will include information from all sections mentioned above, directly related, indirectly related and unrelated. Several of these expenditures, which are paid from Scope Promotions (based the budget office's approval), will be moved from the regular operating budget to the Scope Promotions account.

B. Policies and Processes

CFAE accounting processes for the promotions accounts accounting system have not been reviewed or approved by the Department of Finance. Norfolk City Code Section 65 Department of Finance – General powers and duties – states that “The director shall devise and promulgate accounting procedures that are adequate to record in detail all transactions ... including case receipts and disbursements.” This was noted as an observation in a previous audit report issued by our office March 2014. As an example, the City, to provide assurance that payments are authorized and approved, has control processes and procedures for the management of disbursements through the AMS financial system. The City’s internal control system is supported by requiring multiple levels of approval authority which must be completed in order for payment to be made to a vendor. CFAE’s independent management of the promotions accounts, as currently implemented in QuickBooks, does not provide for levels of authorization to promote the safeguarding of City assets.



Recommendation #2: We recommend CFAE review the accounting policies and processes for the CFAE independent accounting system to ensure the internal controls over disbursements are comparable to those used in the City's AMS financial system, in particular for levels of authorization.

Management Response:

Concur. We will work with the Finance Department to discuss and develop policies and procedures that mirror those used with the City's AMS financial system for our QuickBooks financial system used to account for our promotional activities.

C. Management Controls

We found a lack of management participation in the expenditure process. In our audit we found 45 payments to vendors out of a sample of 98 or 46% which did not have evidence of management approval and 17 checks which were signed only by members of the accounting staff. These exceptions were not consistent with City practices or policies for management oversight.

CFAE experiences industry-specific operational constraints in managing its business operations, including demands for services during the night and on weekends and holidays, and this presents a challenge to a structured system of management oversight. As a result, lacking this control potentially exposes the City's assets to the risk of misuse.

Recommendation #3: We recommend that management enhance internal control by ensuring the adequacy of management participation, oversight and documentation in its disbursement processes.

Management Response:

Concur. It is not normal practice that our accounting staff sign checks without Director or Assistant Director approval. Our process policy states that one accountant and either the Director or Assistant Director will sign all checks and approve all outgoing wires. During this audit time frame, our department did not

have an Assistant Director in place. There were times that the Director was unavailable to sign checks and therefore two accounting staff members signed checks together. This happens very infrequently. Since hiring a new Assistant Director, there are also multiple signatures and initials for approval on all invoices paid from Scope Promotions. These approvers include an Event Coordinator, Production Manager, Accounting, Director, Assistant Director, Marketing Manager, or any other team member to verify the correctness of an invoice. Many past invoices may not have had multiple levels of signatures on them due to the vacancies within the department on all levels when this audit was conducted. Management agrees that proper protocol, including checks and balances for all disbursements, need to be in place and followed.

D. Arrangement for Additional Support Services

We found a vendor under contract was paid for services not covered by the contractual scope or terms. While CFAE has contracting authority (Norfolk Code Section 33.1-23), it must still adhere to city procurement policy which requires contracts for services. The payments were for such work as custodial, maintenance and marketing functions and the persons performing the services were selected and directly managed by CFAE management. The contract was not amended to include the additional services. For the four payments/transactions reviewed for this vendor pertaining to these additional services, payments for these services totaled \$64,785. In particular we noted that 1) the payments were being made regularly for the same vendor employees, 2) the vendor employees were under the direct supervision of CFAE employees and 3) the vendor employees' rate of pay was set by CFAE personnel. As a result, there is the risk that these persons could be considered as city employees.

Recommendation #4: We recommend that a systematic review of CFAE contracts be made to verify compliance with contract terms.



Management Response:

Concur. There is a clause in the current contract that states that we are able to hire “other event related staff” as requested. It is letter “H” on the current contract. We utilized this option to assist with operations, engineering, and marketing staff for event cleaning, duty engineer, social media, group sales and other marketing duties for all of the events taking place throughout our SevenVenues. We are currently in the RFP process for obtaining crowd management and other event staff services. We will make sure, if necessary, to include language in any new agreement that makes clearer what other types of staff that we may hire via our staffing provider.

Auditor’s Comment:

While we acknowledge there is a provision in the existing contract for other related event personnel, we believe this to be for direct event support tied to specific events and not general services to be provided throughout the year such as marketing and maintenance.

E. Arrangement for Security Services

The arrangement for CFAE event security services was not formalized in writing and was not entered into using City-prescribed procurement procedures. City procurement rules have competitive requirements (Norfolk City Code Section 33.1-39) which indicate contracts for goods and services costing between \$5,000 and \$14,999 must have three oral quotations and those between \$15,000 and \$49,999 must have at least three written quotes. Through June 30, 2014, CFAE made payments for event security services through its promotions accounts to off-duty Norfolk Police officers. Such payments were made directly to the officer and the total amount reported annually on Forms 1099. Effective July 1, 2014 a new arrangement to provide security services was entered into with a company owned by a Norfolk Police officer. This arrangement was not in the form of a written contract nor entered into using prescribed procurement procedures and we believe the arrangement may constitute a potential conflict of interest.

Recommendation #5: We recommend that management, in consultation with the City Purchasing Agent and City Attorney’s office and review and address the appropriateness of the security services arrangement.

Management Response:

Concur. Our department currently has 6 RFP’s in the purchasing agent’s office relating to many different contracts and vendors. We now hire our off-duty officers via our staffing contract which does include a clause for security and Police. Management agrees that proper procurement procedures should always be followed when securing services or other necessary purchases.

F. Transmittal of Net Event Proceeds

There is no written CFAE policy which describes the process for the transmission of net event proceeds or the process to be used in determining amounts to be remitted and the schedule to be followed for making the payments. This was an observation in the prior departmental audit and the condition continues.

CFAE personnel informed us that the promotions accounts are to retain balances at least equivalent to ticket revenue received for events that have not yet occurred. This is to ensure that sufficient funds are available to refund ticket payments to customers if the event is cancelled. We were also informed by CFAE personnel that the total retained for all such events is not to be less than the \$100,000 amount originally established for the promotions accounts fund. CFAE did not provide documentation to support these requirements and we could not find an ordinance or other authoritative documentation.

During FY14 CFAE did not remit net event proceeds to the City Treasurer from the promotions accounts on a regular schedule. There were five transmittals from the Scope Promotions checking account and two from the Special Events checking account for a total amount of \$801,889.



Recommendation #6: We recommend that CFAE management work with the Department of Finance to establish policies and procedures for the management of the net event revenue remittance process to ensure timeliness and consistency.

Management Response:

Concur. Since the prior audit was completed, we have completely revised how we remit revenue to the City Treasurer’s Office. We now remit on a monthly basis. This remittance is a net revenue with the deduction of any accounts receivable and utilities from the remittance. We will prepare a written policy and procedure for revenue remittance.

and the City’s financial presentations.	to go over these processes	
Make periodic reporting of financial data to the Department of Finance	Agree - are in the process of setting up a meeting with Finance representatives to go over these processes	Incomplete – meetings with Finance not conducted

Recommendation #7: We recommend that CFAE management continues its efforts to coordinate with the Department of Finance to resolve open audit recommendations.

Management Response:

Concur. We have had several meetings with members of the Finance Department over the past year. These included a meeting with the Director of Finance prior to the end of Fiscal Year 2014 to discuss making any changes to the way we were reporting to Finance. At that time she told CFAE management that we did not need to make additional changes. Since that time, we have been requested to make further changes to our reporting methodologies. The City Controller and the CFAE Accounting Manager have been working closely together to implement these changes. The City Controller will also now have access to QuickBooks so that she is able to run reports at any time that will allow her to review our records.

G. Follow-up from Previous Audit or Status of Previous Recommendations

As part of our audit, we considered the status of outstanding recommendations or previous audit recommendations as to their impact on the management and control of the Scope Promotions Accounts. In March 2014 we released our CFAE departmental audit report which addressed certain aspects of the operations and financial reporting regarding the CFAE Scope Promotions Accounts. The table below provides a summary of the actions taken and notes the status of each recommendation.

Previous Audit Report Recommendations and Current Status

RECOMMENDATIONS FROM AUDIT REPORT – MARCH 2014	SUMMARY OF ACTION TAKEN	STATUS
Perform and participate in a review of the independent processes to facilitate compliance with citywide goals for uniformity and consistency in financial reporting.	Agree – are in the process of setting up a meeting with Department of Finance representatives	Incomplete – meetings with Finance not conducted
Consider revising the formatting of its Comparative Financial Statement to conform with GAAP	Agree – are in the process of setting up a meeting with Finance representatives	Incomplete – meetings with Finance not conducted

Auditor’s Comment:

At the time of our audit we were informed by both CFAE and Finance that meetings regarding these recommendations had not been conducted.