AUDIT OF FIESTA MARKET SQUARE, INC. LICENSE AGREEMENT

APRIL 1999 THROUGH APRIL 2003

Audit Report Dated November 6, 2003

Book One of Three

AUDIT OF FIESTA MARKET SQUARE, INC. LICENSE AGREEMENT
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AUDIT OF FIESTA MARKET SQUARE, INC. LICENSE AGREEMENT
APRIL 1999 THROUGH APRIL 2003
Executive Summary of the Audit Report Dated November 6, 2003

The internal audit of the license agreement between the City of San Antonio and Fiesta Market Square, Inc. was completed in November 2003. This project has been challenging, but it has also been an opportunity to gain significant insight about key business processes and relationships. Several of these began as long as twenty-five years ago and continued to evolve during the five-year term of the license agreement. Others originated with the license and have developed further or since the spring of 1999. Specific recommendations from the audit are included on pages 16 through 18, and on pages 41 and 42 of the full report. City Management has reviewed the report, and has now submitted their responses and proposed implementation items as deemed applicable. A few recommendations by their very nature are directed to the Mayor and City Council as well because of various public and business (operating) policy implications. From information provided as a result of this audit, the Mayor and City Council may want to clarify for all involved parties your current thoughts about these policy matters.

In the beginning, it was anticipated that a modest commitment of resources would be needed to review, test and report on an audit of this license agreement. Advance access to documents provided by the Parks and Recreation Department and the City Attorney's Office gave reasons to develop a broader scope and set of objectives for this audit. Most prominent in these records were two management letters in 2000 and 2001 to the Fiesta Market Square, Inc. (FMSI) Board of Directors from its Certified Public Accountant (CPA), Exhibits III.2 and III.3. This correspondence raised concerns about a number of issues that could be directly linked to actions by FMSI that should have resulted in notice of default being given to them, or in termination of the agreement by the City. The purpose would have been to gain compliance by the licensee if possible, or if not then to remove them.

In June 2003, meetings were held with City staff and representatives from FMSI. At that time, it became apparent that performing the thorough examination requested by the Governance Committee would require more time than expected. Prior to starting the audit, the public had become aware of payments by FMSI Directors to themselves during the five-year period. Some of these were mentioned, motioned and approved in the meeting minutes, while others may not have been. Review of accounting records provided by FMSI indicated that the questions about payments to Board Members, Exhibit IX.1, were only part of the overall issues. It was clear that the FMSI Directors had authorized substantial distributions to the tenant/owner associations, Exhibit X.1. Several of these were characterized as reimbursements, but the invoices or receipts to support them were missing or inadequate. Later, it was determined from two exit conferences and follow-up information that several Market Square area tenants, who were association members, had also received payments for goods or services, Exhibit XI.1.

During the audit, it became apparent that the "Fiesta del Mercado" event was financially and operationally much larger than expected. For example, the City of San Antonio anticipated receiving $50,000 per year for a total of $250,000 for the license term. Checks and records showed that the City was paid more than $450,000 by FMSI due to security costs, health permits, fire inspections, parking permits/fees, and short term rental fees, Exhibit XXIII.1. Overall, FMSI recorded spending more than $3.9 million between early 1999 and the fall of 2003, Exhibits XIV.1 and XXVII; and it could be verified that most of the funds expended were paid by check. Data showed that some items were paid for using daily cash receipts; however, the exact amount could not be ascertained based upon the records made available. Almost thirty percent of the transactions (checks) recorded were for event laborers, security, entertainers, and promoters.

It was determined during the audit that the revenue generating activities and the recorded revenue transactions were much more complicated than the general public knew. Over $3.9 million in revenue was reported by FMSI for the five-years, which included about $2.4 million in cash from the daily/weekend event beverage and miscellaneous sales, Exhibits XXVI.1 and XXVII. Of the remainder, about $1.04 million was recorded for cash or cashier checks for booth lotteries and vendor fees. Corporate sponsor contributions during the license agreement term were greater than $446,000. Interest credit on bank deposits totaled almost $3,400.

Testing and verifying the overall results became complicated because of missing records, such as bank statements, daily cash and monthly bank reconciliations, deposits, and canceled checks. Through reconstruction of the detail records for comparison with the financial statements, it was determined that more than 90 percent of the expenditures recorded were reviewed and/or tested in some manner. Detail supporting recorded revenue for 1999, 2000 and 2001 was examined or evaluated through one or more audit procedures. The audit would have encompassed reviewing more documents if the 2002 lottery and related vendor contracts had been provided before the exit conference with the FMSI Board. Partial revenue records for 2003 were submitted by FMSI in mid-November as well.

While expending many man-hours looking at the revenue and expense transaction detail, procedures were also conducted to compare and relate them to the FMSI Board Meeting minutes and records. In various cases the official meeting minutes provided much more information than an invoice or receipt could. In addition, they were available in place of numerous missing invoices and supporting documents. The primary sources for the minutes were the Parks and Recreation Department, and records provided for an ethics complaint in March 2003 and later by several FMSI Board Members.

The licensee representatives from the Board provided very few copies of meeting minutes for the five-years. Appendix G includes many, but not all, of the available FMSI meeting minutes.

Substantial insight was gained by stepping back and looking at the accounting, cash and financial transactions in conjunction with and in the context of the documented discussions from the Board Meetings. This was relied upon for the audit analysis and conclusions because FMSI provided no documented policies and procedures regarding its business practices and strategies for the license agreement. At best, there were rough outlines or lists of items, activities, and steps.

Similarly, the City Parks and Recreation Department did not provide formally documented policies and procedures that were utilized in the operational and monitoring aspects of this license agreement. From the material submitted for the audit, such as the FMSI minutes, email, correspondence, and the FMSI audit reports, an audit trail of data was discernable.

These records were the centerpieces for interpreting and understanding the accounting, contract, and performance issues identified during the audit. As such, it is important that they be included with the audit report as appendices. Their inclusion provides an opportunity for the organization and its members, the City staff, the Mayor and City Council, and the general public to review them and to draw their own conclusions about the timing and information known concerning compliance, default or termination actions, and the adequacy of internal and management controls.

The license agreement ended in April 2003; accordingly, questions may be raised about the benefits, if any, to be realized from a thorough audit at this stage. Without a doubt, this audit has been invaluable to the City by highlighting previously identified and acknowledged internal and management control problems that had not been resolved. The document trail demonstrated that from the first year of the license period that the FMSI Board Members were made aware of issues that this audit addresses. Despite its CPA bringing forward several times areas for concern and needed improvement, FMSI continued activities that were not compliant with the license agreement.

Likewise, Parks and Recreation Department staff provided the documentation for the audit, Appendix D, that suggested its information and knowledge of problems prior to, Appendices D.1 through D.4; and after the license agreement was signed, Appendix D.5. With the timeframe of data established, the question was then identifying what corrective action was initiated by City staff concerning these issues. From documents provided during (Appendix Q) and after the audit, it appeared that some action was contemplated by Parks Department staff during the five-years. From the FMSI minutes and City records, staff had meetings and contact with the Board about various issues.

The contact, both verbal or written, did not rise to the level of a specific warning or notice of default and/or possible termination. It came close to this in the spring of 2003 in planning for the final Fiesta event.

The City had an opportunity to challenge FMSI about its actions going back to 1999. Again in 2000 and 2001, there were opportunities available to address issues concerning default by FMSI, or the need to initiate termination. Negotiating with FMSI for a proposed agreement of up to ten-years seemed inappropriate given the City documents reviewed during the audit. The impetus to consider recommending that this organization continue to handle the "Fiesta del Mercado" event could have stemmed from Parks Department staff perceptions of the Mayor and City Council's favorable view of the parties involved with the current license and their performance. If this were the case then these perceptions should have been checked out prior to commencement of any license discussions. Negotiation efforts could have resulted from City staff's view that this was not a high-risk contract, financially or otherwise. A third possible scenario for City staff deliberating a new contract with FMSI could be maintaining the status quo. Perhaps the Parks staff did not have adequate confidence that replacing the tenant/owner association management of the Fiesta event was even a viable alternative given their comments about limited City resources.

From the analysis and work done for this audit, it seemed that the City staff, primarily the Parks Department and Market Square personnel, underestimated the direct and indirect value of this license agreement. While the basic license fee was $250,000 for the five-years, FMSI paid for or reimbursed the City over $100,000 for off-duty or contract security at Market Square. The City also received over $110,000 in the five-years for health permits, fire inspections, parking fees and permits, and short term facility rental fees. Exhibit XXIII.1 provides more details about these expenditures.

FMSI also spent $12,000 in 2001 for the Visitors' Center, and $43,800 in 2002 for new air conditioning units and conference room furnishings, as shown in Exhibit XXIII.10. Proceeds used for advertising and marketing from early 1999 until fall 2003 were over $268,000, excluding $51,975 that FMSI believed was owed KSAT-TV as of fall 2003. Exhibit XIV.2 lists the amounts paid to various media organizations during the license period. FMSI paid over $167,000 to contract firms for security of Market Square not related to "Fiesta del Mercado," and more than $23,000 from late 2002 through the fall of 2003 to an individual for daytime patrols of the area. On several occasions Market Square was pressure cleaned by various firms for which FMSI paid about $22,500. These expenditures represented over $536,000 paid from the cumulative proceeds for Fiesta and non-Fiesta events

sponsored by FMSI over five-years. In addition, the City received local sales tax collected from event beverage sales by FMSI and by some of its vendors. All of this was good news for the City of San Antonio.

Based upon the audit, there were potential opportunities to improve the overall benefits realized had the licensee and the Parks and Recreation Department acted more responsibly in their respective roles. It may still be possible to recover some of the foregone benefits. The City should attempt to gain ownership of the trademark for "Fiesta del Mercado" as an asset available to use in merchandise sales, marketing and promotions.

Through the audit procedures, various businesses have been identified that may not have collected and remitted sales tax appropriately. To facilitate determination of liability and to attempt collection for the City of San Antonio, and other agencies, information concerning these businesses will be supplied to the State Comptroller's Audit Division. Documents obtained from the Texas Alcoholic Beverage Commission (TABC) showed that FMSI's President in April 2002 violated the license by obtaining permits for a beer booth in the carnival area, Exhibit XXIV.1h. In doing so, he may also have exceeded the authority granted to him as President of the organization as no reference of this arrangement was seen in the minutes. TABC may have reason to further pursue this matter.

The audit report will also be forwarded to the federal government, Treasury Department and Internal Revenue Service, to ascertain if the City of San Antonio has any potential claims to fees and/or rewards for information related to businesses and individuals associated with this license agreement who may not have followed federal laws and regulations. FMSI could not produce any 1099 Forms filed for those paid miscellaneous compensation or rents. If this is correct, records indicate a significant number of individuals and amount of compensation that may have gone unreported during four of the five-years, Exhibit XIV.4. For example, there were about 87 individuals who received over $122,000 from FMSI in 1999; in 2002, there were over 130 who were paid in excess of $277,000. Review of records such as various canceled checks and substantial cash deposits and transactions may also indicate possible treasury regulations issues related to large reportable cash transactions.

The significant risk of fraud or illegal acts based upon control deficiencies identified from this license agreement audit warrant that the report and related documents be submitted to the Secretary of State, Texas Attorney General, and the Bexar County District Attorney for their review.

Responses from the licensee, Fiesta Market Square, Inc., and the City of San Antonio Parks and Recreation Department are included with this audit report. City staff responses to the issues, findings and recommendations indicated general concurrence with the need to improve or to reorganize the license/contract monitoring functions and the operational activities. Through twenty-five years of nurturing this venture, the City has struggled to maintain "arms length" relationships between the tenant/owners and the staff. Parks and Recreation Department Management should become more proactive initiating change management in this regard, and providing updated training in the areas related to this contract. While the Market Square operating staff could report problems, they appeared to have limited ability to directly deal with the internal and management control problems. They required greater assistance from supervision in handling the events that were somewhat out of control by 2002 and 2003. The license/contract monitoring processes within the Parks Department have similar requirements. Outsourcing activities and new contracting initiatives with these facilities will not resolve these internal City issues.

The licensee (FMSI) responses also indicated some concurrence about prior performance problems. However, they did not come close to acknowledging the seriousness and consequences of their actions. The documented records from 1999 through the response in November 2003 continued to maintain the FMSI's intentions to act unilaterally. Their remarks do not offer encouragement that a continued license arrangement with the organization would demonstrate enough improvements in the control processes and results.

With the ending of the license agreement with FMSI, there is little follow-up necessary. City staff changes and actions can be monitored over the next six to twelve months to report on their accomplishments. The San Antonio Parks Foundation can be briefed on the significant internal and management controls concerns to avoid similar pitfalls with the Fiesta 2004 Event. As information is obtained about potential fees/rewards recoverable for reported violations, the City Council will be updated.

Background

The City passed Ordinance 89551, **Appendix A.1**, in April 1, 1999 authorizing a license agreement with Fiesta Market Square, Inc. (FMSI), a 501(c)(6) non-profit corporation, to conduct an annual event to be called "Fiesta del Mercado". The license agreement, **Appendix B.1**, signed June 4, 1999, was effective beginning April 12, 1999. Attached to the license agreement were the Articles of Incorporation (AI) **Appendix B.3**, for FMSI that were submitted to the State of Texas and the Internal Revenue Service. The AI appeared to be used interchangeably as the draft "By-laws" for the organization in terms of the license agreement. FMSI did have draft "By-laws," **Appendix B.12**, which were amended, **Appendix B.13**, according to the Board minutes dated October 24, 2002, **Appendix B.10**. The revision of FMSI "By-laws" is also addressed in **Appendices B.11, B.14 and B.15**.

The license agreement was developed at the request of City Council, especially the representative for District 1. The license agreement incorporated the Produce Row, Farmer's Market, Market Square and surrounding facilities (Market Square). Documentation for some historical perspective about the "Fiesta del Mercado" event has been provided as **Appendices A.2, A.3, A.4, and A.5**. City Council wanted to formalize a working relationship, or alliance, between various groups that had previously participated in Fiesta events within Market Square. An overview of the various Boards and Commissions related to the area has been developed as **Exhibit I.1** using data provided by City staff. Among the groups were the three merchant associations, known as the Market Square Association (MSA) located at 514 W. Commerce Street, the San Antonio Farmer's Market Plaza Association (SAFMPA) located at 612 W. Commerce Street, and the El Mercado Merchant's Association (EMMA), which included Produce Row. These associations formed a new non-profit organization, known as FMSI, which was sometimes referred to as the "Board of Nine." This pseudonym referred to the composition of the FMSI Board as being three members elected from each of the associations: MSA, SAFMPA, and EMMA. Membership of the FMSI Board during the five years has been recorded by the City's Parks and Recreation Department (Parks), and is incorporated as **Exhibit I.2**.

MSA was comprised of about thirty or more business owners who had shops in the Market Square building. SAFMPA included over fifty business owners who have had shops in the facility on the west side of San Saba Street. EMMA was comprised of about eleven individuals or companies who had property, or business owners with shops, south of the main Market Square building in the area known as Produce Row. **Exhibit II** lists the tenants in Market Square based upon Bexar Appraisal District tax records in November 2003.

The new alliance was expected to more formally address the inclusion and participation of non-profit organizations, referred to as 501(c) entities, in the "Fiesta del Mercado." City Council directed that Gateway Plaza be used for this purpose. The League of United Latin American Citizens (LULAC) was the only 501(c) non-profit group specifically referred to in the license agreement, Section 5.11. However, language in the ordinance and/or back-up material, **Appendix A.2**, referred to the inclusion of other non-profit organizations.

City Council's objectives were to better coordinate and simplify Fiesta events at Market Square so that many stakeholders would benefit in a fair and equitable manner. By doing so, net proceeds generated by the events would partially offset Market Square operating costs incurred by Parks. Council envisioned that the newly formed non-profit organization would assist the City by raising funds through "Fiesta del Mercado" that would substantially be reinvested in municipally owned facilities for electrical, plumbing, air conditioning, and other major components. By doing so, the City could leverage these funds in conjunction with long-term lease/rental fees from Market Square tenants who were represented by the "Board of Nine".

The license agreement required that all charges, including but not limited to permits, inspections, security, and parking, would be paid by FMSI for participating in the annual event. Similarly, LULAC was expected to pay for such costs as related to the twelve booths dedicated to its organization. Other non-profits, sponsors, or individuals participating were also required to pay for permits, inspections, and related costs for their booths. FMSI had authority to establish booth pricing, and to include these charges. The twelve booths for LULAC were priced at $2,000 each, or $24,000 total, for 1999 based upon the license agreement Exhibit C, see **Appendix B.4**. Since this pricing was part of the original license agreement, it was assumed that LULAC would pay this amount for the remaining four years. Notes from a March 2001 meeting between FMSI, the City, and the Council Member for District 1, **Appendix C.15**, reflect that some of the Board Members had this interpretation. This was a very contentious issue between LULAC and FMSI during the license

period. **Appendix C** provided with this report incorporates documentation on the various points of view. This information details actions taken by each party concerning Section 5.11 of the agreement.

The license agreement had specific requirements directed to FMSI, and other issues directed to City staff. For example, the former Office of Internal Review was charged with evaluating FMSI's accounting system. Prior to this license agreement, the City had audited Fiesta related events, and as a result made various recommendations concerning improving internal and management controls. These records and reports gave an indication of problems that needed to be addressed by the Parks staff and the new license-holder, FMSI. **Appendix D** has been incorporated to provide internal audit results just prior to and after the 1999 license agreement.

The Parks Department had a number of stated and implied requirements from the license agreement. Parks was expected to provide general monitoring of the license agreement to ensure that FMSI complied with the terms and conditions. Parks was required annually to review plans proposed by FMSI for booths and entertainment, and to approve them if appropriate. Parks staff was also charged with coordinating plans and expenditures for Market Square facilities that were to be paid from the net proceeds of "Fiesta del Mercado." Funding from FMSI was to be coordinated with other revenue sources available to the City for operating, maintenance, and capital improvements.

Parks staff involvement was critical to ensure that FMSI operated the event using appropriate business practices, and in a fair and equitable manner. Parks staff was to ensure coordination with the other daily activities during the Fiesta event period. They were to perform site logistics and oversight so that tenant businesses could continue to operate as routinely as possible. Correspondence dated May 7, 1997 was supplied by Parks staff which referred to the significance of tightening up controls until a license agreement could be developed, refer to **Appendix D.4**.

An important internal control was for Parks staff to review the independent certified public accountant (CPA) annual report for "Fiesta del Mercado." This was a simple but valuable tool for informing and educating the City staff about business practice issues that could impact compliance with the license agreement. Another essential control in the license agreement was the term and termination clause. The language approved gave the City several conditions for which the five-year license agreement should be terminated. However, Parks had to issue written notice of the specific non-compliance issue before the termination process could begin.

FMSI was accountable for the various internal and management control requirements specified or implied within the license agreement. These included operational functions, cash management,

accounting, and financial reporting. One source of FMSI authority originated from the license agreement attachment, its Article of Incorporation (AI), **Appendix B.3**. The Secretary of State used this document when the FMSI request for incorporation was approved. In addition, the Internal Revenue Service used the information when the non-profit request was reviewed and approved. Section Four of the AI listed the "permitted" activities for this non-profit organization. Subsequently, the original "By-laws" in draft form were revised and adopted, **Appendix B.12 and B.13**. The license agreement language did not allow for changing the "By-laws" without further action by City Council. In addition, no correspondence was provided indicating that the revised "By-laws" had been submitted to the State of Texas and/or the Internal Revenue Service for their review and acceptance.

In 1999, FMSI requested non-profit status as a 501(c)(6) organization, which is known as a "business league". This designation was available to them since the organization was comprised of three associations who represented businesses operating as owners or tenants within Market Square. Some restrictions apply to "business league" entities that do not apply to other types of non-profit organizations. A significant one is that benefits should not "inure" to the directors or members of the organization. This language generally prohibited members of the "business league" from receiving direct economic or financial benefits from the nonprofit organization. Parts of the Internal Revenue technical training materials for 501(c)(6) organizations, including explanation of the "inure" issue, have been provided with the audit report as **Appendix E**.

The license agreement scheduled to end in April 2003 did not include a provision for an extension. In early 2003, FMSI approached Parks staff about making a presentation for a new license agreement. Preliminary discussions occurred for several months with FMSI being represented by an attorney registered with the City as a lobbyist on its behalf. Material submitted by FMSI in November 2003, **Appendix U**, detailed significant discussions through April with City Legal and Parks staff about terms and conditions for a new five to ten-year license arrangement.

In April 2003, publicity drew attention to the license agreement due to the "Fiesta del Mercado" beer booths, **Appendices F.1 and F.2**. About this same time, an ethics inquiry was submitted which involved a member of the FMSI Board who also served on the City Council appointed Market Square Commission. It also became general public knowledge that members of the FMSI Board had been compensated. After several weeks of expressed public concern, the Governance Committee of the City Council asked that an audit of the license agreement activity be started as soon as possible, as addressed in **Appendix F.3**.

In May and June 2003, Parks staff provided copies of information on FMSI, which included meeting notes and minutes, food booth procedures, financial statements, and documents about repairs, security and other matters. The initial review of this material included the FMSI independent certified public accountant (CPA) letter to the Board, which outlined control observations, comments, and related recommendations. These involved general business practices, cash management, and accounting records or reports. Recurring comments and observations about several issues were crucial in determining the scope and objectives for the internal audit. These reports, included as **Exhibit III,** were significant in determining how long the FMSI Board had been aware of several key control issues. **Exhibit III.2** had notations from the Parks Manager designated as the Contract Administrator directing that a letter be written to the Board about the issues raised by the CPA.

In June 2003, the FMSI President and the contract business manager/bookkeeper submitted various records for the audit. During interviews with them, it became known that FMSI had established a 501(c)(3) nonprofit entity, called the Greater Market Square Foundation, Incorporated, in the fall of 2002. Inquiries were made as to the purpose of this additional organization, and FMSI explained that it was to solicit charitable contributions and for expenditures not allowed by the 501(c)(6) nonprofit entity. Documentation for this related party was reviewed, **Appendix V**; and several inquiries were made regarding its financial status. As of November 2003, the Board indicated that the entity was never active, and that it had no funds.

The overall content and condition of FMSI financial and accounting records indicated early in the project issues similar to those presented in the accountant's report to management for 1999, 2000, and 2001. FMSI represented that various financial records for the five-year period could not be located. Bank statements, canceled checks, and invoices for goods or services purchased were missing for different periods during 1999 and 2000. The information for 2001 and 2002 was more complete, but still had some missing documents. Year five (2003) records were expected to be the most complete; however, it also had unaccounted for canceled check, invoice, and sales data. Consequently, some limitations on the audit procedures were expected due to periods with missing or unavailable records. FMSI had no policies and procedures for safeguarding and maintaining important financial and accounting documents which is a fundamental control process.

SUMMARY OF FINANCIAL RESULTS FOR FIVE YEARS

Five Year Total **In Thousands**		**Net Asset Reconciliation** **In Thousands**	
Revenue	$3,942	Total Assets as of September 30, 2003	$ 25
Expenses*	3,996	Less: Total Liabilities as of September 30, 2003 (*Includes accrual of $51,975 for KSAT contract)	52
Net (Loss)*	**$ (54)**	**Net Assets, September 30, 2003**	**$ (27)**
		Less: Net (Loss) For Five Years* (*Includes accrual of $51,975 for KSAT contract)	**(54)**
		Less: Net Assets, beginning Spring 1999	**19**
		Unaccounted For Variance **Statement of Net Assets** (Potentially Due To Un-reconciled Cash For Change Funds; And To Un-reconciled Checking Account)	**$ 8**

Reference **Exhibit XXVII** Financial Summary – Revenue, Expenses, and Net Assets For Five Years and **Exhibit XXVIII** Bank Reconciliation Reconstruction.

Audit Standards and Reporting Requirements

In planning and conducting this audit engagement, generally accepted governmental auditing standards (GAGAS), which are commonly referred to as "Yellow Book Standards," were followed. The United States Government General Accounting Office (GAO) issues GAGAS. This engagement was categorized as a performance audit therefore chapter seven on field work and chapter eight on reporting of the "Yellow Book" were followed. In providing a framework for conducting an audit such as this, the standards require reporting on internal control.

Internal control consists of broad components, which are: (1) control environment; (2) risk assessment; (3) control activities; (4) information and communication; and (5) monitoring. For this type of audit, the internal control objectives include the effectiveness and efficiency of licensee operations and of the City's oversight; the validity and reliability of data maintained and reported by the licensee; and compliance with the license agreement, laws, and regulations. While extensive work

was planned and performed for this audit, its purpose was to provide reasonable but not absolute assurance about the performance of FMSI and the City.

The "Yellow Book" standards address the reporting of fraud, illegal acts, or significant abuse if evidence obtained during the audit indicates that it did occur or is likely to have occurred. There are a series of recognized conditions that may indicate greater risk of fraud. These include, but are not limited to, inadequate management oversight and enforcement of appropriate control processes; lack of segregation of duties; unusual transactions; missing records or documents; untimely reporting of financial results; and information from prior audits. Final determination of whether acts by the auditee(s) constitute fraud or an illegal act must be made by a court of law.

The standards differentiate abuse by defining it as conduct, behavior, and business practices that are far less than that a prudent person would demonstrate. Abuse does not involve fraud, illegal acts, or contract violations. While determination of abuse tends to be subjective, it should be based upon appropriate qualitative and quantitative audit evidence. This audit report should adequately explain significant acts of internal control deficiencies and abuse. In addition, it should present sufficient information about the potential for fraud based upon the conditions found.

Scope and Objectives

The audit plan was to review the entire five-year license agreement period, which was expected to be from April 1999 through April 2003. Some extension of the ending time period was anticipated due to late receipt of vendor invoices and adjusting accounting entries. It was not anticipated that transactions would occur prior to ordinance approval; however, this was observed in the data submitted for 1999. The scope was to examine detail information for sales, revenue and related items, such as applications, contracts and receipts; and to test expenditures, including but not limited to cost of goods sold (beer, margaritas, wine and sodas), event contract labor, entertainment related contractors, advertising, accounting, legal, insurance, equipment and booth rentals, promotional or management services, and sales tax.

Also targeted for review in the audit process were the substantial cash and cash equivalent transactions that amounted to over $3.9 million for the license period, **Exhibits XXVII and XXVIII**. Issues identified prior to 1999 indicated major concerns over the cash handling practices used by "Tres Mercados", the prior licensee. From documentation reviewed, **Appendices A.2 and A.3**, in

developing the five-year license agreement, City Council and City staff clearly intended that this contract improve fiscal and cash controls.

Compliance with the license agreement was the primary focus of the audit. However, the objectives included determining if FMSI followed federal laws and regulations regarding requirements for: 501(c)(6) Business League Non-profit Organizations; filing the Annual Exempt Organization Report Form 990, **Appendix N**; filing 1099 and 1096 Forms annually for miscellaneous compensation and rents paid; filing Form 8300 for cash transactions exceeding $10,000; and changes in its "By-laws."

FMSI and its booth operators should have complied with Texas laws and regulations regarding sales tax permits, and filing and remitting sales tax during the five-year period. FMSI may also have been required to file and perhaps pay fees regarding insurance and its corporate franchise, **Appendix W**.

In terms of local laws and regulations, FMSI was required to ensure that it and all food and nonfood vendors had appropriate permits from the City of San Antonio. Most critical would be the health permits. However, permits would also be required for parking, and peddlers' permits may have been necessary for vendors during the Fiesta event. Inspections by the health and fire department were mandatory.

The license agreement anticipated issues regarding health and safety by requiring a limit on the number of booths and vendors within Market Square. Accordingly, FMSI was expected to submit to Parks staff a proposed plan for booths each year, **Appendices B.5, B.6, B.7, and B.8**, which were essentially updates to the original license agreement Exhibit C, **Appendix B.4**. This plan was to detail the location, type and number of booths and vendors proposed which the Parks Director would review and approve. Similarly for safety reasons, the license agreement required that the entertainment location, groups and times be proposed to and approved by Parks staff.

FMSI was required to have insurance for this event, which included general property and liability, worker's compensation, and hospitalization. The organization was required to hire a CPA to provide direction in establishing the overall, daily cash, and inventory controls for "Fiesta del Mercado." With adequate policies and procedures in place, FMSI was to have team captains/supervisors designated and in place to ensure that proper controls were followed. A CPA was also required to provide audited financial statements for the April event each year by the end of September.

This internal audit included examining City staff performance as it related to the FMSI license agreement. The scope of this effort was to review the policies and procedures in place and the actions taken during the five years by the former Office of Internal Review and the Parks and Recreation Department. Other areas such as the Health, Fire, Police, and Public Works Departments also had involvement with this license agreement. It had been planned to examine their policies, procedures and activities from 1999 through 2003. Steps for these departments were not accomplished due to other testing that was considered more critical. The objectives were to determine the existence, efficiency, and effectiveness of City staff in: monitoring this license agreement; coordinating and administering the agreement in conjunction with routine operations at Market Square during or for Fiesta; and carrying out the City Council's goals related to the establishment of this arrangement.

The City Council had expectations of the City receiving specific direct monetary benefits: the license fee of $50,000 per year; the annual permit, inspection, and parking permit fees; the damage deposit of $2,000 per year; and the use of net proceeds for improvements and expenditures related to Market Square facilities. The Council anticipated indirect monetary benefits through the containment of some City costs by outsourcing the event; through the FMSI's participation with the Fiesta Commission; through the local sales taxes to be paid by FMSI and other vendors; and through the benefit of goods or services purchased locally for use by "Fiesta del Mercado."

City Council had qualitative goals in connection with this license agreement which included: allowing LULAC and other non-profit organizations opportunities to raise funds during the annual Fiesta event; consolidating efforts of the three business organizations representing the tenants in Market Square; forging an alliance between various stakeholders to improve their working relationships; and improving the ambiance and quality of this Fiesta event.

Methodology

FMSI submitted the majority of its available original documents in June and July of 2003; some additional material was presented in August. Other information was made available in mid-November, after the exit conference with FMSI's Board of Directors and their advisors. Available data included audited financial statements for June 30th 1999, 2000, 2001 and 2002; and for December 31st 1999, 2000, and 2001. Letters from its CPA to the Board for the June 30th 1999, 2000, and 2001 periods regarding observations and comments about controls were also made available. For 1999,

FMSI had excel worksheets instead of a general ledger; for the remaining four years, general ledgers produced using automated software packages were submitted. The 2002 and 2003 general ledgers submitted in July 2003 did not have transactions posted for bank deposits and revenue.

After the exit meetings, FMSI presented general ledgers for 2002 and 2003 with the posting of bank deposit and revenue transactions. FMSI stated that these records were still incomplete pending adjusting entries recommended by their new CPA. The June versions of the general ledgers for 2002 and 2003 were compared with the November 2003 versions. FMSI had used an accounting software different from that used by the accountant completing years 2002 and 2003. It was important to note that various postings changed between the versions. These changes included different account classifications and payee name changes for checks.

From June through August 2003, FMSI submitted some of its bank statements, canceled checks, manual check registers, and invoices for goods or services for 1999 through May 2003. In mid-November 2003, additional bank statements for 2003 were presented for examination. In June 2003, FMSI provided entertainment contracts for 1999, 2000, and 2001. Ticket stubs, receipt copies and the related applications for the food booth lotteries in 1999, 2000, and 2001 were available in June 2003. At that time, the food booth contracts and related receipts for payments, and the non-food booth contracts and associated payment receipts were provided by FMSI. The 2002 and 2003 contracts for food booths were provided by FMSI on November 12, 2003. On November 16, 2003, the 2002 food booth lottery ticket stubs, payment receipts, and application forms were submitted along with the 2002 and 2003 non-food booth contracts.

FMSI was asked to provide its sales tax reports, Forms 1099/1096, Form 990, and Form 8300 for the four or five years as appropriate. In June, a sales tax report filed in May 2003 was provided as were the Annual Exempt Organization Form 990 for 1999, 2000, and 2001. In late November 2003, FMSI submitted the recently filed 990 Form for calendar year 2002.

Meetings were held with Parks staff in June 2003, to obtain further information and documentation regarding FMSI. Parks submitted a package of material for review. This notebook of information included: notes and minutes of FMSI Board Meetings; correspondence between Parks and FMSI regarding various issues; financial statements and material from the FMSI CPA; annual updates to the license agreement Exhibit C regarding booth locations, types and pricing; checklists for annual Fiesta requirements, and original and revised FMSI By-laws. Job descriptions for several positions at Market Square were also included. There were no Parks Department policies, procedures or other

formal documentation presented for the monitoring of this license agreement, or for the supervision or operation of Market Square.

Parks supplied limited correspondence regarding Internal Review staff work on Fiesta activities in the years just prior to 1999. The files available from the former Office of Internal Review were researched to determine if a report on the review of the FMSI accounting system in 1999 or 2000 was available. No documentation was located indicating that such a review was done. Communications were available between the internal audit group and other City staff in 2000 and 2001 about investigations of potential improprieties.

A follow-up meeting with FMSI occurred November 20, 2003 to provide a list of issues and findings that would be addressed in the audit report. An exit conference was held with City staff on November 6, 2003; this was followed on December 10, 2003 with another meeting to convey and review a draft of the report. Parks and FMSI cooperated and responded to numerous questions asked during the review and examination of the information provided. Several FMSI members also assisted by submitting minutes, correspondence and records to facilitate the audit work.

Documentation was provided by the City Attorney's Office that was obtained through an inquiry presented to the City's Ethics Review Board in March 2003. This information was subsequently supplemented and added to by the individuals who originally submitted it to the City. This was the primary source for the minutes of the FMSI Board over the five-year period.

Other sources for information relied upon for this performance audit included public Bexar County and voter registration records; and Bexar Appraisal District real and personal property records; Texas sales tax permit and payment status records; and Secretary of State records of incorporated entities. Various internet searches were used as sources of information.

Due to the substantial expense involved, no request was made to have FMSI obtain canceled check, deposit slip, or bank statement copies for those that were not available or provided for inspection during the audit. While having such information may have been beneficial in confirming some findings/observations, it probably would not have altered the results of the audit.

Performance Audit Results

City of San Antonio Issues – Internal Review Department

ISSUE: The license agreement, Section 16, required that the City's Office of Internal Review evaluate the FMSI accounting system. It would have been reasonable to expect this review to occur in 1999 or 2000.

FINDING: No documentation was located to indicate that the City performed this requirement during the five-year term.
Correspondence was obtained from Parks staff regarding Internal Review's assistance with municipal integrity issues in 2000 and 2001. This material addresses some of the internal control concerns raised in this audit; therefore, it has been incorporated for reference purposes as **Appendix D.5.**

City of San Antonio Issues – Parks And Recreation Department

ISSUE: Parks and Recreation Department management and Market Square staff had primary responsibility for detecting significant internal and management control problems for this agreement. The personnel resources assigned to this task were as follows:

Parks had a liaison, known as the Special Activities Coordinator (SAC), assigned to Market Square. The job description is included in **Appendix Q.1.** The essential job functions included coordinating the Fiesta at Market Square and other year round events; and planning activities that would utilize the City facilities. The same individual filled this position for many years prior to the license period; and he continued in this capacity after the term ended.

This City employee appeared to have worked with FMSI and on the "Fiesta del Mercado" on almost a fulltime basis during the five-year agreement. In the early years, this City employee attended the FMSI meetings and prepared the official minutes. FMSI Board meeting minutes, correspondence and other documentation obtained from FMSI, City Staff, and other sources are replete with references to this individual's assistance in conducting FMSI activities.

Correspondence in January and March 2000, **Appendices Q.3 and Q.4**, from the FMSI President provided specific insight into the depth of this person's involvement. It also presented the

FMSI President's perception about the actions of the City employee involved, the SAC. The President indicated that the individual was not always acting in his capacity as a City employee.

This City employee had firsthand knowledge, ample opportunity, and a public duty as one of the official representatives of the Parks Department to advise City Management of license agreement defaults and other noncompliance acts that occurred during the five years. There was no formal documentation that the Special Activities Coordinator (SAC) reported or followed-up on such conditions.

Information reviewed for the performance audit demonstrated recurring instances of potential conflicts of interest for the SAC in relation to the FMSI organization and the "Fiesta del Mercado." In the minutes of May 3, 2001 – **Appendix Q.5**, the FMSI Board considered and included in a motion to pay this City worker $2,000 for his work on corporate sponsorships. These minutes also indicated that the individual would need to ask permission from the City if he could accept the donation.

It appeared that this City worker was involved with FMSI in obtaining a trademark for "Fiesta del Mercado." **Exhibit XIII.2** reflected the employee's name as a contact person on official government correspondence. He also signed several documents and contracts for FMSI; **Appendix H.1** includes a booth contract dated May 12, 2001 with his signature. FMSI minutes, **Appendices G.13 and G.53**, documented that he asked the organization for advertising and entertainment funds. No City procedural requirements could be identified for making such requests.

FMSI minutes, **Appendix Q.20.a**, also reflected that the organization asked the City employee for funds from weekend events. A follow-up letter was sent to the City Parks Department by FMSI's President asking about weekend event proceeds, **Appendix Q.20**. The implication was that FMSI was entitled to all net proceeds from City sponsored events in the Market area. Shortly after this inquiry, a deposit was made. Available documentation indicates that this timing did not coincide with "Fiesta del Mercado."

Documentation presented for the five-year period did not demonstrate an objective or "arm's length," relationship between this City worker and the FMSI Board, or the three associations that it represented. This lack of objectivity contributed to the on-going default and non-compliance actions by the licensee.

In March 2001, the City hired a Facilities Operations Coordinator (FOC) for Market Square. The full job description is part of **Appendix Q.2**. The essential job functions included managing short-

term license agreements for events; supervision of maintenance and administrative personnel - hiring, training, scheduling, and evaluations; and budgetary responsibilities.

The individual employed had experience with FMSI and "Fiesta del Mercado" through prior employment with the YMCA. Records submitted, including Board minutes during the five years often referenced the individual. The records from February 17, 2000, **Appendix G.6**, noted that this individual wanted to participate in entertainment and margarita concession management prior to her employment with the City.

This City employee had specific knowledge, ample opportunity, and a public duty as a principal representative of the Parks Department to advise immediate management of license agreement defaults that occurred from April 24, 2001 until the license agreement ended in April 2003. There were notes of discussions about various concerns and issues with FMSI activities, with City Supervisors, and in some cases City Council Members. There was some documentation that the FOC acted to inform the Board about some issues and conditions that existed during the two-year period. These conversations and the correspondence appeared to result in compliance and/or correction of a few issues, which were not the major control related items.

The individual was not deemed objective in her role with the Market Square due to written documentation reviewed for periods prior to and after her employment. Invoices paid by FMSI in 2002, **Appendix Q.29**, showed this City employee as a contact person for the YMCA. The YMCA had an informal relationship with FMSI to operate the margarita and/or soda booths; **Exhibit XIX.3** is a draft contract regarding this arrangement between them.

Appendix Q.7 is a photocopied 2002 short-term rental contract that the FOC had FMSI execute for the "Fiesta del Mercado." This document illustrated that had the employee sufficiently understood the forms and procedures, it would have been apparent that the rental contract was inappropriate. May 15, 2003 correspondence in the form of email, **Appendix Q.24**, between the FOC and the Parks Contract Administrator provided some insight about the monitoring of the license agreement between 2001 and the termination in May 2003. This information fell short of addressing the substantial internal and management control problems.

The Parks and Recreation Department provided a large binder of information regarding the license agreement. It contained FMSI Board minutes; information on booth planning for the five-year period; email and other correspondence between the City, FMSI, and City Council Members;

association articles of incorporation; City staff job descriptions; insurance certificate information; and YMCA proposals for "Fiesta del Mercado." This material was extremely useful for the audit.

Parks management did not provide operating and/or monitoring guidelines or results of on going monitoring of this license agreement. There were no written notices of default or noncompliance given to FMSI during the five-year period. There were some notes of issues about default conditions or noncompliance, but nothing to indicate action initiated by Parks management to require compliance by FMSI. Among the informal notes was direction given by the Contract Administrator for Parks to another City employee to prepare a letter to FMSI regarding the issues raised by its CPA in the letter to management dated September 19, 2000, refer to **Exhibit III.2.** However, no documents following up on this were located.

There were limited documents addressing the role of City staff, especially the SAC, in relation to FMSI. This material explained and pointed out situations where the City staff appeared to collaborate with the FMSI Board and the association efforts to enhance their business interests. Generally, the services rendered were much broader than the job descriptions implied.

FINDINGS: Parks and Recreation Department's internal and management controls for Market Square operational functions involving FMSI and "Fiesta del Mercado," and for departmental monitoring of the license agreement were inadequate. This was generally the case for the entire five-year period based upon the documentation available for review. The purpose of the new agreement was to significantly improve controls for the Fiesta event because history, and audit information, **Appendix D**, identified prior internal and management control inadequacies.

City staff attributed the state of the control environment to various causes including:

- Perceptions about City Council directives or feedback for handling FMSI and/or LULAC. These perceptions were especially strong during the first year due to extensive publicity related to the agreement.
- Limited manpower to handle the operating and monitoring requirements of the entire Parks Department functions during this five-year period.
- Reliance on the Office of Internal Review to perform or assist with contract audits or control reviews.

Management of the Parks and Recreation Department failed to ensure that the staff had the appropriate job skills, policies and procedures, training, and supervision. This failure to develop and implement fundamental internal and management controls for the Market Square area gave FMSI and City employees opportunities over the five-year period to abuse and mishandle City resources. Monetary losses resulting from any theft, abuse, and/or misuse could not be determined based upon the available records and information.

As a result of such control deficiencies, City employees assigned to Market Square during the five-year term appeared to disregard the business practices used by FMSI to select booth operators and entertainment/promoters. FMSI was allowed to operate more booths than its agreement authorized for the license fee paid to the City, which may have caused an undetermined amount of incremental expense to the City, especially for police resources. City Parks staff allowed FMSI operations during the five years to operate in ways that were unfair and not equitable to the community in general as required by the license agreement.

The handling of this major license agreement demonstrated competency limitations in the operating and monitoring functions. The magnitude of issues, especially the lack of appropriate procedures and of fundamental staff supervision, indicated a high probability that similar control deficiencies have occurred with the short-term rental arrangements. Parks staff and management through their in-action permitted substantial breaches of this license agreement. City staff failed to provide written notice of default to FMSI for a variety of occurrences over the license term. Such notice would have required the termination process to begin had FMSI not complied during the allowed time. Had City staff acted in a timely manner, the inadequate business practices used by FMSI and acts of noncompliance may have been addressed between April 1999 and 2003. Through the default and related termination procedures, it may also have been possible to enforce the license agreement requirements applicable to LULAC, which would have resulted in greater proceeds.

RECOMMENDATIONS:

City Council and City Management should re-evaluate the policy issues and costs associated with enhancing the business opportunities for such a narrowly focused group. For an extended period of time, substantial City manpower and resources have been directed to assist the one hundred or so Market Square area owners/tenants. From documentation reviewed, it appeared that in its earlier years this was deemed necessary to develop the area's tourist traffic and small businesses. However, it

appears that these policies regarding the Market Square area have not been looked at for many years. The status quo continued which has now created new issues and problems to address, such as potential monopolization of City business opportunities by individuals, small groups, or organizations.

The City's Management Team should continue to address their organization and alignment changes to deal with the impact that the 2001 City Charter revisions had on the utilization and reliance on the internal review function for control monitoring and assessment. Contracts and agreements should no longer specify routine operational responsibilities for internal audit in their administration. Where this language currently exists, the departments should ensure that department monitoring functions are enhanced to cover these requirements until the contract terminates or can be revised.

It is further recommended that City Management consider the control benefits, uniformity of process, and cost savings that could result from consolidating all City contract-monitoring functions into a single organization. This solution would provide an opportunity for greater segregation of controls, for enhancement of the City staff skills related to control environments, and for overall improvement in the City's contract monitoring functions. A significant advantage of such a change would be improved detection and warning whenever City staff or vendors demonstrate noncompliance with license/contract terms.

It is evident from the audit work performed that while changing the Fiesta event operator is required; it would only be a partial solution. Substantial control thought process enhancements within the Parks Department are needed. City Management should strongly consider taking appropriate administrative actions to deal with the Market Square personnel and other Parks Department staff involved in the mishandling of this contract over the five-year period. Immediate reassignment of some individuals to other positions is recommended due to objectivity and performance impairments identified during the audit of this license agreement.

The City still needs to address the maintenance, security and promotional needs for Market Square. The Convention and Visitors Bureau (CVB) could potentially provide more cost effective marketing benefits to the City and its Market Square tenants. There appeared to be significant redundancy between the City staff positions and the large amounts paid by FMSI to firms and individuals for similar services. Handling tenant leases and related issues could potentially be consolidated with Asset Management's property and contract functions. Facility issues could be consolidated with similar Public Works functions in the vicinity of Cattlemen's Square. By doing so,

the Special Activities Coordinator position in Market Square and the Facilities Operations Coordinator positions could potentially be eliminated.

For the future, the City should evaluate its options for operating Market Square facilities and events. This could include outsourcing all property management functions and responsibilities for special events such as "Fiesta del Mercado." As an alternative, the City could elect to continue in-house property management, and only outsource the special events, or night, weekend and holiday celebrations in the plaza areas. The City could consolidate the Market Square with La Villita, Hemisfair, Sunken Gardens, and similar venues for purposes of event and property management. Whether outsourcing of any type occurs in the future, there must still be major improvements in the City's oversight, or monitoring, of such activities. Outsourcing is not a cure for the general absence of internal and management controls.

Performance Audit Results

Fiesta Market Square, Inc. (FMSI) Issues –

ISSUES: The performance audit procedures indicated that FMSI was substantially non-compliant with its license agreement with the City of San Antonio during the five-year period.

ISSUES: Records and information examined did not demonstrate measurable improvement in the control processes during the fifth year as compared to the prior four years.

Findings Related To License Agreement

FINDINGS: The following are sections of the license agreement that FMSI did not comply with for which a default notice should have been given, or the agreement should have been terminated:

Section 2 Demise (Use) of Premise – Locations, Dates, and Times

April 2003 corporate sponsorships were committed to by FMSI event promoters without adequate space in the licensed area. After the fact, FMSI contacted the City about other available space, and as a result the Public Works Department rented the Cattlemen's Square area for exhibits and booths for various corporate sponsors. This should have been addressed in advance with proper arrangements and details involving City property worked out prior to solicitation of sponsors. **Appendix T** further explains the timing and extent of the situation that occurred and the resolution proposed by City staff due to the actions taken by FMSI.

Section 2.8 Written consent for any use of Market Square facilities other than for "Fiesta del Mercado".

FMSI's financial and other records demonstrated the organization's use of the Market Square area for numerous events. For several non-Fiesta events in 2002 and 2003, it could be confirmed that a separate short-term rental contract was signed and paid for by FMSI. For several other occasions no records were located of short-term rental contracts and/or payments to use the City facilities.

The license fee paid the City for "Fiesta del Mercado" was not calculated to include other events for which a separate contract should have been prepared and paid for. In the FMSI minutes of February 2003, **Exhibit XXXVII.5** attached, the Board was inquiring of City staff present at the

meeting about "why they were not receiving the proceeds from weekends (events) being held at Market Square." No response was documented in the minutes or other correspondence about this question. This indicated that FMSI believed the organization was entitled to more proceeds than the license agreement covered.

Section 4.1 City of San Antonio's Consideration Due For Granting Hosting Rights. Payments were timely in 2000, 2001, and 2002. The payment for 1999 could not be confirmed by the documentation provided by FMSI or the Parks Department however, the 1999 financial statements does reflect a $50,000 expenditure for this fee. The April 2003 annual hosting rights fee was paid June 13, 2003; however, it was due May 15th.

Section 4.2 Taxes and/or Assessments To Be Paid By FMSI and All Exhibitors.

FMSI was required pay all taxes and assessments related to "Fiesta del Mercado" operations. This would include sales tax, and City permit and inspection fees.

For its own operations during Fiesta, FMSI was liable for sales tax on its beverage (beer, margaritas and sodas/aguas frescas) and miscellaneous (ice, pins, etc.) sales revenue. They should have reported and promptly paid the taxes when due in mid-May each year. Reports for sales tax were requested for examination in early June 2003.

FMSI taxpayer records from the Texas Comptroller's website, **Exhibit IV**, indicated that the required permit for FMSI was obtained April 20, 2001, or after two years of Fiesta events. FMSI balance sheets reported sales tax liability of $37,086 as of June 30, 1999; and no liability as of December 31, 1999. The $37,086 corresponded to the sales tax expense shown on the statements of activities for June 30th and December 31st, 1999. However, no disbursement record for this tax payment could be located in 1999. In December 2003, FMSI submitted records that indicated that the tax was paid using a different taxpayer identification number. The check number referenced, 6723, showed no entry on the excel worksheets provided by FMSI for 1999. There were no bank statements provided for September 1999 to verify when the check cleared. **Exhibit V** includes the data recently submitted by FMSI regarding the 1999 sales tax payment.

Canceled check, number 5324, to the State Comptroller for $27,981 which referenced "sales tax 2000" cleared the bank on March 12, 2001. The FMSI manual check register showed a similar notation for this check dated February 27, 2001. This payment occurred more than ten months after the 2000 "Fiesta del Mercado" event, which would indicate that penalties and interest to be paid.

For 2001, FMSI provided three receipts from the State of Texas, which showed payments of: $42,768 on August 31st; $4,275 on September 4th; and $582 on September 20th. The manual check register had these disbursements recorded as check numbers: 5589 dated July 12th; 5629 dated September 4th; and 5644 dated September 20th, respectively. The June 30, 2001 balance sheet and statement of activities reported $42,768 as sales tax payable and expense. It was concluded from this data that the sales tax for the April 2001 Fiesta event was paid more than three months late, which would have resulted in penalties and interest being assessed.

Check number 6022 to the State Comptroller for $43,494 cleared the bank on May 24, 2002, which indicated that the filing and payment for Fiesta 2002 was timely. This same amount was shown on the June 30, 2002 statement of activities for sales tax expense.

For the five-year period, FMSI was only able to provide the report filed in May 20, 2003, which documented $217,837 in taxable sales and $17,068 in net sales tax due and payable, **Exhibit VI**. A review of the bank statement showed that check number 6586 for this amount cleared on May 22nd. This was timely reporting and payment for Fiesta 2003.

The computation of taxes recorded as paid, that did not have filed returns for support, could not be reasonably recomputed based upon the financial statements and general ledger. In addition, the taxable sales as reported May 20, 2002 could not be recomputed. **Exhibit VII** illustrated the taxable revenue and sales tax computation verification procedures.

The independent public accountant (CPA) hired by FMSI brought unpaid sales tax to the Board's attention in the management letters dated August 12, 1999, **Exhibit III.1**, and September 19, 2000, **Exhibit III.2**.

The City is entitled to local sales tax; due to various internal and management control issues identified it apparently did not receive funds on a timely basis. It could not be determined if FMSI was billed and subsequently paid any penalties and interest.

Section 4.2 also required that FMSI ensure that the vendors/exhibitors during the Fiesta events reported and paid the appropriate sales taxes. No information or support was provided by FMSI to verify that the vendors had permits from the State. Nor did the records reflect any request or follow-up with individuals to determine when and if event sales were reported and the taxes paid on a timely basis.

State records were reviewed as part of the audit procedures to determine whether a group of recurring food and non-food booth operators or other vendors had a permit to do business from the

State; and if the State had them "on Vendor Hold" status for not filing and/or paying sales tax. Results from testing sixty-eight entities indicated that thirty of those selected were not located as of November 2003. Of the remaining thirty-eight, thirteen were non-permitted, and two were not set-up. Six of thirty-eight entities were "on Vendor Hold" status in November 2003. This meant that the City, State, and other taxing authorities were probably not compensated as required by law. Unfortunately, the amount involved could not be determined, as FMSI was not expected to have this data. It may be possible for the Comptroller's Office to locate the individuals/businesses involved and recover the tax, along with penalties and interest. **Exhibit VIII** provides the details behind this testing.

Section 4.3 Use of net proceeds shall be consistent with Article Four, the FMSI by-laws attached to the license agreement, and included as **Appendix B.3** to this audit report.

The Articles of Incorporation were submitted to the City Clerk with the license agreement. This same document was submitted to the Internal Revenue Service (IRS) and the Secretary of State for Texas. It listed ten categories of "permitted" activities summarized as follows:

1. "Improve tourism in Market Square.
2. Sponsor public events and celebrations that promote tourism in Market Square.
3. Advertise Market Square as a tourist destination.
4. Conduct the annual Market Square Fiesta Week celebration and to use the proceeds from such activities and events for purposes exclusively identified in this article four.
5. Solicit funds for the preservation of Market Square municipally owned public buildings and open spaces.
6. Publish, distribute, and offer for sale brochures, booklets, videos, or products that promote tourism at Market Square.
7. Provide training and seminars to Market Square businesses primarily engaged in sales of merchandise to tourists.
8. Operate a tourist information center at Market Square.
9. Represent common and business interests of the Market Square community within the tourism industry of San Antonio and before officials of local and state governments.
10. Do all of this without prejudice to the rights of the individual members, the community and the City of San Antonio."

Article Ten of the Articles, paragraphs A and C, refer to the use of net proceeds and the Internal Revenue Service Code. It excluded earnings of the nonprofit from "inuring" to the benefit of any director, and addressed "non-permitted" activities.

Various FMSI Board members approved expenditures during the five years that were not considered to be among the "permitted" activities categories. Actions initiated by the FMSI Board resulted in outcomes that favored a relatively small group and in doing so were potentially prejudicial

to the public. Examples of these are: selecting booth operators or event vendors; designating suppliers or service providers; and disbursements for goods or services.

Other activities not considered "permitted" included but are not limited to the following:

- Payments in excess of $107,000 to Board Members and their immediate or extended families, **Exhibit IX.1**. Checks were written for services rendered during Fiesta or as Board Member compensation, reimbursements for expenditures, purchasing merchandise from their individual businesses, meals and refreshments for meetings, and buying gifts (shirts, pens, etc.). Other items, such as equipment, hand tools, and a personal computer were purchased that were available for their personal or business use.
- Payments of $163,000 to FMSI and its three associations/affiliates (EMMA, SAFMPA and MSA) are detailed in **Exhibit X.1**.
- Payments to tenants and association member related businesses are listed in **Exhibit XI.1**. The largest of these included:
    - $9,750 paid in 2003 to Que Lindo Es Jalisco for drink containers (bones) (SAFMPA Member), **Exhibit XI.2**.
    - $2,100 paid to Patricia Alarcon (SAFMPA Member) for consulting services, **Exhibit XI.4**.
- Expenditures of $ 9,200 through September 2003, **Exhibit XII.1**, for a lobbyist registered with the City of San Antonio on behalf of FMSI whose main purpose was negotiating for a new license agreement.
- Payments amounting to $4,418 to a law firm for services to trademark "Fiesta del Mercado" as shown in **Exhibit XIII.1**.
- Some expenditures classified as contributions to non-profit events and organizations while some were recorded as other types of expense that were essentially contributions, **Exhibit XV**. Examples of these are the following:
    - Direct payment of $7,568 for nineteen hotel rooms for thirteen days for American GI Forum visitors – an acting group, **Exhibits XV.2 and XV.3**.
    - Entertainment, gifts and other expenditures for a Rotary Club Convention in 2001, **Exhibits XV.9 and XV.10**.

- Expenditures related to the Latino Laugh Fest in 2000, **Exhibit XV.11 and XV.12.** (No evidence was located that this was a not for profit organization.)
- Contribution of $3,500 to the Guadalupe Cultural Arts Center (GCAC), **Exhibit XV.4**; and another $3,500 to GCAC for the Valerio Longoria Scholarship Fund, **Exhibit XV.5**.
- Payment of $1,000 for a KLRN auction sponsorship by Jesse Moreno, **Exhibit XV.6**.
- Payment of $411 for electrical work related to the annual San Fernando Cathedral Passion Play, **Exhibit XV.13**.
- Spent $500 to sponsor a table for the Mayor's First Gala benefiting the Cancer Therapy and Research Center (CTRC), **Exhibit XV.8**.
  (No mention as to who attended.)
- Donation of $350 to United Care, **Exhibit XV.7**.

Selection of and payments for advertising, entertainment, media and other promoters during the five years appeared to include a small group of vendors. There was no documentation that demonstrated using generally accepted business practices, such as requests for proposals, advertised solicitations, or competitive bidding. FMSI Board minutes, **Appendix G**, reflected some discussions about proposals submitted and comparison of these amongst a small number of vendors. **Exhibit XIV** provides specific information about the limited group of goods and services providers.

- DBA: Fiesta Festival Rentals –Owner, Raymond Guajardo $112,072 in rents for booths, tents, etc., **Exhibits XIV.3, XIV.4, and XVI**.
- DBA: Groove Entertainment- Principals, Mark Grado and Mac Hernandez $15,487 for promotion and entertainment services, **Exhibits XIV.3, XIV.4, and XVII.2**.
  La Ley Radio $14,250 for promotion and entertainment services, **Exhibits XIV.2 and XVII.8**.
- Martin [Mike] Ortega $16,950 for sound systems services, **Exhibit XIV.3, XIV.4, and XVII.5**.
- Mariachi Azteca $46,500 for entertainment, **Exhibit XIV.3, XIV.4, and XVII.11**.

- Mexico Espana Dance Co. $31,700 for entertainment, **Exhibit XIV.3, XIV.4, and XVII.12.**
- Patricia Horsford (Groove Entertainment until March 2001, and former spouse of Mac Hernandez) $42,750 for promotion and business management services, **Exhibits XIV.3, XIV.4, and XVIII.**
- Ralph Wooster $16,796 for event cleanup services, **Exhibits XIV.3, XIV.4, XXXIII.4, XXXIII.5, XXXIII.6, and XXXV.1.**
- Jose Ignacio Martinez $11,000 event cleanup services, **Exhibits XIV.3, XIV.4, XXXIII.2, XXXIII.3, and XXXV.1.**
- John Aguayo $23,866 for Market Square security guard services, **Exhibits XIV.3 and XIV.4.**
- YMCA $76,939 for margarita and soda concession management services, **Exhibit XIX.**
- Soft Frozen, owned by Dean Stanke of Houston, Texas $53,308 for frozen beverage products, **Exhibit XX.**

Numerous individuals have been paid by the organization over the five-year period. The FMSI Board minutes, **Appendix G.14**, referred to obtaining a legal or Internal Revenue Service opinion about whether anyone being paid qualified as an "employee." Records were not submitted to indicate that any payroll tax returns were filed or that taxes paid at any time during the five years. As a result, during four of the five years, these persons should have been given 1099 Forms for miscellaneous compensation paid, refer to **Exhibits XIV.3 and XIV.4.** A copy of these forms should have been submitted along with a transmittal document Form 1096 for years 1999, 2000, 2001 and 2002. The filing of these forms for 2003 is due in January 2004. This would include individuals working as event contract labor as well as those who rendered other services, such as promoters, entertainers, sound engineers, public relations consultants, attorney, accountants, maintenance. It may also have been required to submit a Form 1099 for rents to the individual who provided the booths for the events.

Summary Of Compensation Reportable On Form 1099

Form 1099 Miscellaneous:	**1999**	**2000**	**2001**	**2002**
Amounts Paid Over $600	$107,622	$173,028	$181,258	$250,626
Number Of Individuals	86	103	99	133
Form 1099 Rents:				
Amounts Paid Over $600	$15,037	$20,880	$23,365	$26,605
Number Of Individuals	1	1	1	1

Section 4.4 Required that the 501 (c) nonprofit status of FMSI be secured.

Records provided, **Exhibit XXII,** indicated that this was accomplished March 1, 2000, or 59 days late.

Section 4.5 required payment to the City annually of a $2,000 damage deposit.

The amount was to be paid ten days prior to "Fiesta del Mercado." A record of the deposit for 2000 could be located in the check register or the general ledger; however, there were no records for other years. Likewise, deposit refunds were expected after the City inspected the property following the event. Only one of four years showed such transaction.

FMSI indicated that checks were written for the deposit and later returned by the City. On December 1, 2003, FMSI submitted check copies and registers to show the 1999, 2001, 2002, and 2003 deposits.

Section 5 Use of Premises.

This section provided specifications about the "Fiesta del Mercado" event booth planning process.

Section 5.1 Stated that the license granted was for the sole operation of the "Fiesta del Mercado."

Records showed that FMSI signed rental agreements for other events during the five years. Supporting material provided showed that these and other events were sponsored, or paid for, with FMSI funds. The license agreement essentially provided for only "Fiesta del Mercado" to be held using these funds and the related bank account.

Section 5.4 through *5.8* Space assignment and approval, nondiscrimination in process, sub-leasing and assignment of spaces to vendors/exhibitors, limitation on number of spaces, booth variety, and establishing and approving rental fees; reference to license agreement.

This section required that the Market Square Office of the Parks and Recreation Department approve space assignments at least 45 days prior to the event. The documentation located indicated no formal review and approval by the Market Square and Parks Department.

FMSI stated that advertisements for the lottery system were run each year, but no such documents were available for verification. There was information, in the form of minutes and other notes or documents, which would infer someone in the Parks Department had information to review for at least four of the five years. However, this data may have only included the food booths, Exhibit C of the license agreement.

For nonfood booths and vendors, FMSI documentation showed that fees varied and sometimes changed after a contract was signed or during the event. There was no data as to how the vendors were solicited or chosen, and various vendors were used repetitively during the five years. Several of these individuals were not from the local area or state.

Section 5.9 stated that FMSI had sole fiscal accountability as required in Section 16.18 for booth activities.

Section 5.9.1 designated that "off premise" alcoholic beverages would be sold exclusively by FMSI.

An April 2003 deposit of approximately $2,500, **Exhibit XXIV.3**, represented proceeds from a 2002 beer concession granted to a booth in the carnival area near Flores and Dolorosa Streets. No contract or written agreement was made available concerning this arrangement so the amount paid could not be verified. This was clearly not compliant with the license agreement because of the location.

FMSI allowed the YMCA to operate the margarita/wine concession for several years. In September 2000, FMSI paid the YMCA a check for $75,896 related to the soda and margarita concessions. There was no documentation to support the computation or authorization for this payment. Unsigned proposals from the YMCA were presented by FMSI and Parks staff, which did not help in verifying the payment, refer to **Exhibit XIX** for the related documentation.

Section 5.11 referenced the provisions of the license agreement that related to LULAC operating in the Gateway area.

Section 5.11.1 granted LULAC 12 booths in the Gateway area for each of the five years.

Information indicates that during the five years, they may have had more than the 12 booths. LULAC was required by Exhibit C of the 1999 license agreement to pay $2,000 per booth, or $24,000 for 1999. For five years, this would have totaled $120,000 in proceeds from LULAC for the booth rentals.

FMSI submitted documents on December 1, 2003 for LULAC proceeds. These included copies of two checks before deposit; number 91 for $6,912 and number 92 for $4,500 dated April 20, 2001. These two checks were traced to a combined deposit of $11,412 shown on May 15, 2001. The general ledger posting showed this deposit as sales revenue from food vendor fees. The $4,500 amount was per Section 5.11.2 for "aguas frescas" beverages instead of food vendor fees.

The $6,912 deposit does not compare to the $24,000 amount required for booth rental fees under the original Exhibit C of the license agreement.

FMSI submitted a deposit slip copy for April 2003 in the December 1, 2003 documents. It listed three checks number 1025 for $7,000 (booths 2002), number 1026 for $4,500 (aguas 2002), and number 1027 for $3,673 (booths 2003).

The combined deposit of $15,173 was traced to the April 28, 2003 bank statement posting. This amount was then traced to the general ledger posting of a similar amount in the revenue from food vendors fees dated April 28th.

LULAC proceeds of $106,088 for booth rentals fees could not be located in the bank statements or general ledgers for the five years. Correspondence by the FMSI Board and the minutes, **Appendix C**, showed difficulty in collecting the payments from LULAC. The FMSI Board submitted letters to them for payment, which were not answered or were answered without payment. The minutes indicated that the Board was not in agreement regarding collecting fees owed by LULAC. This contributed to the lack of response from the organization, and the lack of action by the Board to require payment.

Several FMSI Board Members and/or their immediate families were serving LULAC in either a volunteer or compensated capacity. An example was Director Gregory Pena's father and employer Roman "Nick" Pena served on the LULAC Board. Director Isabel Sandoval's sister Ms. Angie Garcia actively worked for LULAC. This appeared to create a conflict within FMSI such that the "Board of

Nine" could not obtain a majority to enforce the license agreement provisions, especially about payment. Without consensus amongst the FMSI Board during the five years, action taken to collect from LULAC, or to enforce advance payment, were inadequate. This included attempts to solicit assistance from the City Parks staff or from the Council District 1 Member.

Section 5.11.2 extended exclusive rights to LULAC to sell "aguas frescas" in the Gateway area for each of the five years in exchange for a $4,500 annual license fee.

Records submitted by FMSI on December 1, 2003 showed specific reference to $4,500 paid on check number 92 for April 20, 2001, and another check number 1026 for $4,500 deposited April 2003 for the 2002 aguas frescas fee. No records were presented showing that LULAC paid this amount for 1999, 2000, and 2003. This would have been $13,500 in proceeds from LULAC.

Section 5.11.3 stated that FMSI would share fifty percent of the net revenue from sodas and margaritas sold in the Gateway area with LULAC.

Checks paid by FMSI for 2001 and 2002 were located which indicated a split of the net revenue; however, the computations for these splits could not be recalculated, or verified. These payments amounted to $ 9,000 for both years.

Despite not being properly paid by LULAC, FMSI continued to provide electrical, booths, entertainment, and other services to the organization. Discontinuing these "free" services and accommodations could have been used to leverage LULAC's compliance; however, this was not attempted. These represented substantial expenditures that could have been used for other purposes.

Section 6 addressed provisions for the term and termination of the license agreement.

It specified a process for the City to give FMSI written notice of termination if it were in default. Thirty days was designated as the period to remedy the default. Only ten days were granted if the default involved rent, which did occur in 2003.

No formal documentation was presented by either the City staff or FMSI that indicated any written notice of default and/or termination. Ample evidence was encountered in the audit to conclude that in each of the five years one or more default events occurred for which notice should have been given. City staff indicated that they gave them verbal warnings and mandates to perform according to the license agreement. There were some emails and notations of discussions between the staff and FMSI about various license agreement issues. From the on-going actions of the licensee, the organization did not recognize nor express concern that it may be in any jeopardy.

Section 8 detailed issues relating to utilities, including temporary electric services and who was responsible for it and the related costs.

Evidence of payment to the Centro Alameda for reimbursement of electric usage for 2000, is shown in **Exhibit XXV**. It could not be determined how water consumption during the five years and other years of electric usage were metered or paid for. This appeared to be un-reimbursed costs to a tenant/owner, or more than likely the City of San Antonio.

Section 9 specified that permanent improvements to be made with funds from FMSI must have advance approval of the Parks and Recreation Department.

From the payments made with supporting documents or check register notations, it appeared that the City staff requested FMSI to pay for certain costs related to Market Square repairs or improvements. Payments were made directly by FMSI for costs related to the visitors' center at Market Square. These expenditures were in compliance with the license agreement; however, FMSI recorded the visitors' center conference room furniture, about $3,800, as their capital assets instead of a contribution to the City of San Antonio. The payments reported as contributions for the facility included: $40,000 for heating and air conditioner replacements, and $8,000 for window glass. Further details are shown in **Exhibit XXIII.10.**

Section 10 stated requirements for maintenance of the premises during the "Fiesta del Mercado" Event.

FMSI had expenditures for solid waste removal, contract cleaning services through an agency, and contract cleaning services with several individuals. The services for waste removal, for steam cleaning, and for temporary cleaning services appeared to be permitted costs; however, they did not appear to have been competitively bid in spite of the significant amounts paid. **Exhibit XXXV.1** summarizes the costs incurred in five years in relation to annual revenue.

Several vendors, Mr. Jose Ignacio Martinez, Mr. Ralph Wooster, Mr. Quintanilla, and Mr. Valenzuela lacked or had inadequate supporting documents for the funds expended to them, refer to **Exhibit XXXIII**. There was no evidence of competitive bidding for purposes of awarding such large engagements in 2000, 2001, and 2002. As contractors, who may have had crews working at Market Square, they should have had formal contracts with proof of adequate insurance, especially workers' compensation. These individuals should have been issued Form 1099s by FMSI for 2001 and 2002.

Section 11 addressed requirements for FMSI and its vendors to comply with federal, state, local and other tax and license requirements.

Failure to comply was a cause for default/termination. The CPA hired by FMSI submitted letters to management dated August 12, 1999 and September 19, 2000 and each had statements about the sales tax reports not being filed and paid timely, which should have resulted in unnecessary penalties and interest. Minutes from March 1, 2001, **Appendix G.34**, documented the late reporting and payment of sales tax for 2000. A search of the Texas taxpayer and vendor account information records in November 2003 showed that the sales tax status for FMSI had been active since April 20, 2001, the date that the permit was issued. This was about the time of the third "Fiesta del Mercado." Clearly, default occurred during the license period due to sales tax issues. While written notice from the City was not given to remedy the default, it seemed to be corrected by the fall of 2001.

FMSI records submitted for 1999 showed a liability of $37,086 as of June 30, 1999; this liability was not shown on the December 31, 1999 balance sheet. No check was located on the excel worksheets of receipts and disbursements, or the list of accounts payable for 1999 that FMSI submitted in lieu of a formal general ledger. On December 1, 2003, FMSI provided a record from a prior Board Member that showed check number 4671 in the amount of $37,086 paid in September 1999, see **Exhibit V**. Accompanying support also indicated that the sales tax was paid under a different permit. FMSI indicated that it was the number for the Tres Amigos organization, but this was not confirmed. Neither the 1999 nor 2000 general ledgers reflected such a payment or the check for this transaction.

This was not considered reported and paid timely based upon state sales tax guidelines. It should have been paid and reported by mid-May 1999. The state requires organizations to use their own permit numbers for filing and paying taxes; therefore, using "Tres Amigos" was not appropriate.

Additional detail regarding the timeliness of sales tax reporting and payment have been addressed earlier on pages 20 through 22.

As of November 2003, FMSI had an active permit and was not on "vendor hold" by the State.

Sections 11.1 and *4.2*, addressed the issue of FMSI ensuring under the license agreement that exhibitor/vendor taxes, including sales tax, be paid.

Since FMSI had a direct responsibility in this regard, a procedure should have been implemented for exhibitors to show proof of valid Texas permits. No records were provided to show any type of permit verification process.

As part of the audit procedures, a sample of the list of booth operators or vendors selling food and nonfood items was selected for comparison with state records. The purpose was to determine if

the vendors had a sales tax permit in Texas, when it was issued, the location address, and the "hold" status.

Exhibit VIII summarizes the records research results. Permits or status in Texas could not be located for thirty of sixty-eight vendors selected for testing. Thirteen of the remaining thirty-eight vendors showed a "non-permitted" status on Texas records, while two were identified in the state system as "not set-up" as yet. Six operators of twenty-three remaining in the test sample had a permit in Texas but were on "vendor hold" status due to unresolved issues with the Comptroller's Office. It was likely that the issues were related to late reporting and/or non-payment of sales tax. The overall result was that seventeen operators selected to test were permitted and clear of issues with Texas. Available public data does not report the amount of taxable revenue and related sales tax for these entities.

State and local taxing authorities may still be owed money from the Fiesta events during the five years by the exception vendors above and possibly others not selected for testing. The amount that was potentially due could not be determined. As an example, a vendor from another state paid FMSI $8,800 per year for several non-food concession rights. Since no record existed in the Texas database for this business, it was unlikely that he paid the appropriate sales tax or filed the reports required.

Similarly, it is felt that Mr. Obregon should have filed and paid sales tax on beer sales in 2002 from the booth using the FMSI beer permit. We could not locate record of a permit for him.

FMSI was in default for not complying with the tax requirement themselves and for not ensuring that the operators had the necessary permit and paid the required sales taxes.

Section 12 addressed the issues of assignment and subletting which required the City's written approval and City Council authorization through an ordinance.

There was an undocumented arrangement with Mr. Obregon in 2002, which resulted in a $2,500 deposit in April 2003 for the prior year Fiesta event, refer to **Exhibit XXIV.3**. FMSI indicated that this individual's booth was located in the carnival area, of Flores and Dolorosa Streets, and that only use of the FMSI beer license was involved.

Other booth or vendor arrangements granted by FMSI over the five years may have been outside the specifications of the license agreement. For example, an FMSI agent obtained a sponsorship with Toyota. This resulted in obtaining Public Works authorization to use the Cattlemen's

Square area after the engagement was made, **Appendix T**. City Council was never asked, nor approved such which constituted a change in the license agreement.

Various documents obtained for the audit indicated that FMSI may have granted tenants and/or association members' booths to conduct their own for profit business. The tone of the remarks as recorded in the minutes did not seem compatible with City Council's thoughts in 1999. When requests were made of FMSI by the auditors to confirm this situation, it was denied several times. It appeared that the Board granted booths to several sponsors to do on-site solicitation for profit to sell their products or services, as distinguished from simply displays or advertising opportunities as part of the sponsorship arrangement. FMSI minutes in 2002, **Appendices G.45, G.46, and G.47,** and 2003, **Appendices G.61, G.66, and G.67**, implied that booths for sponsors and tenants took priority over any other categories of exhibitors. The statements recorded in these last years seemed far removed from the intent of City Council in 1999 to make this event a meaningful celebration and cultural experience.

These occurrences were evaluated as noncompliant with this section of the license agreement.

Section 13 addressed default issues and the noncompliance and remedy or cure requirements within a period of twelve hours after written notice.

FMSI was in default in various ways and certainly not fully complying with its license agreement throughout the five years. There were ample events and documentation at the Parks and Recreation Department's disposal, especially the FMSI CPA's reports and related letters to management, and the Board minutes, to support delivering written notice of default or termination.

FMSI was not maintaining an "arms length" in dealings with City staff at Market Square. Their minutes and other correspondence reviewed indicated that FMSI appeared to give specific work direction to one or more City employees during the license period. City Parks staff appeared to have accepted some direction from FMSI and its member associations to avoid negative comments and feedback about their performance being relayed to the City Council or to the City Manager.

The extent of the customer service provided for this license agreement and related activities appeared to be a misuse of City resources and manpower during the period April 1999 through April 2003. Without being addressed by management, it probably continues today, therefore, the audit results include concerns about whether FMSI actions violated any laws or regulations about misuse, theft or abuse of public property and resources. Audit standards permit raising the increased risk or potential for such issues; however, local, state or federal authorities must make any specific legal determination.

Section 15 gave details of insurance required under this license agreement. No record of workers compensation coverage was located. It was required if there were employees. No documentation was provided to ensure that all subcontractors or contract labor used had their own such coverage. Also there was an unresolved issue about liability coverage required which was not documented.

FMSI minutes in 2000, **Appendix G.2**, included discussions about an accident involving an entertainer in 1997 or 1998. The injured individual apparently sued the former organization for damages sustained which required hiring an attorney to resolve. This documented case highlighted the reason for the license agreement having specific insurance requirements. Their minutes also indicated remarks from an attorney that encouraged requiring contractors, including performers, to show proof of proper coverage. Data provided did not show that this was done which resulted in FMSI assuming substantial risks from its contractors.

The lack of appropriate insurance verification procedures and practices was determined to be not in compliance with the license agreement.

Section 16 stating the rules and regulations for operations of FMSI's "Fiesta del Mercado" event was a critical part of the license agreement.

Section 16.4 stated that no gambling activity was allowed.

Beginning in 1999 and through 2003 some form of lottery system was used each year for the assignment of food booths, including some beverages. Annually substantial numbers of chances were sold at either $25 or $20 each to enter a drawing for specific booth types and locations. FMSI did use the services of a CPA to guide them in this process in 1999; after that the organization appeared to proceed on their own using similar practices. They submitted to the City the annual plans and pricing for these drawings. FMSI indicated in November 2003 that they had run advertisements in the local paper announcing the annual lotteries to the public. No advertising copy was provided for review, however a copy for a public service announcement that may have been sent to the paper was reviewed.

Generally, the documents reviewed regarding this process appeared to demonstrate a type of gambling activity by FMSI. Recently, City staff verbally notified them that lottery processes could no longer be utilized because they deemed it to be a form of gambling.

The City should have issued FMSI notice of default and/or termination concerning this activity. Excerpts from the state statutes that define "gambling" and "lottery", attached as **Appendix R,** were used in the audit to make this finding.

FOOD AND BEVERAGE BOOTH REVENUE

Year	Contracts	Lottery Tickets Sold	Price Per Ticket	Lottery Proceeds Per Receipts
1999	21	1,244	$25	$31,100
2000	24	1,633	$25	$40,825
2001	25	1,335	$25	$33,375
2002	24	2,073	$20	$41,460
2003	21 5*	1,135 0	$20 NA	$22,700 0
TOTALS	**120**	**7,420**	NA	**$169,460**

*Note: 1 "Aguas Frescas"; 2 Specialty Items; and 2 Ice

Section 16.5 required that FMSI not discriminate in its operation.

Several references in Board minutes refer to complaints by third parties of perceived discrimination through various activities. Documentation submitted by the Parks staff also included correspondence from third parties about perceived discriminatory practices by FMSI. The manner of notifying organizations about the availability of booth opportunities appeared to be limited, and as a consequence favorable to a rather small group who were for profit operators. Some of these individuals were tenants of Market Square, immediate family, or closely related associates. A schedule of individuals that had recurring opportunities for selling products during Fiesta has been included as **Exhibit XXIV.2.**

In addition, there did not seem to be reasonable process in place for competitively soliciting and contracting with vendors to provide products and services to FMSI. Various key expenditures were made to the same vendors over the five-year period. FMSI responded that repetitive use of certain vendors demonstrated nothing more than satisfaction with their products or services. Examples of the

larger repeat vendors can be found in **Exhibits XIV.2 and XIV.3,** which list the highest paid providers of goods and services to FMSI during the five years.

Section 16.14 and *15* discussed the process for event entertainment, including a plan for hiring, scheduling, etc.

A proposed plan was to be submitted annually to the City's Market Square Office for approval. Documentation provided indicated that the Market Square staff had knowledge of the various activities related to acquiring event entertainment. In the documentation of their Board deliberations about entertainment promoters and acts, there were references to using persons that were Market Square tenants, or that were FMSI Board Members relatives or friends. There also were comments about using certain persons or firms without using generally accepted business practices to solicit, evaluate and select them. These have included the following examples:

- Bill Angelini
- Groove Entertainment represented by Mark Grado, Mac Hernandez, Patricia Horsford (former spouse of Mac Hernandez)
- Jason San Miguel
- La Ley Radio
- Sound City Productions
- Margo or Mirta Morones as individuals, or as The Embroiders
- Mariachi Azteca
- Mexico Espana Dance Company
- Martin [Mike] Ortega Sound and Lights
- San Antonio Entertainment Network (represented by Louis Ramirez

Examination of various entertainment contracts, payment records, and canceled checks reflected unusual relationships between the entertainers, the promoters, FMSI, and its promoters. From the signatures on the documents and endorsements on the checks, there appeared to be a pattern of role swapping amongst some of those named above.

Section 16.18 stated requirements for FMSI to ensure that proper financial controls were in place.

An event like "Fiesta del Mercado" should have formally written policies and procedures to ensure that the substantial amounts of cash handled are appropriately collected, deposited, accounted for, and reported. The City anticipated this by incorporating into the license agreement various provisions for accountability and control. This included engaging a CPA to oversee the booth assignment process, which was done for 1999. However, no information was submitted to reflect that a CPA participated in the other four years.

No records or documents for daily cash controls and reconciliation were presented for the audit by FMSI even though substantial sums of cash were processed daily during Fiesta. The CPA used for the annual filings with the City Clerk provided the FMSI Board with a management letter in 1999, 2000, and 2001. These reports to management included observations and comments about cash management, accounting, and Board policy issues. The documents reviewed in this audit and the information not provided for the review indicated that these issues were not corrected or properly addressed by the FMSI Board during the five-year period.

This section also required that the bank account to be used for "Fiesta del Mercado" be exclusive. It appeared that an existing bank account was converted by FMSI in 1999 due to disbursements prior to the contract date. There are multiple examples of deposits and expenditures in the general ledger and shown on bank statements and check registers for events other than "Fiesta del Mercado."

As part of the audit procedures, reconciliation of cash, checking and investment accounts with available external records, such as bank statements, was performed. **Exhibit XXVIII** illustrated the results; however, this could not be compared with FMSI data as reconciliations were not provided for almost all months of the license period. Having a monthly reconciling process and related procedure is a very established and generally accepted internal control. The CPA letter to FMSI management dated September 19, 2000 advised the Board that this was not being done but certainly should be done monthly. It was unclear how the organization Treasurer could report on finances without such a formal process. The report could have been related to balances as reported by the bank.

Lack of adequate cash controls during the five years provided an opportunity for proceeds received during the Fiesta event to be stolen or mishandled. Consequently, an undetermined amount of revenue may not have been accounted for, deposited and reported. Duties of numerous contract personnel used by FMSI to manage/operate booths were not properly segregated as required by the

license agreement. Individuals handled goods for sale as well as collected the cash from customers. FMSI had no daily reconciliation of product sales to purchases and to cash deposited. Cash safeguards were also of concern as it was unclear where the daily proceeds were held for safekeeping prior to the daily bank deposit. There was no record of using an armored car service to pickup, hold, and deliver the daily cash to Plaza Bank. It could not be determined from the minutes who was responsible and accountable for the substantial amounts of cash each day during Fiesta.

In addition, substantial amounts were withdrawn from the bank account each year for change and petty cash funds. The use of these funds was not properly accounted for in the financial records. At the end of the license agreement, there appeared to be about $8,000 that had not been reconciled or accounted for.

Section 19 conflicts of interest were prohibited.

Board Members and their families, and through inference their business establishments, could not receive payments for services or be involved in hiring entertainment or in the lottery for booths.

Board minutes and disbursements support that many such payments occurred. There are instances of Board Members such as 'The Morones' being paid for entertainment services or promotion management. There are instances where Board Members discussed and approved paying for services by other Board Members family related businesses, such as Yvette Ramirez's father, Louis Ramirez, in conjunction with the San Antonio Entertainment Network. A payment of $4,000 to Long Horn Diner, which has been operated by S. Barker Washburn, a Board Member. Numerous payments to individuals of the Herrejon Family, the Cortez Family, the Pena Family and business, the Barker Family, and others. These payments are all considered violations of the license agreement.

Additionally, the IRS has rather specific requirements regarding 501c(6) business league nonprofit entities regarding not using funds that would "inure" to the benefit of organization members individually or through their businesses. It appeared likely that all of these payments violate these provisions and that these violations, in some cases, have been intentional in spite of a warning in management letters by the independent auditor that they should be very careful about such payments. These type payments accounted for a substantial amount of the disbursed net proceeds over the five years. This was obviously one of the more publicized and critical problem areas for the FMSI Board and member associations.

Section 27 explained the amendment process for the agreement.

The document was explicit in the requirement to have all terms and conditions in writing. It also was clear that all amendments needed an ordinance.

Actions documented in the FMSI Board minutes enumerated many events that were not in compliance with the license agreement. These have been previously detailed in the report. The minutes or other documents infer or refer to City staff being involved or having had knowledge of many of these occurrences.

Regardless of City Parks staff knowledge, FMSI had an obligation and contractual requirement to bring these rather significant actions to the City Council for its review and approval, or denial. Merely having an approval from a majority of the FMSI Board Members was not adequate to override the license with the City.

FMSI Board approval may also not be acceptable in terms of concerns about violations of federal, state and local laws or regulations noted during the audit and referenced elsewhere in the report.

Findings Related To Internal And Management Controls

FINDINGS: Audit procedures demonstrated that FMSI had substantial internal and management control deficiencies during the term of the agreement. This was unexpected since the FMSI Board always included nine individuals who were experienced business owners or managers. It also seemed unusual given the FMSI Board's propensity to use professional services during the five years, such as attorneys and certified public accountants. The records provided gave specific examples of recommendations from these professionals about actions that the Board should consider to ensure against legal or contractual problems.

FMSI did not provide reasonable documented evidence that the Board and its contractors used generally accepted business practices and accounting principles in the large volume of cash transactions related to sales revenue and change funds. There were no records of inventory procedures and control processes used during the five years. Several large hand tools and equipment were purchased that need to be accounted for. Among them are personal computer hardware and software. These items could be turned over to the Market Square Visitors' Center for common use and control instead of personal use by FMSI or its contractors.

The records provided did not include financial authorization and approval requirements for banking activities. FMSI did not submit reports of bank or fund reconciliation to the general ledger accounts for any period from 1999 through September 2003. The CPA letter to management commented on this in 2000 and recommended that it be routinely done. There were various cases where canceled checks provided for review had only one of two required signatures. In addition, among them were checks signed by someone who was also the payee, or receiver of the funds. Cash on hand from Fiesta was used to cash very large checks for vendors, such as check number 1232 to Raymond Guajardo in the amount of $21,000 dated April 15, 2001. This is not a recognized accepted accounting or control practice, and was viewed as irregular.

Significant numbers of disbursement transactions have not been supported with appropriate invoices and other documentation. FMSI did not take reasonable steps to require, capture and secure such records. This inaction occurred despite three written comments and recommendations from the CPA hired by the Board.

This CPA gave written warning to the Board from 1999 to 2001 that certain transactions approved and subsequent disbursements authorized may violate the 501(c)(6) nonprofit status of the corporation. Payments to and purchases from members of the three tenant organizations continued, and substantial amounts were distributed to the three associations without support. FMSI was incorporated as a business league entity; it represented fewer than one hundred members. Through the events held during Fiesta and at other times, the tenants realized direct and what appeared to be significant economic or financial benefits. An even smaller group of association members received direct payments from FMSI for goods and services. It seemed unlikely that the City's operating leases with these tenants were priced to include these additional benefits. Without notification by City staff, the Council and Mayor would not be aware of such economic benefits.

The Board of Directors did not establish and implement adequate policies and procedures to ensure that their actions were properly documented in minutes as required for incorporated entities. It did not develop and implement reasonable records retention and document processes for this agreement. This results in some unresolved audit questions about receipt and disbursement transactions. In December 2002, FMSI approved By-laws changes; however, there was no record or indication of such revisions being submitted to the Secretary of State for Texas or the Internal Revenue Service. Revising

the By-laws was also a default of the license because the originally approved version was part of the agreement.

The practices and procedures used to select booth operators and providers of goods or services appeared to show discrimination and favoritism. As a result, this significantly limited the participation of nonprofit organizations and local citizens in the Fiesta event. Another consequence of no competition was the potential to pay more than fair market price for goods and services, which would reduce the funds available for Market Square improvements and programs.

RECOMMENDATIONS: LICENSE AGREEMENT PERFORMANCE AUDIT

Based upon the examination of available records, the audit has confirmed various observations and comments that the CPA expressed in the three letters to FMSI management. Documents provided and those missing or unavailable demonstrated that the Board of Directors did not act to correct the internal control and management problems identified early in the term of the license agreement. Of particular concern were minutes and other correspondence submitted or comments by FMSI representatives during the audit. After the exit conference, written responses further expressed deliberate intent regarding certain inadequate and inappropriate business practices and issues.

Since the license agreement ended April 2003, FMSI has no opportunity to resolve audit issues that were identified. However, there may still be actions that the City could and should initiate for closure regarding several issues.

The City Manager should direct the City Attorney's Office to initiate legal action to require Fiesta Market Square, Inc. to transfer any trademark rights that are registered in its name, including "Fiesta del Mercado," as this was improperly obtained with the assistance of public resources.

The City Manager should request a legal opinion from the City Attorney's Office about potential civil claims or actions that could be brought against FMSI Board Members and any insurer that they may have for Directors and Officers coverage. The purpose of such inquiry would be to determine if the City could recover funds improperly disbursed by FMSI to its directors, and member associations or their members. Also, to ascertain if the City could require LULAC to submit rents, fees, or un-reimburse expenditures that were not paid during the five years.

The City Manager should inquire of counsel as to the legal status of Fiesta Market Square, Inc. regarding opportunities for future short-term rental arrangements. It would seem that without "Fiesta del Mercado" this nonprofit group would no longer be a going concern for legal purposes. This inquiry should include a determination if the City of San Antonio could act to place the three associations that comprised the "Board of Nine", EMMA, SAFMPA, and MSA, on a "Suspense and Debarment" List for any City contracts for an appropriate period of time. If this is not possible, it is recommended that the City not permit FMSI or the three associations (EMMA, MSA, SAFMPA) that comprise FMSI to enter into any City contracts for a minimum period of one-year.

The City Attorney's Office should evaluate and recommend to City Council actions that it should take regarding ethics violations or inappropriate acts by individuals involved, including current or former Directors of FMSI. These acts may also warrant reconsideration by City Council of appointments involving these individuals to various City Boards and Commissions.

The audit produced ample information to conclude that one or more violations of local, state and federal regulations and/or laws may have occurred. It is recommended that the final audit report be forwarded to the Bexar County District Attorney's Office, the Texas Attorney General, Secretary of State and Comptroller Offices; and the Treasury Department and Internal Revenue Service. Audit standards require that this data be submitted to these entities for investigation and determination about any crimes that may have occurred.