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June 14, 2004

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Terry M. Brechtel
City Manager

Enclosed is the report for the audit of the Food and Beverage Service Agreement for the Henry B. Gonzalez Convention Center. This audit was to determine if the RK Group Joint Venture complied with its contract. No one disputes that the RK Group of Companies has performed well for the City of San Antonio, and that their high quality innovative service has enhanced the City's offerings to convention and meeting Clients. Given the community's general knowledge and satisfaction with the services provided by the RK Group, including the Joint Venture, other areas of the contract were emphasized for evaluation and testing.

This engagement began in the spring of 2002 by establishing an objective for the audit, and by developing the scope and related planning activities. In early 2003, the audit team began to focus on the major issues and findings which included: security, minority partner participation, purchases from small/minority and/or woman owned businesses, equipment inventories, and recycling.

Work at the Convention Center by the RK Group Affiliate organizations surfaced as an area of interest that needed clarification. It became apparent that work performed off-site, that is away from the City's facility, by the RK Group Joint Venture Partners and/or its Affiliates also required clarification. After a February 2003 meeting with the Managing Venturer, additional documentation was provided, primarily Invoice History Reports for Catering by Rosemary, Inc. and Circa Texas, Inc. Preliminary analysis of this information occurred in spring 2003; and as a result, the audit was expanded. The objective was then to include comparing events at the Center with the commissionable sales revenue reported, and supporting records, to the City, and with the Invoice History Reports for the Managing Venturer, Catering by Rosemary, Inc., and for Circa Texas, Inc., an RK Group Affiliate.

While the audit was in progress in 2003, organizational changes occurred in City's Internal Audit Department and at the Convention Center. The audit was temporarily interrupted due partially to the staff transitions. Other audit work scheduled also contributed to this project being delayed until January 2004. In a series of conferences and meetings with City Management and Staff, the various contract compliance issues were discussed at length. This included the areas of work on-site that may not have been reported as referrals and of work off-site that may not have been reported as awarded without the specified competitive bidding processes.

The Facilities Director and his Staff worked with the Managing Venturer to answer and/or otherwise address the identified issues and findings. From January to early March 2004, more data was presented to either clarify or resolve the areas of interest involving the RK Group Joint Venture (JV). Most of this information was submitted to the Facilities Director who then summarized and/or added to the responses from the RK Group JV. Beginning in March 2004 and continuing through last week, the audit team began meeting directly with the Managing Venturer and when required with the JV Partners. The Managing Venturer, and its legal representative, reviewed finding drafts and the final draft report. They were also given opportunity to edit the RK Group Joint Venture responses shown in the attached final report.

Their position on several issues has been consistent. The RK Group Joint Venture believes that it has tried to comply, in good faith, with a contract that contains imprecise and unusual language. An agreement subject to substantial interpretation of key issues has been further complicated by requiring Client actions that the RK Group JV deemed as intrusive and unrealistic. A City imposed joint venture structure for this contract required the RK Group to make modifications to its established business policies and procedures. Based upon its understanding of the contract terms, the RK Group JV believes that it has paid the City the proper commission revenue. Dealings and practices, while not formalized as contract amendments, have been the method of operation since February 1997 for the RK Group JV. During the last year, it has recognized that formal documentation of various issues would be a better course. The RK Group Joint Venture has concerns about the proper resolution of several key areas, especially minority partner participation, Affiliate sales at the Center, off-site services by JV or Affiliates, and clarifying the application of the 19 percent service fee charged to Clients.

Auditors, in this and other engagements, must objectively report on the conditions that exist as compared with those expected per the contract. In this report, City Council is being given an analysis of how the vendor complied with the contract requirements. This evaluation has been substantially impacted by actions taken, or not taken as in this case, when the City developed the joint venture requirement for the request for proposal in 1996. It has also been complicated by acknowledged unresolved negotiations that lead to serious language compromises in the contract. The RK Group Joint Venture and City Staff should share responsibility and accountability for areas of noncompliance identified. While the audit team understands the RK Group JV's explanations for various findings, the data it provided has not been sufficiently adequate to revise the finding and recommendation for several critical issues.

It is recommended that the City seek to recover a claim from the RK Group Joint Venture for an estimate of unpaid commissions ranging from $269,000 without interest, to $503,600 including 18 percent interest. This represents the auditors' computation of one-half of potential commissions and related interest on the limited sample of transactions, 1997 to 2002, reviewed for Catering by Rosemary, Inc. and Circa Texas, Inc. The City Council will need advice from the City Attorney on a variety of legal issues surrounding this claim. While expanded/additional audit work may be another alternative to immediately pursuing the claim, the audit team suggests seeking a settlement resolution with the RK Group JV if possible. This would afford the knowledge gained by the audit being applied on the unresolved contract policy issues for the completion of this term, and for the potential five-year extension or for the new contract proposal process if required.

The Governance Committee instructed that this final report be distributed to the City Council in anticipation of an executive session on legal matters concerning this claim that may occur on June 24, 2004. Shortly, a draft report discussing the City's issues and findings related to the administration, operation and monitoring of this contract will be sent to the City Manager and Staff for their final review and responses.

Sincerely,

Patricia M. Major CPA, CTP, CGFM
City Internal Auditor

RK Group Joint Venture – 8 copies
Andrew Martin, City Attorney

CITY INTERNAL AUDIT DEPARTMENT
CITY OF SAN ANTONIO

AUDIT OF THE FOOD AND BEVERAGE SERVICE AGREEMENT FOR THE HENRY B. GONZALEZ CONVENTION CENTER

Report Dated June 10, 2004

AUDIT OF THE FOOD AND BEVERAGE SERVICE AGREEMENT FOR THE HENRY B. GONZALEZ CONVENTION CENTER
Report Dated June 10, 2004

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EXECUTIVE SUMMARY
AUDIT OF THE FOOD AND BEVERAGE SERVICE AGREEMENT
FOR THE HENRY B. GONZALEZ CONVENTION CENTER
June 10, 2004

Overview

An audit of the City of San Antonio's (City) agreement (Contract) with the RK Group Joint Venture (RK Group JV) to provide food and beverage and other services at the Henry B. Gonzalez Convention Center (Facility) has been completed. Planning for this engagement began in May 2002. The fieldwork phase involving substantial contact and interaction with the RK Group JV's Managing Venturer generally occurred from October 2002 and continued through spring 2003. Analysis of data collected occurred during fieldwork and continued through the exit conferences and meetings with the RK Group JV in 2004.

This audit was conducted in accordance with generally accepted government auditing standards issued by the Comptroller General of the United States. These are commonly referred to as the General Accounting Office (GAO) or the "Yellow Book" Standards. This audit was designed to provide reasonable but not absolute assurance whether the RK Group JV complied with its contract with the City. Sampling techniques and other common forms of audit methodology were used during this engagement. While the procedures performed were rather extensive, there could be instances of non-compliance that were not identified.

City of San Antonio Contract Responsibilities

The operation, administration and monitoring of this agreement has been the responsibility of the City's Department of Convention Facilities. The City's Economic Development Department has been charged with monitoring the RK Group JV's compliance with the Small, Minority or Woman-owned Business Advocacy policy set forth in contract Sections 22.1 and 22.2. A separate audit report will be issued regarding the performance of the various City Departments in the handling of this contract. That report will incorporate the responses of the City Management and Staff regarding the issues, observations, findings, and recommendations that pertain to the audit of their actions.

The RK Group Affiliates and Joint Venture

Prior to this Contract, Catering by Rosemary, Inc. had been providing catering services to the City. The firm experienced significant growth during its period as the exclusive caterer for the City. The RK Group Affiliates (Affiliates) were formed between 1983 and 1993 to handle full service party rentals, transportation, tours and related activities. It also formed the RK Group JV in 1996 for the purposes of this Contract to meet the requirements of Small, Minority or Woman-Owned Business Advocacy Policy.

Current Food and Beverage Agreement for the Henry B. Gonzalez Convention Center

The City has a Contract with the RK Group JV to provide food and beverage and related other services to customers of the Facility. The Contract with the RK Group JV was executed by the City on March 3, 1997, pursuant to Ordinance No. 85056 dated October 24, 1996. The Contract term is for eight years commencing on February 1, 1997, and ending January 31, 2005, with one option to renew for a five-year term, subject to City Council approval. The City is required to give the RK Group JV 180 days notice, on or before August 2, 2004, of its intent to grant the option. If the City does not agree to the extension option, then a new request for proposal process would be initiated.

Article XV of the Contract addresses reports, records and audits. The City's broad access to financial and accounting data as well as the rights to examine and/or audit the Contract are stated.

Section 15.2 generally gives various City Departments the ability to review original documents and records related to the Contract. It states that the City may conduct annual audits; however, Section 15.3 gives the City sole discretion to modify the audit intervals and records retention requirements.

Understanding the functions performed by and the relationships between the various Affiliates was critical to the audit of this Contract. Even though this Contract was signed by the RK Group JV, Affiliates were referenced in Contract Article III. SCOPE OF SERVICES, Article XLI. COMPENSATION TO CITY, and the ADDENDUM III – CONTRACTOR'S PROPOSAL, Sections 1-9. The Managing Venturer, Catering by Rosemary, Inc., has sole ability to designate which RK Group JV Partner and/or Affiliate performs work for the Facility Clients (Clients). This includes services performed at the Facility and at other locations off-site (such as La Villita, Southwest Craft Center, etc.) Affiliates had significant opportunities for on-site and off-site work and the associated compensation as a result of direct access to or contact with Clients because of this Contract.

The Managing Venturer has been the contact point for Clients to discuss, request, and/or arrange for catering and related services. In its role, the Managing Venturer develops Client event plans and cost proposals; coordinates work schedules; prepares billings; and receives deposits and payments. It performs all accounting and general business functions, including those for this Contract.

Commission Revenue

Commissions generated from the Contract represent the second largest source of Convention Facilities operating revenue ranging from slightly over $.9 million, or almost 28 percent, of total revenue in fiscal year 1997, to over $2.3 million, about 30 percent, of total revenue for fiscal year 2003. Fiscal years 1997 and 1998 showed revenue growth over the prior contract. From fiscal year 1999 through 2003, each year demonstrated higher commissions to the City than the previous year. Compared with commission revenue forecast by the City, actual commissions exceeded the projections from fiscal year 1999 through 2003, except for 2000. Even 2001 and 2002 showed actual revenue exceeding the City's forecast after the 9/11 event.

Revenue and commission performance can be and have been impacted by various regional and national factors. During this Contract period, the most unique and unexpected factor has been 9/11. No one could have foreseen this disaster and the resulting nationwide financial and economic implications. The RK Group JV's revenue and commission performance to date has also been greatly influenced by the City's success in attracting conventions and events to the Facility and the economy's impact on the tourism industry in general. In turn, the RK Group JV and the City have had to contend with the economic pressures because achieving their goals requires continuous economic growth.

Compensation to the City – Articles III and XLI

For events and services performed at the Facility by any of the RK Group JV Partners, or Affiliates as a result of referrals, the following commissions apply:

- 16.8 percent of gross receipts for food and non-alcoholic beverage services;
- 27 percent of gross receipts for alcoholic beverage services and portable concession stands; and
- 19 percent of gross receipts for all "Other Services" and Affiliates services when there is a referral by the RK Group JV.

For events and services not held at the Facility, the City will receive 5.5 percent of gross receipts for all food and beverage services and/or any other services if the RK Group JV cannot demonstrate that the Client chose them through a documented competitive bidding process.

ARTICLES III. SCOPE OF SERVICES and XLI. COMPENSATION TO CITY, as well as ADDENDUM III - CONTRACTOR'S PROPOSAL, SECTIONS 1-9, were especially relied upon in the audit for compensation issues.

Results In Brief

Based upon the work performed for this audit, a number of issues and observations have been identified and discussed with the RK Group JV. Since this is the first audit of this Contract, the RK Group JV has indicated some uncertainty about the audit processes, especially communicating its responses on findings and recommendations. There has been substantial commitment by the individual partners and the Managing Venturer to provide information to clarify issues when possible. In some cases, the RK Group JV has offered explanations of facts and situations that may have been the basis for its performance under this Contract. While the candidness of this information has been appreciated and helpful to further understand the Contract, the audit team cannot, in all cases, accept this as justification for non-compliance. There may truly be areas addressed by the audit where a mutual understanding of the concerns may not be achieved. Ultimately, formal agreement must be reached for a workable consensus so that the same issues about compliance do not persist.

Collectively, the issues identified were considered both significant and material to the overall assessment of Contract compliance. Recommendations were made to assist the RK Group JV and its Managing Venturer to improve, or correct as the case may be, the degree of contract compliance. The audit team has been informed about corrective action that has already been implemented by the RK Group JV, or that will soon begin, to ensure greater compliance.

There remain issues regarding financial claims against the RK Group JV addressed in the report, for which the City may want to consult the City Attorney as to a proper course of action. The audit team has provided a range for the financial claims, between $269,000 and $503,600 based upon extensive analysis of invoice history reports provided by the Managing Venturer. This material was compared with Facility reports and records to determine correlations between Clients and events on-site, or off-site as the case maybe.

The RK Group JV has consistently indicated in the exit conferences that it does not concur with the findings or issues involving the service fee, and sales revenue for the Affiliates and the RK Group JV from on and off-site events.

While the audit team understands its perspective on these matters, it represents important policy issues concerning revenue sources for the Facility. Additional audit work might determine more specifics about the claims; however, this would also require substantially more audit expense to continue examining records. Even then, the RK Group JV may still continue to disagree. The City Council is encouraged to determine if a settlement of the financial issues as presented is appropriate and feasible based upon advice of the City Attorney. This part of the audit engagement will be closed unless City Council directs otherwise.

AUDIT OF THE FOOD AND BEVERAGE SERVICE AGREEMENT FOR THE HENRY B. GONZALEZ CONVENTION CENTER

June 10, 2004

BACKGROUND

The RK Group Affiliates and Joint Venture

The City has an agreement (Contract) with the RK Group Joint Venture (RK Group JV) to provide food and beverage and related other services to customers of the Henry B. Gonzalez Convention Center (Facility). Prior to this Contract, Catering by Rosemary, Inc. had been providing catering services to the City. The firm experienced significant growth during its period as the exclusive caterer for the City. The RK Group Affiliates (Affiliates) were formed between 1983 and 1993 to handle full service party rentals, transportation, tours and related activities. It also formed the RK Group JV (in 1996 for the purposes of this Contract to meet requirements of the Small, Minority or Woman-Owned Business Advocacy Policy. The components of the Affiliates and Joint Venture Partners are listed below:

	The RK Group Affiliate Name and Locations	Services/Products Provided
1	Catering by Rosemary, Inc. SA Convention Center 1220 E. Commerce St	Catering, purchases flowers for affiliates, engages event entertainment, and manages Contract business for JV Partnership
2	Rosemary Kowalski & Associates, Inc. 1220 E. Commerce	Training JV Partners; public relations for the RK Group
3	Spezaturra Florals of San Antonio (unincorporated) 1220 E. Commerce	Floral products and services (Assumed Name Registered 01/07/1993)
4	RK Association Management, Inc. 1220 E. Commerce	Meeting and/or event planning services
5	Illusion Rentals and Designs KKH Rentals, Inc. 119 Idaho St	Sale or rental of catering equipment, furniture, dining utensils, etc.
6	Circa Texas, Inc. 1220 E. Commerce St	Transportation, tours, some food and beverage service

	The RK Group JV Partner	Share Ratio
1	Catering by Rosemary, Inc. (Designated as Managing Venturer for the RK Group JV)	53.4%
2	Rosemary Kowalski & Associates, Inc.	14.9%
3	La Casita Enterprises, Inc. d.b.a. Catering by Nick	9.9%
4	Taco Flats, Inc. d.b.a. Black Tie Affairs Catering, Inc.	9.9%
5	All Star Catering, Inc. (Issues with corporate status and Bexar personal property filings)	9.9%
6	Richard Burton d.b.a. Burton's Catering Service (Withdrew from the RK Group JV in March 2004)	2.0%
	Total Partnership Shares	100.0%

Current Food and Beverage Agreement for the Henry B. Gonzalez Convention Center

The current Contract with the RK Group JV was executed by the City on March 3, 1997, pursuant to Ordinance No. 85056 dated October 24, 1996. The Contract term is for eight years commencing on February 1, 1997, and ending January 31, 2005, with one option to renew for a five-year term, subject to City Council approval. The City is required to give the RK Group JV 180 days notice, on or before August 2, 2004, of its intent to grant the option. If the City does not agree to the extension option, then a new request for proposal process would be initiated.

Article XV of the Contract addresses reports, records and audits. The City's broad access to financial and accounting data as well as the rights to examine and/or audit the Contract are stated. Section 15.2 generally gives various City Departments the ability to review original documents and records related to the Contract. It states that the City may conduct annual audits; however, Section 15.3 gives the City sole discretion to modify the audit intervals and records retention requirements.

Understanding the functions performed by and the relationships between the various Affiliates was critical to the audit of this Contract. Even though this Contract was signed by the RK Group JV, Affiliates were referenced in Contract Article III SCOPE OF SERVICES, Article XLI COMPENSATION TO CITY, and the ADDENDUM III – CONTRACTOR'S PROPOSAL, Sections 1-9. The Managing Venturer, Catering by Rosemary, Inc., has sole ability to designate which RK Group JV Partner and/or Affiliate performs work for the Facility Clients (Clients). This includes services performed at the Facility and at other locations off-site (such as La Villita, Southwest Craft Center, etc.) Affiliates had significant opportunities for on-site and off-site work and the associated compensation as a result of direct access to or contact with Clients because of this Contract.

The Managing Venturer has been the contact point for Clients to discuss, request, and/or arrange for catering and related services. In its role, the Managing Venturer develops Client event plans and cost proposals; coordinates work schedules; prepares billings; and receives deposits and payments. It performs all accounting and general business functions, including those for this Contract.

Commission Revenue

Commissions generated from the Contract represent the second largest source of Convention Facility's operating revenue ranging from slightly over $.9 million, or almost 28 percent, of total revenue in fiscal year 1997, to over $2.3 million, about 30 percent, of total revenue for fiscal year 2003. Fiscal years 1997 and 1998 showed revenue growth over the prior contract. From fiscal year 1999 through 2003, each year demonstrated higher commissions to the City than the previous year. Compared with commission revenue forecast by the City, actual commissions exceeded the projections from fiscal year 1999 through 2003, except for 2000. Even 2001 and 2002 showed actual revenue exceeding the City's forecast after the 9/11 event.

RK Group JV's Forecast for Sales Revenue and Commissions

The ADDENDUM III in the RK Group JV's proposal Section 1 – 9 presented projections of sales and the related commissions for five years of operation under the new agreement. The projected revenue was compared to actual commissionable sales reported in the RK Group JV's Income Statements for calendar years 1997 through 2001. Cumulatively, the actual sales revenue for five years totaled almost $35 million, which was about $7.8 million, or 18 percent, less than forecast. This resulted in actual commissions being nearly $2 million, or about 24 percent, less than the estimate submitted by the RK Group JV (in mid-1996) for the same period.

Revenue and commission performance can be and have been impacted by various regional and national factors. During this Contract period, the most unique and unexpected factor has been 9/11. No one could have foreseen this disaster and the resulting nationwide financial and

economic implications. The RK Group JV's revenue and commission performance to date has also been greatly influenced by the City's success in attracting conventions and events to the Facility and the economy's impact on the tourism industry in general. In turn, the RK Group JV and the City have had to contend with the economic pressures because achieving their goals requires continuous economic growth.

Compensation to the City – Articles III and XLI
For events and services performed at the Facility by any of the RK Group JV Partners, or Affiliates as a result of referrals, the following commissions apply:

- 16.8 percent of gross receipts for food and non-alcoholic beverage services;
- 27 percent of gross receipts for alcoholic beverage services and portable concession stands; and
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For events and services not held at the Facility, the City is to receive 5.5 percent of gross receipts for all food and beverage services and/or any other services if the RK Group JV cannot demonstrate that the Client chose them through a documented competitive bidding process.

ARTICLES III. SCOPE OF SERVICES and XLI. COMPENSATION TO CITY, as well as ADDENDUM III - CONTRACTOR'S PROPOSAL, SECTIONS 1-9, were especially relied upon in the audit for compensation issues.

OBJECTIVES

The objective of this audit was to evaluate the RK Group JV Partnership compliance with the terms and conditions of the Contract.

SCOPE AND METHODOLOGY

This is the first audit of this Contract performed by the City's Internal Audit Department. Planning for this engagement incorporated a search for other reviews and/or audits that may have been done as part of the Facility's monitoring processes or as part of the Economic Development Department procedures. Any reports may have been helpful in determining the scope for this project.

In planning this audit, selected contract provisions in the following areas were reviewed:

- General Contract Requirements, e.g., Article 25 CHANGES
- Revenue Related Requirements, e.g., Article 41 COMPENSATION TO CITY
- Non-Revenue Related Requirements, e.g., Section10.8 RECYCLING

The audit team compared invoices to event documentation provided by the RK Group JV and the Convention Facilities Director (Facilities Director); tested the mathematical accuracy of commission calculations; verified percentages used in determining commissions paid to the City;

and examined supporting evidence for any reductions in fees, charges, or commissions. Other audit procedures included:

- Meeting with the Managing Venturer and Facility Staff on various occasions from mid 2002 through February 2003, and reviewing records provided in response to discussions, requests or questions;
- Examining documents made available to the City by the RK Group JV and Affiliates, including monthly caterer's reports and income statements;
- Reviewing the available quarterly summaries of activities with certified and non-certified small, minority, and women owned business enterprises;
- Performing an on-site visit with the RK Group JV at the Facility during a scheduled catered event to determine, through inquiry and observation, whether requirements related to security, safeguarding of assets, and recycling were being met; and
- Researching local and state public information sources to verify compliance with applicable laws/regulations as required by the Contract.

Based upon the review of field samples collected and analyzed, the scope of testing was enlarged in the spring of 2003. The expanded scope of testing included the invoice history reports for Catering By Rosemary, Inc. and Circa Texas, Inc. for various months between calendar years 1997 and 2002, and portions of 2003 for Circa Texas, Inc.

Formal meetings with the RK Group JV were observed or held by the audit team from February through May 2004. Discussions between the Facilities Director and each RK Group JV Partner were observed as part of the audit. Conferences with the RK Group JV Partners and/or the Managing Venturer regarding specific audit observations, issues and/or findings occurred from March through June 2004 as part of the audit process. City Staff participated in several, but not all, of these meetings. As a result, the RK Group JV has provided additional data for clarification and/or support of various issues raised.

FINDINGS, OBSERVATIONS, RECOMMENDATIONS, AND THE RK GROUP JOINT VENTURE'S RESPONSES

RESULTS IN BRIEF

Based upon the work performed for this audit, a number of issues and observations have been identified and discussed with the RK Group JV. Since this is the first audit of this Contract, the RK Group JV has indicated some uncertainty about the audit processes, especially communicating its responses on findings and recommendations. There has been substantial commitment by the individual partners and the Managing Venturer to provide information to clarify issues when possible. In some cases, the RK Group JV has offered explanations of facts and situations that may have been the basis for its performance under this Contract. While the candidness of this information has been appreciated and helpful to further understand the Contract, the audit team cannot in all cases accept this as justification for non-compliance. There may truly be areas addressed by the audit where a mutual understanding of the concerns may not be achieved. Ultimately, formal agreement must be reached for a workable consensus so that the same issues about compliance do not persist.

Collectively, the issues identified were considered both significant and material to the overall assessment of Contract compliance. Recommendations were made to assist the RK Group JV, and its Managing Venturer to improve, or correct as the case may be, the degree of contract compliance. The audit team has been informed about corrective action that has already been implemented by the RK Group JV, or that will soon begin, to ensure greater compliance. There remain issues regarding financial claims against the RK Group JV addressed in this report, for which the City may want to consult the City Attorney as to a proper course of action.

For the audit objectives related to insurance and performance bond, it was determined that the RK Group JV had complied with the requirements of the Contract.

GENERAL CONTRACT REQUIREMENTS:

Finding 1: Commission Service Fee Application, Contract Changes, and Modifications

(A) The RK Group JV did not always follow contractual provisions for requesting changes, obtaining clarification, and resolving open issues to facilitate contract compliance by formalizing changes to the Contract. (Article 25, CHANGES) There was substantial evidence of informal practices used by the RK Group JV working with the Facilities Director and Staff to address issues. Within the last year, it appeared that some efforts to formalize resolutions had occurred.

(B) The RK Group JV and City did not complete the nine-month review of the commission calculation and reporting processes (Section 41.3) for Other Services (Section 41.1c) and non-Facility Food and Beverages Services (Section 41.1d)

City Council approved the selection of the contractor in October 1996 for the agreement period to commence February 1, 1997. The City Manager and Staff were authorized by the ordinance to complete negotiations with the RK Group JV. After more than ninety days, consensus on

several critical issues could not be reached, so in early March 1997 the parties agreed to terms so that the Contract could be executed. As a result, several significant compromises were agreed to on these open issues.

Two major provisions incorporated into the Contract for continued dialogue and possible changes to the Contract were:

- Article 25 states, "City and Contractor may, at any time, mutually agree to changes in the general scope of this Agreement" and "equitable adjustments" may be made.

  The Managing Venturer indicated that this provision was utilized on at least one occasion. Documentation provided for this situation showed that "certain portable concessions" operations were transferred to the ARAMARK organization, and subsequently discontinued by the RK Group JV in April 2000. The City received commission revenue of about $135,000 during the thirty-three months between1997 and 2000. Based on this conveyance, future commission revenue would come to the City from ARAMARK.

- Section 41.3 established a nine-month period, until October 31, 1997, to review the process for calculating and reporting compensation to the City pursuant to Sections 41.1(c) and 41.1(d). The Managing Venturer acknowledged that it did not complete this action formally before or after the nine-month period. An informal practice of addressing some issues evolved, which the Facilities Director did not object to.

Recommendation 1:
The RK Group JV should perform as obligated by the Contract. Any contract terms it believes are impractical or inappropriate should be put in writing to the Facilities Director. Formalization of the process can then lead to agreement, if not at least consensus, which can then be documented within the Contract.

The RK Group JV Response To 1:
Correspondence from the Managing Venturer directly, or from documents submitted to the audit team by the Facilities Director, indicated efforts to improve compliance with Contract terms and conditions. Examples of specific areas addressed are as follows:

- On February 3, 2004, the Managing Venturer requested from the Facilities Director approval of written guidelines for commission waivers, credits, and special pricing. A letter dated February 5, 2004 was issued by Convention Center Management to the RK Group JV granting it authority to offer Clients pricing discounts/allowances of up to five percent without specific approval.

- On March 28, 2003 and again on February 6, 2004, the Managing Venturer corresponded with the Facilities Director indicating its thoughts about prospective solutions to concerns about the level of participation of the minority RK Group JV Partners.

REVENUE RELATED REQUIREMENTS

Finding 2: Portions/Pricing/Product Lists – Article XII
The RK Group JV submitted lists of competitive facilities; however, several of these were not prepared in accordance with Contract requirements in terms of number of competitors and frequency of reporting.

To assure that the catering products and pricing remain competitive, the Contract requires an annual comparison of pricing and products. Review of six annual price analyses submitted for 1998 through 2003 indicated that four did not comply with the Contract terms, as follows:

- 1998 price comparison included two competitors in the San Antonio area, instead of three, and it was not dated.
- 2001 price comparison included only one facility; however, the Facilities Director stated that it was considered "sufficient".
- 1999 and 2000 price comparisons were not on file with the Facility.

Recommendation 2:
The RK Group JV should submit price comparisons that include at least three competitors to ensure overall competitiveness. The list should be provided annually on a timely basis.

The RK Group JV Response To 2:
The Managing Venturer submitted the most recent product/pricing comparisons to the City; this material was made available for audit review on February 6, 2004. This analysis also incorporated data for comparable convention center facilities in other cities, which exceeded the requirement of three competitors as specified in the Contract.

Finding 3: Processes for Discounts, Allowances, Credits, and Adjustments
The RK Group JV did not always request prior written approval to discount pricing or to grant allowances/ credits. The formal request by the RK Group JV must occur before these are offered to Clients. (Section 12.3) The Managing Venturer or the Facility Staff did provide documentation for various events addressing discounts, allowances and similar issues. This informal practice became the routine for the parties.

Section 12.3 specifies that the Facilities Director's approval is necessary for any waived fees and/or charges before they are offered to customers. Audit testing revealed that one Client was given a credit of $2,400, identified as "convention center space rental credit" on the RK Group JV's Catering invoice, which resulted in the City receiving about $485 less in commission revenue than it should have. No waiver request or any other form with written approval from the Facilities Director for the credit taken on the invoice could be located. In order to keep the business in the Facility, the rental credit was deducted from the RK Group JV's revenue, and the City received full rental revenue as contracted.

Audit test work identified other examples where it did not appear the current Contract commission rates were used to invoice Clients in 1997, 1998 and 1999. Documentation provided supported that these cases involved event commitments made prior to October 1996. A letter to the Facilities Director was provided evidencing these commitments in February 1997. This material should have been maintained with the Contract and with the monthly commission reports to the City to establish the proper facts about the Client billings.

Recommendation 3:
The Managing Venturer should ensure that advance approval must be received in writing from the Facilities Director prior to providing such incentives to Clients. The Facility Staff supplied a memo to the requesting hotel declining offering this discount/allowance. It should also remit the commissions $487 plus interest to the City.

RK Group Joint Venture Response To 3:
The Managing Venturer presented documentation attempting to explain and justify its actions by stating that the Client would not do business in the City without the reduction on the rental. The event involved another local facility and was very complex.

The Managing Venturer also submitted correspondence to the Facilities Director acknowledging guidelines approved for RK Group staff to negotiate with prospective Clients. These guidelines were authorized for a trial period from February 4 through September 30, 2004.

Auditors' Comments 3:
The action initiated for improved efficiency was reviewed and seemed reasonable and appropriate. The RK Group JV should include with its Monthly Caterer's Report the frequency and value of commissions waived due to discounted pricing, allowances, and/or credits.

Finding 4: Commission on 19 Percent Service Fee
In awarding the Contract to the RK Group JV, City Staff emphasized that this was the only proposal that would pay the City commissions on services fees invoiced to Clients. This component was critical in the Staff and Council selection process. The RK Group JV clarified in a letter dated September 11, 1996 that its revenue includes a 19 percent service fee for serving food and beverage and other services. The executed Contract did not define or discuss the service fee issue. The audit testing showed that the RK Group JV has not been consistently invoicing Clients for the 19 percent service fee. A letter of clarification was submitted indicating that there are at least three services for which the RK Group JV would not routinely invoice for this fee.

Audit testing of four months in years 2001 and 2002 revealed that such charges were not consistently assessed to Clients. Not invoicing the service fee resulted in about $4,145 less commission revenue to the City for the transactions tested.

While the 19 percent service fees were not specifically addressed in the main contract document, the clarification letter became a part of the overall documentation package.

Recommendation 4:
The RK Group JV should clarify the application of service fees, obtain agreement from the City, and formalize the fees in the Contract. It should also establish procedures to ensure that this fee is consistently applied.

RK Group Joint Venture Response To 4:
The Managing Venturer, through the Facilities Director, presented documentation to explain the test exceptions identified. The Managing Venturer also submitted correspondence to the Facilities Director acknowledging guidelines approved for RK Group staff to negotiate with prospective Clients. These guidelines were authorized for a trial period from February 4 through September 30, 2004.

Auditors' Comments 4:
The action initiated for improved efficiency was reviewed and seemed reasonable and appropriate. The RK Group JV should include with its Monthly Caterer's Report the frequency and value of commissions waived due to discounted pricing, allowances, and/or credits. This would also mean summary reporting on transactions where the 19 percent service fee was not assessed Clients.

Finding 5: Potential Commission Due City for Services On-Site and Off-Site by the RK Group Joint Venture and RK Group Affiliates

The City may not be receiving a significant amount of commission revenue due from:

- ***Other services performed by Affiliates of the RK Group at the Facility, such as shuttle transportation to/from hotels, entertainment, linens, and floral decorations; and***
- ***Any services for Clients that are performed at other locations, such as the Southwest Craft Center or La Villita.***

Section 41.1c requires the RK Group JV to pay the City a 19 percent commission on all gross receipts for other services provided at the Facility. The provision specifies that commissions would be paid by the RK Group JV for business it refers to its Affiliates. For the four months we tested, the City did not receive any commissions for other services provided by Affiliates. The Managing Venturer stated that it referred very little business to Affiliates.

Section 41.1d requires the RK Group JV to pay the City a 5.5 percent commission on gross receipts for all food and beverage and other services provided to Clients at locations other than the Facility. Self-monitoring of Affiliate services and off-site services did not appear to be practical nor in the best interest of the City.

The Facilities Director, in a letter dated January 11, 2002, informed the RK Group JV that a copy of the request for proposal (if available), a bid tabulation, or a letter indicating the RK Group JV

was the successful bidder for off-site services to Clients would be sufficient for the Facility records.

The Managing Venturer has routinely provided letters to the Facilities Director stating that an RK Group Affiliate was the successful bidder. This method does not provide assurance that the RK Group JV has complied with Section 41.1d.

Review of invoice history reports for Circa Texas, Inc. (an Affiliate) identified that the City may be due over $179,000 in commission revenue. Of this amount, about $129,000 relates to off-site services for Clients, such as transportation, tours, tickets, entertainment, decorations, staffing, and service fees. The remainder, about $50,000, relates to commissions on revenue from on-site services, mainly shuttles to/from hotels. This estimate is based on analyzing fifty-one months of gross receipts totaling over $2.2 million during the period of 1998 through 2002.

Analysis of invoice history reports for the Managing Venturer identified that the City could potentially be due approximately $411,000 in commissions for on- and off-site services that were not previously reported to the City. This estimate is based a analysis of sixty-four months of invoices for Catering By Rosemary, Inc. (the RK Group JV Partner). These invoices amounted to over $6.1 million in sales revenue during the period of 1998 through 2002. Over $337,000 related to off-site services, such as catering, floral, linens, and entertainment. About $74,000 was attributed to on-site services such as food and beverages, entertainment, decorations, floral, linens, and service fees to Clients.

Invoice history reports for 2003 and 2004 were not reviewed. This report was requested for other Affiliates – Illusion Rentals and Designs and RK Association Management; however, the information was incomplete or not available.

Recommendation 5:
The Managing Venturer should remit unpaid commissions plus interest to the City for the months covered in the audit sample testing.

It should submit invoice history reports each month for all RK Group Affiliates beginning in 2003 and continuing through the remaining term of the Contract.

It should work with Facility Staff to improve and formally document the process of identifying commissions for on-site work based on referred business; by necessity this would mean clarifying the term "referred" business.

It should work with the Facility Staff to clarify and formally document the process for identifying when the City should be compensated for off-site services performed for Clients.

RK Group Joint Venture Response To 5:
The Managing Venturer does not concur with the audit analysis and resulting recommendations. Some data was provided to the audit team for clarification and explanation of their perspective.

Auditors' Comments 5:
Based upon the limited scope analysis performed, it is recommended that the City present a claim for unpaid commissions and 18 percent interest. Recognizing that City staff actions may have partially contributed to the RK Group JV Contract compliance issues, it is further recommended that one-half of the commission revenue underpayment calculation and interest be deducted from the claim amount proposed.

These claims have a range in value between $269,000 and $503,600. The City Council should make the ultimate determination using advice from the City Attorney as to how to proceed with the claim against the Managing Venturer. This does not involve sales revenue for the Minority RK Group JV Partners.

NON-REVENUE RELATED REQUIREMENTS

Finding 6: Recycling Program
The RK Group JV did not implement a recycling program as stated in the Contract. (Section 10.8)

Section 10.8 required that the RK Group JV implement a recycling program unless otherwise directed by the City. Requiring a program for the RK Group JV was part of the City's overall environmental awareness and improvement strategies to reduce landfill requirements in this area. The RK Group JV stated that no recycling program was in place during the site visit in February 2003.

Recommendation 6:
The RK Group JV should implement the required recycling programs as soon as possible.

RK Group Joint Venture Response To 6:
The Managing Venturer stated in correspondence to the Facilities Director that an arrangement would be developed between the Facility Staff and the RK Group JV to have the City of San Antonio handle the recycling of card board and paper products.

It also provided additional information about the programs that would have been in place at the beginning of the Contract term, and why these no longer are being done. It seems that the City coordinated recycling for this, and maybe other Facility vendors. It appeared that the various recycling programs were discontinued by the City due to the logistics, such as the growth of the disposed items.

Auditors' Comments 6:
No information was provided to indicate if the City would be paid for providing this service to the RK Group JV Partnership. There was no information or indication of other recycling efforts, such as aluminum cans, bottles and plastics. This needs to be scheduled for follow-up review in several months.

Finding 7: Security – Article XIV
The RK Group JV did not implement security measures including an employee name list and identification badges.

Sections 14.1 and 14.2 required the RK Group JV to:

- Furnish City with a list of the names of its employees and provide updates as changes occur; and
- Issue identification badges to its employees and recover inactive badges.

It was noted that a list containing the names of RK Group JV employees was not in the Facility files; and identification badges were not issued to all RK Group JV employees.

The risk to the City includes potential loss of property due to theft, disappearance, or destruction and safety of Clients due to terrorist actions. Additionally, the RK Group JV 's Commercial Crime Coverage insurance policy excludes losses due to war and similar actions or any related act or incident.

Recommendation 7:
The RK Group JV should furnish a list of its employees' names and update it as changes occur. It should also issue identification badges to all its employees and require that it be worn when on duty.

The Managing Venturer should provide revisions to the Facility Director as changes occur.

RK Group Joint Venture Response To 7:
In February 2004, the Managing Venturer submitted to the Facility Director various items pertaining to security. Included were updated employee listings for the current RK Group JV Partners. The material also included a general security plan as required by the Contract, and representations that these would be updated and/or reviewed as needed.

Auditors' Comments 7:
The data presented has not been checked for accuracy and completeness by the audit team. The significance of this finding warrants that specific follow-up procedures be designated and scheduled to ascertain the adequacy of the presented action plan. This will also serve to test the effectiveness of the newly implemented security processes once in place for several months.

Finding 8: Equipment – Article XXVI
The RK Group JV did not provide a list of Contractor-owned and leased equipment that it has brought on site between 1997 and 2003. The Managing Venturer acknowledged that annual joint inventories have not been conducted.

Sections 26.1 and 26.3 could reduce the risk of loss of City and contractor equipment due to theft, disappearance, and destruction. Section 26.1 requires that the RK Group JV provide a list of all Contractor-owned and leased equipment brought on site. It was noted that such a list is not on file with the Facility.

Section 26.3 requires that a joint inventory of the equipment be taken by City and RK Group JV to verify the correctness of the equipment. The Facility Staff stated that joint annual inventories had not been conducted.

Recommendation 8:
The RK Group JV should comply with Contracted terms to provide the Facility a list of all Contractor-owned and leased equipment it has brought on site, and to conduct a joint inventory.

RK Group Joint Venture Response To 8:
The Managing Venturer with participation from Facility Staff conducted and completed a complete inventory of equipment at the Facility in February 2004.

Auditors' Comments 8:
Working papers for the inventory process were provided to the audit team on March 29, 2004. This documentation was given a general review pending completion of Facility Staff's review and responses to variances shown in the data. Additional test procedures will be developed and scheduled for follow-up in several months.

Finding 9: Partnership Structure
The RK Group JV has not demonstrated the operational and financial structure presented in the Contract, especially ADDENDUM III, CONTRACTOR'S PROPOSAL, SECTIONS 1-9.

The City formulated the Food and Beverage Service Request for Proposal (RFP) in the summer of 1996, which provided for advantages to Small, Minority or Woman-Owned Business Enterprises (SMWBE) with the opportunity to participate in partnership with experienced caterers. Section 2.0 of the RFP defined Joint Venture as an association that provides for the sharing of economic interest and the equal proportionate control over management, interest in capital, and earnings. The definition continues to say the Minority Business Enterprise/Women Business Enterprise joint venturer must have a proportionate interest in the control, management, and operation of the affairs of the joint venture.

Section 5.0 indicated that the joint venture association should provide that participating businesses must have a proportionate interest in the control, management, and operations of the affairs of the joint venture. The contractor should be responsible to provide broad opportunities to foster the growth of and increase the skills and capabilities for the SMWBE partners in this field.

The RK Group JV submitted a proposal in response to the City's RFP. The proposal outlined information on their experience, team qualifications; financial strength; SMWBE utilization; local business participation; product quality, food specialty, and service type; administration and management; and operational plans. The Joint Venture Operations Plan introduces the partners and presents the ownership interest percentages for each joint venture partner. These documents, including the Joint Venture Agreement, were taken into consideration when awarding the

Contract to the RK Group JV. The Joint Venture Agreement was included in Section 11 of the proposal.

Sections 1-9 of the RK Group JV's proposal are included as Contract ADDENDUM III. Contract Section 22.3 requires the RK Group JV to submit quarterly reports to the Facilities Director outlining participation levels of the joint venture partners and further specifies that the participation levels of all Joint Venture Partners be equal to their ownership share percentages described in the proposal.

Section 20.4 states that if the Joint Venture fails to maintain the percentage of ownership as described in the proposal, the RK Group JV shall be declared in default and the City shall have termination rights.

Procedures were performed to determine Contract compliance with the required partnership structure. The participation amount and percentage were determined based on actual gross receipts reported to the Facilities for calendar years 1997 through 2002. While ownership percentages have remained the same, participation by the minority partners from contract inception through calendar year 2002 was substantially less than the levels agreed to in the Contract for five of the Partners. The percentage ownership, participation levels, and roles for each of the six RK Group (JV) Partners are detailed below:

Joint Venture Partner	Role in Addition to Catering	Percent Ownership	Actual Percent Participation	Actual Participation Amount Feb 97 - Dec 02	Contract Participation Expected at % Ownership
Catering by Rosemary	Managing Venturer	53.4%	91.4%	$44,606,600	$26,053,500
Rosemary Kowalski & Assoc., Inc.	Director of Marketing & Public Relations	14.9%	0.0%	19,700	7,269,600
Subtotal		**68.3%**	**91.4%**	**$44,626,300**	**$33,323,100**
Catering by Nick	Director of Purchasing and Estimating	9.9%	3.8%	1,832,200	4,830,200
Black Tie Affairs	Director of Operations	9.9%	3.6%	1,732,800	4,830,200
All Star Catering, Inc.	Director of Training & Customer Service	9.9%	1.1%	553,800	4,830,200
Burton's Catering Svc	Director of Promotions	2.0%	0.1%	44,400	975,800
Subtotal		**31.7%**	**8.6%**	**$ 4,163,200**	**$15,466,400**
Total		**100%**	**100%**	**$48,789,500**	**$48,789,500**

On February 24, 2003, the Facilities Director forwarded correspondence to the RK Group JV advising them that the participation levels of Section 22.3 of the Contract were not being met and requested they provide a corrective action plan addressing how they would ensure the

participation levels were met in the future. The Managing Venturer responded that Joint Venture Partners now recognize that participation percentages established in the 1997 contracting process were optimistic.

The RK Group JV presented correspondence from the three 9.9 percent Joint Venture Partners that indicated satisfaction with their participation. However, there was no correspondence from the 2.0 percent Partner, Burton's Catering Service. The audit team observed interviews with all of the RK Group JV Partners. The minority partners indicated they did not regard the current participation levels as attainable.

The audit team's communication with Mr. Burton (d.b.a. Burton's Catering Service) and the RK Group JV indicated that there was mutual dissatisfaction with the arrangement. In March 2004, Mr. Burton went to arbitration with the Joint Venture Partners and afterward withdrew from the partnership. No replacement partner has been selected; however, a SMWBE has been identified.

Recommendation 9:
The RK Group JV should resolve the participation issues as soon as possible through one of the two recommended options:

Comply with the Contract terms, in particular ADDENDUM III – CONTRACTOR'S PROPOSAL, SECTION 1-9, Joint Venture Operations Plan in the spirit and scope the City intended, which means replacing Burton's Catering Service and Rosemary Kowalski & Associates, Inc.

Request an amendment to the Contract under Article 25 CHANGES to adopt a revised minority participation level plan. This plan needs to be documented and presented to the Facility Staff.

While either of these options is recommended, the RK Group JV can propose an alternative solution to be in compliance.

The RK Group JV Response to 9:
The RK Group JV maintains that the participation levels presented in their proposal were only goals, which they now recognize are unobtainable.

Finding 10: Small Business Economic Development Advocacy Article XXII
The RK Group JV did not consistently submit the required quarterly Good Faith Effort Plan (GFEP)indicating its subcontracting utilization of SMWBE. (Section 22.1)

Section 22.1 states it is the policy of the City that SMWBEs shall have the maximum practical opportunity to participate in the performance of public contracts. The intent and purpose of this Small Business Economic Development Advocacy (SBEDA) policy is to ensure that these firms have the opportunity to compete for City contracts without discrimination on the basis of race, color, religion, national origin, age, sex or handicap. Section 22.1 also requires the RK Group JV to submit, not less than quarterly, a GFEP to the City's Department of Economic Development indicating its subcontracting plan utilization levels beginning August 1, 1997.

The RK Group Joint Venture provided their SMWBA goals in Section 5 of their Proposal. It is included as ADDENDUM III – CONTRACTOR'S PROPOSAL, SECTION 5. Their GFEP outlined the businesses and corresponding utilization level amounts they planned under the Food and Beverage Service Agreement.

The RK Group Joint Venture has submitted 13 out of the 26 required quarterly reports on Small, Minority and Women-Owned Business Activity participation levels through December 2003. This information was provided to the audit team by the City's Department of Economic Development through Facility Staff.

Only companies certified as a Minority Business Enterprise (MBE), Woman Business Enterprise (WBE), African-American Business Enterprise (AABE) or Small Business Enterprise (SBE) through the South Central Texas Regional Certification Agency, or as approved by the City Director of Economic Development, can be applied towards the contracting goals.

SBEDA activity reported to City Staff by RK Group JV for contract inception through December 31, 2003, based upon thirteen of the required twenty-six reports, is detailed below:

Total Purchases Since Contract Inception	Total Proposed SWMBA Purchases	Total Purchases from SWMBA's	Total Purchased from Certified SWMBA's	Percent of Total	Total Purchased from Non-Certified SWMBA's	Percent of Total
$31,612,764	$1,413,900	$257,110	$234,917	.74%	$22,193	.07%

Through audit tests, it was determined that some of the RK Group Joint Venture Minority Partners appeared on several of these quarterly GFEP reports.

The City's Department of Economic Development verbally confirmed that the RK Group JV is in compliance with the SBEDA requirements for the reports submitted.

Recommendation 10:
RK Group JV should provide the City's Department of Economic Development with copies of the missing quarterly GFEP reports, if still available.

The RK Group JV Response to 10:
The Managing Venturer was not aware that reports were not filed. It provided the audit team with the complete report for twelve quarters and partial information for another quarter.

Auditors' Comments 10:
After review and evaluation of the material, copies will be sent to the City's Department of Economic Development.