

**Performance Audit 17-03:  
Tivoli Foundation Contract Audit**

**July 2017**

**City Auditor**

Stan Sewell, CPA, CGFM, CFE

**Senior Auditor**

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# OFFICE OF INTERNAL AUDIT

## Stan Sewell, City Auditor

July 7, 2017

To: Mayor Andy Berke  
City Council Members

Subject: Tivoli Foundation Contract Audit (#17-03)

Dear Mayor Berke and City Council Members:

The attached report contains the results of our audit of the Tivoli Theater Foundation contract. The audit found General Services has not properly overseen some requirements of the contract. We found the Foundation's contract was not competitively bid and payments were made without proper support. We also found the City Code has not been updated to reflect the management change. In order to address the noted areas for improvement, we recommended actions to identify and enforce the contract requirements, ensure future contracts are competitively bid and update the City Code where applicable.

As we were completing field work, we learned the General Services Department was disbanded with responsibilities being assigned to other City Departments. We are providing this report to those who may be responsible for implementing our recommendations. Be aware the current contract with the Tivoli Foundation has multiple reporting and approval requirements related to the Director of General Services. It appears the contract requires an amendment to ensure reporting and requests are directed to the appropriate City representative.

We thank the management and staff of General Services, Finance, Purchasing, the Tivoli Foundation and A.C. Entertainment for their cooperation and assistance during this audit.

Sincerely,

Stan Sewell, CPA, CGFM, CFE  
City Auditor

Attachment

cc:    **Audit Committee Members**  
      **Stacy Richardson, Chief of Staff**  
      **Maura Sullivan, Chief Operating Officer**  
      **Cary Bohannon, Manager Facilities Operations**  
      **Daisy Madison, Chief Financial Officer**  
      **Bonnie Woodward, Purchasing Director**  
      **Donna Williams, ECD Administrator**  
      **Jim Arnette, TN Local Government Audit**

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## AUDIT PURPOSE

This audit was conducted in accordance with the Office of Internal Audit's 2017 Audit Agenda. The objectives of this audit were to determine if:

- The City is properly overseeing the Tivoli Foundation contract.

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## BACKGROUND

The City built and has managed the historic Soldiers and Sailors Memorial Auditorium since 1924. Over the last nine decades, the auditorium has had success and near failures. It has been closed several times due to disrepair. Its last major renovation occurred in 1991 when it reopened. The historic Tivoli Theatre was opened in 1921. However, the City didn't acquire ownership until 1976.

In August 2015, the City contracted with the Tivoli Theatre Foundation (Foundation) to lease and operate these two facilities over a five year period. The Foundation was formed in 2015, based upon recommendations from the Mayor's Chattanooga Forward/Entertaining and Attractions Task Force.

The Foundation is a nonprofit organization whose sole purpose is the operation and maintenance of these facilities. The City has contracted with the Foundation to provide management services and in exchange the City pays a management fee, as well as provides funds for capital expenditures. The Foundation hired AC Entertainment to run day to day operations, book acts and handle facility management of the Auditorium and Tivoli (Venues).

### Financial Information

The contract requires the Foundation to pay all utility expenses and fees. In addition, it allows the Foundation to collect and manage all earned revenue from operations of the Venues. Such revenues must be used to fund future operations and maintenance. As of June 30, 2016 earned revenue was \$3,787,300 from the prior twelve months.<sup>1</sup>

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<sup>1</sup> Source: Tivoli Theatre Foundation's Statement of Activities

## Exhibit 1: City's Contractual Financial Obligation

Fiscal Year	Operating Funds	Capital Funds
2016	750,000	175,000
2017	750,000	250,000
2018	750,000	250,000
2019	750,000	250,000
2020	500,000	500,000
Total Financial Obligation	3,500,000	1,425,000

Source: Tivoli Foundation Contract

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**FINDINGS AND RECOMMENDATIONS**
**City Code and policies were not followed**

The City Code requires purchases over \$25,000 be competitively bid. It also requires the use of City property by an outside entity to have a formalized contract that is approved by Council. The City Code has set fees and prices for the Venues. It is management's responsibility to be familiar with applicable code sections and ensure they are followed properly.

**The management contract was not competitively bid.**

The City's *Procurement Instructional Manual 2014* requires any purchase over \$25,000 be competitively bid, with few exceptions. Examples of exceptions include some narrowly defined professional services, emergency purchases, and sole source purchases.<sup>2</sup> As a last resort, a competitive request for sealed proposals can be used. This process may only be utilized after some limiting criteria are met and the City Council has determined the use of competitive sealed bidding is not practicable or not advantageous<sup>3</sup>. This procurement of management services for the venues did not meet the qualifications for these exceptions.

The City has a well-defined process for procuring services. However, the established procedures were not followed for this contract. On June 23, 2015, a resolution was passed by Council authorizing the Mayor to enter into a lease and operating agreement with the Tivoli Foundation. Finance originated the procurement process in the City's Oracle system without stating the purpose.

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<sup>2</sup> As described in City Code Section 2-556 and the City's *Procurement Instructional Manual 2014* Section 2.05 & 2.14.

<sup>3</sup> TCA 12-3-1207 Authorization to use competitive sealed proposals.

The requisition only referenced the FY16 budget ordinance (in the manner typical for a nonprofit appropriation payment)<sup>4</sup>. Purchasing followed their standard steps for payment of an appropriation to a nonprofit. This allowed the purchase order to be initiated without required competitive bidding.

This was not an appropriation to a nonprofit, rather a procurement of management services requiring a formalized contract be executed before any payments are rendered. City Code Section 2-520 states “Every warrant shall set out the purpose for which it is issued.” Had the requisition/request for payment included the purpose as required by City Code, the City’s Purchasing Division would have had a flag/notification identifying the need to abide by competitive bidding requirements.

### **Payments were made without a signed contract.**

City Code Section 2-520 requires the CFO to examine all requested payments and states the CFO “shall issue no warrant for payment unless [s]he has found by diligent investigation that the claim is in proper form, correctly computed and duly approved, and that it is justly due and payable.”

Typically, the payment process is initiated by the Department responsible for the contract (in this case, the General Services Department). Additionally, the normal payment process requires minimum documentation (such as a copy of the contract<sup>5</sup> for services) and reference to City Council approval when over \$25,000. A final requirement in the typical payment process is an assertion from the responsible department that the product or service warranting payment has been received.

Administration received Council approval to enter into a contract with the Foundation in June 2015. However, this contract was not executed. Subsequently, City Council approved a revised version of the contract on August 11, 2015. The contract was executed on August 12, 2015. We found two payments totaling \$112,388, were made to the Tivoli Foundation (via the Community Foundation)<sup>6</sup> prior to the contract being signed.

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<sup>4</sup> The requisition had no indication it was for the purchase of management services.

<sup>5</sup> City Code Section 2-756 (b) requires an executed contract as approved by City Council. See our finding below titled *Unauthorized use of City facilities*.

<sup>6</sup> These payments were made to the Community Foundation and not to the Tivoli Foundation. The funds were later passed to Tivoli Foundation.

### Unauthorized use of City facilities

City Code Section 2-756 (b) states, “an official or employee shall not use or authorize the use of municipal time, facilities, equipment or supplies for private gain or advantage to any private person or entity, except as authorized by legitimate contract or lease that is determined by the governing body to be in the best interests of the municipality.”

The Foundation took over the facilities and operations of the Venues on July 1, 2015. The agreement allows the Foundation to lease the facilities and manage operations of the Venues. City management did not obtain an executed contract until August 12, 2015.

### Contract terms and practices contradict City Code.

The contract allows the Foundation to set prices and fees at the Venues. City Code Section 2-581 to 586 establishes rental rates for the facilities, as well as, a preservation fee. The Foundation increased fees and prices at the Venues. However, the City Code has not been amended to allow these changes.

#### Recommendation 1:

We recommend the Purchasing Division competitively bid all contracts for management services.

***Auditee Response (Purchasing):** We concur with the audit finding and recommendation.*

#### Recommendation 2:

We recommend the Purchasing Division update the *Procurement Instructional Manual* with formalized steps for payments to nonprofits. This would include, but not be limited to, requiring specific documentation of (not a mere reference to) the appropriation and amount.

***Auditee Response (Purchasing):** We concur with the audit finding and recommendation.*

#### Recommendation 3:

We recommend the Finance Department ensure payments are made only when proper documentation and authorization are present. This should include obtaining an executed contract, documentation of any



necessary Council approval/resolution, and confirmation the product or service has been received consistent with contract requirements.

***Auditee Response (Finance):*** *We concur with the audit finding and recommendation.*

#### **Recommendation 4:**

We recommend City Management ensure an executed contract is in place prior to allowing use of a City asset by a third party.

***Auditee Response (General Services):*** *We concur with the audit finding and recommendation. The General Services Department is being dissolved as a department. It is our understanding real estate/leases (and the responsibility of this contract) will fall under the Economic and Community Development Department.*

#### **Recommendation 5:**

We recommend the General Services Department (or its successor) work with the City Attorney to draft an amendment to the City Code to allow contracted management services at the Venues.

***Auditee Response (General Services):*** *We concur with the audit finding and recommendation. The General Services Department is being dissolved as a department. It is our understanding the responsibility of this contract will fall under the Economic and Community Development Department.*

### **The terms of the contract were not enforced**

The contract between the City and the Foundation imposes multiple requirements on the Foundation to ensure the City is sufficiently informed to provide oversight.

#### **Reporting requirements have not been enforced.**

Section 11 of the contract requires the Foundation submit annual financials, performance reports and an annual budget to the Mayor and Council by March 1<sup>st</sup> of each year. Performance reports were not submitted to the City. Further, financials and a budget were submitted to the Mayor, but not the Council. These reporting requirements enable the governing body, and management, to make informed decisions on future funding.

Further, Section 11.3 states fees and prices established by the Foundation must be reported in writing to the General Services

Director on an annual basis. We found the revised fee structure was not submitted to the General Services Director, as required by the contract.

In addition, the contract appears to impose requirements described in City Code Section 2-526. This code section requires furnishing various documentation including, but not limited to, proof of non-profit status, annual audited financials, operating budget, and charter to the City's Chief Financial Officer. We found the Foundation did not follow the reporting requirements of Code Section 2-526.

### **Review of capital expenditure reimbursements is needed.**

When reviewing the capital expenditure payments, we found the Foundation did not always clearly detail what was being purchased. The reimbursements were missing proper backup and some documents lacked dates of work, descriptions of work, or invoice number. Contract Section 11.7 requires all Foundation expenditures shall be supported with documentation and information to clearly identify the payee, purpose, and use of funds.

The agreement allows reimbursement for capital improvements, upon written request. The request must include a description of the improvement and a cost quote. This request must be approved by the General Services Director prior to commencing the improvement.<sup>7</sup> Further, any capital improvement or alteration exceeding \$50,000 must receive express written permission by the General Services Director, or Mayor.<sup>8</sup> Requests were not submitted before beginning improvements and the Foundation did not obtain required authorization prior to spending funds for projects over \$50,000.

Upon completion of improvements, the Foundation must provide copies of final as-built plans and specifications to the General Services Director. The City has reimbursed the Foundation \$143,013 during fiscal year 2016 and \$177,388 in fiscal year 2017<sup>9</sup> for such improvements. The Foundation has not submitted copies of the final as-built plans and specifications to the General Services Director, as required by the contract.

By approving capital projects prior to initiation, the City can make decisions about the priority and value of improvements to be performed. The retention of as-built plans/designs ensures more

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<sup>7</sup> As described in Section 5.2 of Tivoli Foundation contract.

<sup>8</sup> As described in Section 9.1 of Tivoli Foundation contract.

<sup>9</sup> The scope of the audit included capital improvement payments through February 28, 2017.

efficient work in future years. City management should ensure all supporting documentation contains clear information showing the purpose, date, quantity and cost of a purchase. Payment requests lacking this information should be rejected.

### **Recommendation 6:**

We recommend the Finance Department ensure supporting documentation is present demonstrating the Foundation is in compliance with the contract's reporting requirements prior to authorizing payments.

***Auditee Response (Finance):** We concur with the audit finding and recommendation. We will enhance our payment policies and procedures to emphasize all contract terms should be adhered to before final payment approval is provided by each Administrator.*

### **Recommendation 7:**

We recommend the General Services Department (or its successor) develop a checklist of contract terms to ensure they are being met within the stated timeframe.

***Auditee Response (General Services):** We concur with the audit finding and recommendation. The General Services Department is being dissolved as a department. It is our understanding the responsibility of this contract will fall under the Economic and Community Development Department.*

### **Recommendation 8:**

We recommend the General Services Department (or its successor) develop performance criteria and measurements to evaluate the management services of the Foundation. The performance requirements could be included in the terms of the contract when it is renewed.

***Auditee Response (General Services):** We concur with the audit finding and recommendation. The General Services Department is being dissolved as a department. It is our understanding the responsibility of this contract will fall under the Economic and Community Development Department.*

**Recommendation 9:**

We recommend General Services Department (or its successor) not approve payments to the Foundation for capital requests that lack prior approval. Each request must include a cost quote and description of work.

***Auditee Response (General Services):** We concur with the audit finding and recommendation. The General Services Department is being dissolved as a department. It is our understanding the responsibility of this contract will fall under the Economic and Community Development Department.*

**Recommendation 10:**

We recommend the General Services Department (or its successor) ensure expenses submitted by the Foundation are properly documented before payment is initiated, as required by the contract. The documentation should at a minimum identify the payee, purpose and use of funds, as required by the contract.

***Auditee Response (General Services):** We concur with the audit finding and recommendation. The General Services Department is being dissolved as a department. It is our understanding the responsibility of this contract will fall under Economic and Community Development Department.*

**Recommendation 11:**

We recommend General Services Department (or its successor) acquire from the Foundation copies of final as-built plans and specifications on any applicable capital improvements.

***Auditee Response (General Services):** We concur with the audit finding and recommendation. The General Services Department is being dissolved as a department. It is our understanding the responsibility of this contract will fall under Economic and Community Development Department.*

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## APPENDIX A: SCOPE, METHODOLOGY AND STANDARDS

Based on the work performed during the preliminary survey and the assessment of risk, the audit covers Tivoli Foundation's contract from July 1, 2015 to February 28, 2017. When appropriate, the scope was expanded to meet the audit objectives or to ensure sufficient reporting of fraud, noncompliance with provisions of laws, regulations, contracts, or grant agreements, or abuse that warrant reporting to those charged with governance. Source documentation was obtained from Finance and General Services Department as well as the Tivoli Foundation. Original records as well as copies were used as evidence and verified through physical examination.

To achieve the audit's objectives and develop our recommendations, we reviewed the Tivoli Foundation's contract to determine the terms and requirements of the contract. City Code was referenced when necessary to ensure adherence to it. City financial data was reviewed as well as the Tivoli Foundation's records. When appropriate, judgmental sampling was used to improve the overall efficiency of the audit. Interviews were conducted with General Services, Finance and the Foundation staff.

We conducted this performance audit from February 16, 2017 to June 21, 2017 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.

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