

TO: BOARD OF DIRECTORS
CITIES ASSOCIATION OF SANTA
CLARA COUNTY

FROM: Sharon W. Erickson,
City Auditor

SUBJECT: *EXPENDITURE REVIEW, FISCAL
YEARS ENDING JUNE 30, 2017 & 2018*

DATE: August 31, 2018

SUMMARY

The Office of the City Auditor has performed an expenditure review of the Cities Association of Santa Clara County (Association) for the fiscal years ending June 30, 2017 and 2018. We also reviewed the controls in place to protect Association assets. Based on our review, we found that the Association has not always accurately reported its expenditures or financial position to its Executive Board due to accounting entries being miscategorized, omitted, or recorded in the wrong accounting period. The errors causing the inaccuracies appear to be resolved. Controls are in place to protect Association assets, however, the Board is evaluating options to reorganize the Association, including reviewing potential IRS filing requirements. Several controls documented in Association bylaws or in past expenditure reviews have not been consistently practiced. We made two recommendations to improve financial reporting and reinstitute stronger financial controls. The Executive Director agreed with the recommendations.

BACKGROUND

The Association is a collaboration of the fifteen cities of Santa Clara County. It was formed in 1990 to improve cooperation among city governments in addressing issues of common interest and its Board is composed of a representative from each member city. Within the last two years, the Association has had three Executive Directors. The current Executive Director was hired in July 2017.

SCOPE AND METHODOLOGY

The Office of the City Auditor was asked to review the Association's revenues and expenditures to determine whether they are being accurately reported to the Board of Directors (Board) and whether controls are in place to protect Association assets. In order to address these questions, we:

- Reviewed financial reports provided to the Executive Board, and compared reports to those currently available in the Association's internal accounting software, Quickbooks, for the same reporting period.
- Reviewed Association bank statements and Association-prepared bank reconciliations.

- Compared payroll tax reports prepared by the Association's outside payroll firms with payroll entries recorded in Quickbooks.
- Compared revenues entered and reported in Quickbooks to the Association's member dues schedule.
- Reviewed transaction detail for selected asset, revenue, and expense categories.
- Reviewed procedures for bank reconciliations and budget practices for membership events.
- Reviewed the Audit Control Log within Quickbooks, sampling edited transactions for reasonableness and support.
- Interviewed the Association's Executive Director.
- Reviewed IRS filing requirements for tax-exempt organizations.

We conducted this performance audit in accordance with generally accepted government auditing standards.¹ 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.

Prior Year Expenditure Reviews

An expenditure review was last issued in November 2015 and covered the fiscal years ending June 30, 2014 and 2015. The Office of the City Auditor has periodically issued expenditure reviews since 1996.² Based on prior reviews, we have found that the Association had accurately reported its expenditures to its Board and had controls in place to protect Association assets. In past reports, we have made recommendations to improve controls, such as:

- Establishing a policy whereby the Board Treasurer reviews the monthly bank reconciliation.
- Adjusting accounting procedures to ensure more timely reporting of payroll expenditures and proper accounting of capital expenditures.
- Improving procedures surrounding expense reimbursements.

We have also recommended the Executive Director make minor adjusting journal entries to report more accurately Association activity. The Association agreed with and implemented each of our recommendations in past reports.

¹ A performance audit differs from a financial statement audit. As a result, we do not express an opinion on the attached unaudited financial statements.

² Prior year reports can be found on the City Auditor's website at <http://www.sanjoseca.gov/index.aspx?NID=307>.

ACCURACY OF REPORTED REVENUES AND EXPENDITURES

The Executive Director submits monthly Association financial reports to the Executive Board,³ a subset of the full Board. The reports generally include a balance sheet, profit and loss statement, and budget reports, and are generated from the Association's Quickbooks files. We found that these reports have not always been accurate due to items being miscategorized, omitted, or recorded in the wrong accounting period, resulting in several reports understating expenses and assets. For example, the February 2018 profit and loss statement provided to the Executive Board reported employee wages as a negative revenue amount of over \$6 thousand dollars. Prior to the start of this review, the Executive Director contracted a bookkeeper due to repeated crashing of the Association's Quickbooks software and difficulty in reconciling transactions which occurred prior to her tenure. The bookkeeper resolved most of the errors.

Executive Board Members have been kept apprised of the accounting challenges and have discussed contracting a bookkeeper on a regular basis considering that current and planned Association initiatives will continue to require greater Executive Director attention. The Executive Director expressed preference during this review for bookkeeping assistance given the competing priorities of the Association and reservations with being responsible for processing, recording, and reporting on transactions, including editing those which occurred prior to her tenure. We recommend that the Board contract a bookkeeper to assist the Executive Director in maintaining Association accounting records and providing accurate financial reports to the Executive Board.

During the review, we recommended that the Executive Director make additional adjusting journal entries in the Association's Quickbooks files. This included corrections to accurately record employee expenses and interest income, and record annual depreciation expense for the current and prior fiscal years. The Executive Director agreed and made the recommended journal entries. See appendices A and B for the revised balance sheets and profit and loss statements for the fiscal years ending June 30, 2017 and 2018 generated from the Association's Quickbooks files.

CONTROLS TO PROTECT ASSOCIATION ASSETS

Based on our review, we have found that there are controls to protect Association assets, however, we also found that several controls documented in the Association's bylaws or in past expenditure reviews have not been consistently practiced.

The Association's primary assets are its checking account and investments in the California Local Agency Investment Fund (LAIF). The Executive Director reconciles the checking account monthly, and provides monthly financial reports to the Executive Board. The content of the financial reports can vary, but they generally include a balance sheet, profit and loss statement, and budget reports. Budget reports monitor the Association's performance to Board-approved operating and membership event budgets. Although Association bylaws require the Treasurer or Secretary to review and initial monthly bank reconciliations, we did not observe this in practice. Additional controls noted in past reviews but not observed during this review include not providing monthly activity reports to the Executive Board showing all monthly activity (including

³ The Executive Board consists of the President, First and Second Vice Presidents, Secretary/Treasurer, the Chair of the Association's Legislative Action Committee, the Immediate Past President of the Board, and the Santa Clara County/Cities' Managers Liaison.

expense reimbursements to members of the Association); and the performance of quarterly LAIF reconciliations. The Executive Director has agreed with our recommendation to reinstitute these controls.

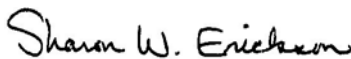
Compliance with IRS Filing Requirements

The Association is currently organized as an Unincorporated Association.⁴ As such, the Association may be required to file Form 990⁵ with the IRS. The Association has not been filing the form which may expose the Association to “Failure to File” penalties. At the time of our review, the Board was evaluating options to reorganize the Association, potentially to operate under a Joint Powers Agreement, as an official non-profit, or as an instrumentality of another government unit. This would include determining whether the Association is required to comply with IRS filing requirements, and if so, what actions are necessary to account for the years in which the Association did not file. The Board expects to make its decision by the end of the current fiscal year.

CONCLUSION

Based on our expenditure review, we found prior reports provided to the Executive Board included errors that have since been corrected. We recommend that the Board contract a bookkeeper to assist the Executive Director in maintaining Association accounting records and providing accurate financial reports to the Executive Board. Although we found controls are in place to protect Association assets, several controls documented in Association bylaws or prior reviews have not been consistently practiced. We recommend that the Executive Director reinstitute these controls.

We reviewed this memorandum with the Executive Director of the Association and thank her for her cooperation and assistance during our review.


Sharon W. Erickson
City Auditor

SE: lg
18-05

Audit staff: Joseph Rois
Juan Barragan

Attachments

⁴ California Corporations Code 18035 defines an Unincorporated Association as “an unincorporated group of two or more persons joined by mutual consent for a common lawful purpose, whether organized for profit or not.”

⁵ Per IRS Form 990 Instructions, “Form 990 is an annual information return required to be filed with the IRS by most organizations exempt from income tax under section 501(a), and certain political organizations and nonexempt charitable trusts.” <https://www.irs.gov/pub/irs-pdf/i990.pdf>

APPENDIX A

CITIES ASSOCIATION OF SANTA CLARA COUNTY

BALANCE SHEET

As of June 30, 2018

	TOTAL	
	AS OF JUN 30, 2018	AS OF JUN 30, 2017 (PY)
ASSETS		
Current Assets		
Bank Accounts		
Checking - Union Bank	3.77	3,802.23
Total Bank Accounts	\$3.77	\$3,802.23
Accounts Receivable		
Accounts Receivable	0.00	0.00
Total Accounts Receivable	\$0.00	\$0.00
Other Current Assets		
Accrued Interest	44.60	44.60
LAIF Funds	56,630.28	53,518.00
Undeposited Funds	0.00	0.00
Venue Deposit	1,000.00	0.00
Total Other Current Assets	\$57,674.88	\$53,562.60
Total Current Assets	\$57,678.65	\$57,364.83
Fixed Assets		
Accumulated Depreciation	-1,926.59	-1,649.78
Machinery and Equipment	2,203.41	2,203.41
Total Fixed Assets	\$276.82	\$553.63
TOTAL ASSETS	\$57,955.47	\$57,918.46
LIABILITIES AND EQUITY		
Liabilities		
Current Liabilities		
Accounts Payable		
Accounts Payable	0.00	0.00
Total Accounts Payable	\$0.00	\$0.00
Credit Cards		
First National Bank of Omaha	-794.48	
Total Credit Cards	\$ -794.48	\$0.00
Other Current Liabilities		
Accrued Expenses	0.00	0.00
Accrued Payroll	0.00	0.00
Payroll Liabilities	0.00	0.00
FICA		
Company	0.00	0.00
Total FICA	0.00	0.00
Payroll Taxes Payable	0.00	0.00
SDI	0.00	0.00
State Withholding	0.00	0.00
Total Payroll Liabilities	0.00	0.00
Total Other Current Liabilities	\$0.00	\$0.00

APPENDIX A

	TOTAL	
	AS OF JUN 30, 2018	AS OF JUN 30, 2017 (PY)
Total Current Liabilities	\$ -794.48	\$0.00
Total Liabilities	\$ -794.48	\$0.00
Equity		
Opening Bal Equity	-34.00	0.00
Reserves	0.00	0.00
Reserve for Equip. Replacement	0.00	0.00
Reserve for New Equip.	5,000.00	5,000.00
Reserve for Operations	35,000.00	35,000.00
Reserve for Program/Opport.	0.00	0.00
Unreserved	0.00	0.00
Total Reserves	40,000.00	40,000.00
Unrestricted Fund Balance	17,918.46	11,391.60
Net Income	865.49	6,526.86
Total Equity	\$58,749.95	\$57,918.46
TOTAL LIABILITIES AND EQUITY	\$57,955.47	\$57,918.46

APPENDIX B
CITIES ASSOCIATION OF SANTA CLARA COUNTY

PROFIT AND LOSS

July 2017 - June 2018

	TOTAL	
	JUL 2017 - JUN 2018	JUL 2016 - JUN 2017 (PY)
Income		
Directory Income	915.00	1,132.00
Dues Income	87,868.00	87,868.00
Gusto/Payroll	0.00	
Total Income	\$88,783.00	\$89,000.00
GROSS PROFIT	\$88,783.00	\$89,000.00
Expenses		
Depreciation Expense	276.81	276.81
Dues and Subscriptions	650.00	
Interest Expense	21.58	
Office		
Directory Production	961.38	1,083.92
Dues and Subscriptions	540.00	375.00
Hospitality	759.73	344.73
Insurance	821.52	
Internet - Web Hosting Services	219.66	59.85
Miscellaneous		
Bank Service Charges	71.00	51.00
Total Miscellaneous	71.00	51.00
Post Office Box	162.80	43.00
Postage and Delivery	173.55	223.80
Printing and Copying	723.77	
Recognition	390.22	175.02
Repairs and Maintenance		
Others		59.85
Total Repairs and Maintenance		59.85
Software Licenses	761.37	464.23
Supplies and Equipment	455.78	414.65
Telephone	443.85	544.62
Total Office	6,484.63	3,839.67
Office/General Administrative Expenses	117.00	
Other Miscellaneous Service Cost	12.71	
Professional Services		
Consultants	2,568.75	
Employee Expenses		
Payroll Service Fees	427.50	933.60
Payroll Taxes	6,157.95	6,046.83
Payroll Wages/Salary	69,999.96	73,370.44
Total Employee Expenses	76,585.41	80,350.87
Total Professional Services	79,154.16	80,350.87
Programs and Initiatives	1,000.00	
Project Support		1,000.00

APPENDIX B

	TOTAL	
	JUL 2017 - JUN 2018	JUL 2016 - JUN 2017 (PY)
Total Programs and Initiatives	1,000.00	1,000.00
Workers Compensation	430.00	
Total Expenses	\$88,146.89	\$85,467.35
NET OPERATING INCOME	\$636.11	\$3,532.65
Other Income		
General Membership Meeting	3,507.20	3,584.08
Interest Income	1,112.28	608.81
Membership Dinners - Proceeds	2,345.00	3,265.00
Membership Dinners - Sponsors	10,000.00	6,700.00
Total Other Income	\$16,964.48	\$14,157.89
Other Expenses		
General Meeting - catering	4,242.03	
General meeting - office supplies/signage	357.73	
Holiday party - entertainment	509.00	
Membership Dinners - Cost	11,626.34	11,163.68
Total Other Expenses	\$16,735.10	\$11,163.68
NET OTHER INCOME	\$229.38	\$2,994.21
NET INCOME	\$865.49	\$6,526.86