



City Council Agenda Item

City Council Meeting Date: May 21, 2024

TO: Dean Albro, City Manager

FROM: Christie Donnelly, Management Services Director
c_donnelly@ci.lompoc.ca.us

SUBJECT: Approval of Response to the 2024 Santa Barbara County Grand Jury Report – “Lompoc Tourism Improvement District Management Agreement 2019-2028”

Recommendation:

Staff recommends the City Council review the Santa Barbara County Grand Jury (Grand Jury) report entitled “Lompoc Tourism Improvement District Management Agreement 2019-2028” (Attachment 1) and approve the proposed response letter presented on behalf of the City, pursuant to California Penal Code Sections 933 and 933.05 (Attachment 2).

Background:

Visit Lompoc, Inc. (VLI) manages the Lompoc Tourism Improvement District (LTID) which provides marketing and sales promotion efforts for assessed businesses. The LTID was formed in 2013 by Resolution No. 5886(13). Pursuant to the resolution and enabling law, it was established that assessments will be levied upon the transient occupancy businesses located within the LTID, and that such assessments levied and collected by the City for the LTID shall be used only for the purposes set forth in the Resolution and Management District Plan (MDP) for the LTID.

VLI entered into the Management Agreement with the City on July 28, 2014, for the management of the LTID for a five-year term. That agreement was later renewed on August 29, 2018, for a ten-year term. The management of the LTID by VLI is subject to both the agreement and the MDP. The LTID must also comply with Streets and Highways Code § 36600, et seq., which lays out rules and regulations for tourism improvement districts. VLI is required to submit an Annual Report to the City Council within 60 days of the end of each calendar year until the end of the 2028 calendar year. The 2020 Annual Report, which reported 2020 budget and 2019 actual activity, and the 2021 Annual Report, which reported 2021 budget and 2020 actual activity, was provided to the City in March 2022. The 2022 Annual Report, which reported 2022 budget and 2021 actual activity, was provided to the City in February 2023, and the 2023 Annual Report, which reported 2023 budget and 2022 actual activity was provided to the City in July 2023. Prior

staff reports and presentations, specifically one from August 15, 2023, have explained the reasoning VLI has provided to the City for the delay in completion of its annual reports, and VLI has stated that due to the inherent timeline constraints of the Tourism Business Improvement District (TBID) collection and disbursement process, a July or August submission date is the earliest reasonable deadline.

From a logistical and practical perspective, each transient occupancy business within the boundaries of the improvement district remits payment of the TBID collected in the prior month to the City at the same time that it remits its Transient Occupancy Tax. The City retains a nominal administrative fee for processing the TBID assessment on behalf of VLI – currently 1.5%, – and records the deposits directly as a liability on its financial statements. Each month, the City disburses the balance of collected TBID assessments to VLI. The City does not recognize any money collected and subsequently disbursed as revenue to the City.

Public Comments and City Initial Analysis

Between the months of March and June 2023, three individuals made public comments during the regularly held City Council meetings alleging unaccounted funds in VLI's annual reports, calling for the City of Lompoc to either conduct or commission an independent financial audit of VLI.

In July 2023, a VLI representative provided the City with VLI's financial records for 2019 through 2022. In August 2023, City staff performed an analysis of the submitted records, alongside the annual reports and TBID disbursements. Staff noted that revenues reported on the statements differed from the annual report, and was able to pinpoint the discrepancy as caused by timing issues and differing accounting methodologies. Staff did not conduct a complete analysis or audit of VLI's financials at that time due to the City's capacity as a passthrough agent and that capacity disallowing the City from authority to conduct a financial audit or render an independent opinion regarding the presentation of VLI's financial statements. On August 15, 2023, staff presented its summary analysis at the regularly scheduled City Council meeting. A representative from VLI also spoke to the City Council and the public during that presentation. No public comments were made on this topic following the presentation and City Council discussion.

The Grand Jury and the City's Subsequent Analysis

In or around mid-to-late 2023, the Civil Grand Jury of Santa Barbara County conducted an investigation regarding allegations made of financial irregularities and alleged violations of the contract between the City of Lompoc and VLI.

In November 2023, staff initiated a deeper analysis of VLI's financials by using the records provided by VLI in July as well as VLI's annual reports. Staff identified one discrepancy in the 2019 reporting of expenditures in the amount of \$9,450. Other than that one error that staff could not reconcile, all other net profits and all balances reported by VLI were properly reconciled. Based on VLI's records and annual reports, staff then prepared a spreadsheet showing the resulting standardized financial statements and its reconciliations.

The Grand Jury report

The City received the 2024 Grand Jury report, “Lompoc Tourism Improvement District Management Agreement 2019-2028”, on March 18, 2024. All jurisdictions noticed in the Grand Jury Report must file a response to the findings and recommendations pursuant to the above referenced California Penal Code sections within 90 days of its receipt, or no later than June 16, 2024. The Grand Jury report contained six findings and ten recommendations related to Lompoc. The City is required to respond to the stated findings and recommendations, listed on pages 7-8 of the Grand Jury report.

Discussion:

The attached response to the Grand Jury identifies specific responses for each finding and each recommendation. Responses to the findings and recommendations meet the requirements of California Penal Code sections 933 and 933.05.

In addition, in order to allow for an informed evaluation by the City Council, staff has prepared this discussion and analysis of the findings in the Grand Jury report, as follows.

City of Lompoc’s Role

A key accounting principle under generally accepted accounting principles (GAAP) is that of materiality. This principle states that an accounting standard can be ignored if the net impact of doing so has such a small impact on the financial statements that a user of the statements would not be misled. Until the Grand Jury report was published, the City maintained the position that the issues surrounding VLI were both “outside the City’s purview” and that they “did not rise to the standard of materiality.” Its initial and proportionate review of the claims against VLI led to the conclusion that the accusations were, in all material respects, unsubstantiated. The City held, and continues to hold, the opinion that as a passthrough agent of non-City funds, the City does not hold responsibility to audit nor to impose regulations other than those specified in the VLI agreement on VLI, and that spending time on such activities would be a misuse of taxpayer funds if the City were to devote additional staff time to researching, analyzing and opining on an entity outside of the City’s purview. However, given the Grand Jury report and the continued implication that the City holds responsibility for a separate entity’s financial reporting, City staff are now compelled to fully analyze the financials of VLI, the accusations against them, and to render an opinion on the integrity and accuracy of VLI’s annual reports and use of TBID revenue. However, while City staff are now spending the time and resources to do this work, the City maintains the following assertions:

- VLI is independent of the City of Lompoc.
- The City of Lompoc does not retain nor report as revenue the money collected via TBID, other than the administrative fee it charges VLI for processing the deposits.
- The City of Lompoc serves solely as a passthrough entity of VLI’s TBID funds and does not hold any responsibility outside of what is specified in the VLI agreement to monitor or opine on VLI’s financial status.

Underlying Assumptions & Differences of Definitions

Difference between Annual Report and Annual Financial Statement

One of the first discrepancies in the grand jury report is the interchangeable usage of the term “annual report” with the term “annual financial statements.” Annual reports are inherently more general in nature compared to financial statements, and their scope and purpose is broader than financial statements. While financial statements focus solely on presenting quantitative financial data following strict accounting principles, annual reports present a wider array of information, often including narrative sections such as management discussions and analysis (MD&A), strategic initiatives, and future outlook. Such qualitative information in annual reports provides stakeholders with a comprehensive understanding of the company's operations, achievements, and future prospects. In annual reports, subjective assessments and forward-looking statements are common. Therefore, annual reports are not typically subjected to the same level of auditing as financial statements. Auditing annual reports would require assessing the accuracy and appropriateness of qualitative information, which can be subjective and difficult to measure objectively. Conversely, annual financial statements offer a detailed snapshot of a company's financial position and performance over a specific period. These statements adhere to strict accounting principles and provide essential quantitative data regarding revenues, expenses, assets, and liabilities.

Accounting Principles under GAAP

Generally Accepted Accounting Principles (GAAP) are a set of accounting principles, standards, and procedures that companies and organizations use to compile their financial statements. GAAP provides a common framework for preparing financial statements, ensuring consistency, comparability, and transparency in financial reporting across different organizations. In the United States, these principles are established by various standard-setting bodies, including the Financial Accounting Standards Board (FASB) and the Governmental Accounting Standards Board (GASB). These standards are regularly updated to reflect changes in the business, nonprofit and government environment and accounting practices. GAAP covers many accounting topics, including revenue recognition, expense recognition, asset valuation, and financial statement presentation. Compliance with GAAP helps ensure the integrity of financial reporting and facilitates financial analysis. Lompoc reports in accordance with GAAP in its annual financial statements.

The Securities and Exchange Commission (SEC) mandates that publicly traded companies follow GAAP in their financial reporting to ensure consistency, comparability, and transparency for investors and other stakeholders. In addition, many private companies, especially larger ones or those seeking external financing, voluntarily follow GAAP. However, privately held companies are not automatically required to adhere to GAAP. Nonprofit organizations may opt to forego GAAP requirements for a number of reasons, including limited resources or a desire for additional flexibility in painting a clearer picture of the nonprofit's finances in light of its mission, and to communicate in a specific way with its unique stakeholders. VLI does not report financial statements in accordance with GAAP standards.

Standard Financial Statements

Under GAAP, the four foundational financial statements include: balance sheet, income statement, statement of cash flows, and statement of changes in equity.

1. The balance sheet provides a snapshot of the company's financial position *at a specific point in time* (typically the last day of the fiscal year), detailing its assets, liabilities, and shareholders' equity (referred to as “fund balance” in nonprofit and governmental accounting).
2. The income statement summarizes the company's revenues, expenses, and net income or loss *over a period of time* (typically one fiscal year), detailing all the activities for the period.
3. The statement of cash flows shows the sources and uses of cash during the period, categorizing cash flows into operating, investing, and financing activities.
4. The statement of changes in equity outlines changes in shareholders' equity, including contributions, distributions, and changes in retained earnings, reflecting transactions with owners and other comprehensive income. This statement is not included with nonprofit or governmental entities.

Because VLI is not required to, and does not issue financial statements under GAAP, and because, as stated in the Grand Jury report, “VLI is not required to provide Lompoc with its financial statements,” VLI’s annual report does not contain or present GAAP financial statements. Instead, VLI’s annual report uses tables to compare budgeted and actual costs, and references terms such as collections, expenses, contingency, and carryover. These presentations and terms are not GAAP-defined, and as such, the use of them instead of GAAP-standard presentation and terminology can lead to confusion for readers when interpreting the non-standardized data presented.

However, after a thorough review of all documents available, City staff has identified that the underlying issue between the VLI annual reports and the findings of the Grand Jury is simply one of “semantic ambiguity.” Semantic ambiguity occurs when communication breaks down due to different meanings assigned to words by parties in a conversation, or in this case, a reading of an annual report. Specifically, the crux of the issue is the difference in the assumed definitions and use of the term “carryover.” VLI used the term “carryover” as a synonym of “net income (loss),” which is a product of the *income statement*, whereas the grand jury report assumed the use of the term “carryover” as a synonym of “equity” or “fund balance,” *which is a product of the balance sheet*. Neither of these definitions is intrinsically wrong, since the term “carryover” is not a term defined under GAAP, and therefore could mean any number of things.

What leads to confusion, though, is that one definition (the one used by VLI) is specific to one period of time, whereas the other definition (the one used by the Grand Jury), reports a cumulative total over multiple periods of time. Staff has concluded that there is no misrepresentation in the VLI annual reports, but there is a difference in usage of the word “carryover.” One uses the term to report “an annual amount to carry over” – specifically the surplus or deficit available to include with the budget for the following year; whereas

the other uses the term to report “a cumulative amount carried over and added to equity.” It is a subtle but distinct difference, and one that results in a misperceived discrepancy of over \$500,000.

Said another way, VLI reports each year’s carryover without reporting a cumulative total, and the Grand Jury report incorrectly assumes that “carryover” must mean “cumulative.” The term carryover is likely derived from California Streets & Highways Code section 36650(b), which states:

“(b) The report shall be filed with the clerk and shall refer to the property and business improvement district by name, specify the fiscal year to which the report applies, and, with respect to that fiscal year, shall contain all of the following information: ... (5) The estimated amount of any surplus or deficit revenues to be carried over from a previous fiscal year.”

This usage of the term carryover by the code does not state or imply a cumulative nature of carryover, it merely directs that surplus or deficit from the previous fiscal year be reported.

Analysis of the Grand Jury report:
Annual Report Analysis

The Grand Jury presented the table shown in Table 1 on page 3 of its report:

| | Est. Budget | Carryover | Total Budget | Collections | Actual Spent | Balance | Carryover | Discrepancy |
|-------------------|---------------|---------------|-----------------|---------------|---------------|---------------|---------------|---------------|
| 2018 | \$ 365,000.00 | \$ 152,012.60 | \$ 517,012.60 | \$ 424,986.60 | \$ 461,132.01 | \$ 115,867.19 | \$ 115,867.19 | \$ (0.00) |
| 2019 | \$ 440,000.00 | \$ 115,867.19 | \$ 555,867.19 | \$ 296,449.32 | \$ 393,325.19 | \$ 18,991.32 | \$ 18,991.32 | \$ 0.00 |
| 2020 | \$ 136,426.85 | \$ 18,991.32 | \$ 155,418.17 | \$ 435,153.53 | \$ 170,562.04 | \$ 283,582.81 | \$ 264,591.49 | \$ 18,991.32 |
| 2021 | \$ 360,000.00 | \$ 264,591.49 | \$ 624,591.49 | \$ 526,509.12 | \$ 272,926.84 | \$ 518,173.77 | \$ 253,582.28 | \$ 264,591.49 |
| 2022 | \$ 480,972.00 | \$ 253,582.28 | \$ 734,554.28 | \$ 782,526.00 | \$ 479,898.00 | \$ 556,210.28 | \$ 302,628.00 | \$ 253,582.28 |
| 2023 | \$ 740,000.00 | \$ 302,628.00 | \$ 1,042,628.00 | | | \$ 302,628.00 | | |
| Total Discrepancy | | | | | | | | \$ 537,165.09 |

Table 1

The report states that the Grand Jury calculated the balance (in blue) by “adding the prior year’s carryover to the current collections and subtracting the actual expenses,” and that they calculated the discrepancy value (in yellow), “from the calculated balance less the carryover numbers published by VLI.” *What the report failed to point out was that the “discrepancy” value equals the prior year’s “carryover” value.* It also incorrectly combined numbers reported as part of the budget section with numbers reported in the actual section. A more accurate table would have looked like Table 2, with the two “discrepancies” in fact equal to the prior year’s carryover.

| | Budget | | | Actuals | | | Reported Carryover | Discrepancy |
|------|--------------|--------------|-----------------|---------------|-----------------|-----------------------------|--------------------|----------------|
| | Est. Budget | PY Carryover | Total Budget | Collections | Actual Expenses | Balance (Net Income (Loss)) | | |
| 2018 | \$365,000.00 | \$152,012.60 | \$ 517,012.60 | \$ 424,986.60 | \$ 461,132.01 | \$ (36,145.41) | \$ 115,867.19 | \$(152,012.60) |
| 2019 | \$440,000.00 | \$115,867.19 | \$ 555,867.19 | \$ 296,449.32 | \$ 393,325.19 | \$ (96,875.87) | \$ 18,991.32 | \$(115,867.19) |
| 2020 | \$136,426.85 | \$ 18,991.32 | \$ 155,418.17 | \$ 435,153.53 | \$ 170,562.04 | \$ 264,591.49 | \$ 264,591.49 | \$0.00 |
| 2021 | \$360,000.00 | \$264,591.49 | \$ 624,591.49 | \$ 526,509.12 | \$ 272,926.84 | \$ 253,582.28 | \$ 253,582.28 | \$0.00 |
| 2022 | \$480,972.00 | \$253,582.28 | \$ 734,554.28 | \$ 782,526.00 | \$ 479,898.00 | \$ 302,628.00 | \$ 302,628.00 | \$0.00 |
| 2023 | \$740,000.00 | \$302,628.00 | \$ 1,042,628.00 | | | | | |

Table 2

Table 2 demonstrates that the VLI numbers represent annual values correctly, they just do not sum the prior years' carryovers together. In fact, the Grand Jury report recognizes this fact when it states on pg. 4, "this discrepancy appears to be directly related to the annual carryover values not being included in VLI's profit and loss record keeping." However, two points are important to note in regard to this statement:

- 1) Neither the State code nor the VLI agreement require that VLI report a cumulative of each year's carryover. Nor are they required to report equity or fund balance.
- 2) Standard GAAP accounting would never include cumulative carryovers (equity) in profit and loss record keeping. The first is a balance sheet item, and the other is an income statement item.

In addition, using the data provided by VLI and the Grand Jury, including the annual reports, VLI bank records, and profit & loss statements, the City prepared and compared two sets of simple standard financial statements (balance sheet and income statements) for years 2019 – 2022. One set of financial statements was prepared using VLI's publicly reported data, and the other set was prepared from VLI's bank records, profit & loss statements, and other data shared from VLI with the City. In its comparison of the two sets of financial statements, there was one discrepancy discovered in 2019 for a total of \$9,450. This discrepancy was due to the difference between reported net income (loss) of \$(96,911.37) on VLI's annual report versus a calculated net income (loss) of \$(87,461.37), as calculated by the City. The City was unable to determine if this discrepancy was due to a difference in cash versus accrual reporting, an error forwarded from a prior year, or a math error. This 2019 error of \$9,450 is the only error the City identified.

Regarding Money Market Funds

On page 4 of the report, the Grand Jury states that, "The Jury also discovered a total of \$800,000 that VLI transferred out of their checking account and into a separate Money Market account. The Money Market account funds are not reported in the annual reports submitted to Lompoc." This is a true statement, and the City takes no issue with this fact. Again, the reason why VLI does not report checking or Money Market total balances is because it does not issue a balance sheet or report equity in its annual reports. VLI only submits data in its annual report for actual activity for the year, including actual collections (cash-basis revenue), expenditures for the year, and carryover (net income(loss)). Assets and investments such as checking accounts and money market funds are to be reported on a balance sheet, and are never included with revenues and expenses on the income statement. In addition, City staff does not have concerns about VLI investing funds in a money market account versus a checking account. The City itself invests its cash held in

investments that meet its established policy requirements of safety and liquidity. Such a practice is not only acceptable, it is often considered to be a wise use of resources.

Other Points of Concern
“Failure of Oversight”

The Jury made reference to a failure of oversight finding by the 2013-2014 Grand Jury, and stated that “During the 2013-2014 investigation, the Jury received no evidence that Lompoc had implemented or was even considering establishing such a [non-profit audit] policy.” The City takes issue with several aspects of this section of the Jury’s report.

First, the City did in fact adopt a non-profit audit policy entitled “Sub-Recipient Financial, Programmatic, and Monitoring Reporting Requirement Policy”, and it sets a policy for financial and monitoring compliance reporting for those Sub-recipients who receive \$50,000 or more in City funding. The City Council approved the Administrative Procedures Manual Chapter 45 – Issue 1 through adoption of Resolution No. 5916(14) on May 6, 2014. However, the issue addressed with this policy was related to the oversight of *City-directed funding*, and it does not apply to passthrough agreements such as the one with VLI for TBID collections. It would pose an unreasonable burden upon staff time and taxpayer dollars if other exempt organizations that receive funding from the City in either passthrough or service agreement methods were to require the City to maintain fiscal oversight or to perform independent financial audits of the organizations. At the time of this report, there are 92 vendors registered with the City that are also registered as tax-exempt 501(c)(3) organizations. Ultimately, there is nothing in the law or in the VLI agreement or in the MDP that gives the City fiscal oversight responsibility over VLI.

City Recommendations:

After its full analysis, the City has answered the Grand Jury’s findings and recommendations in the attached letter. In addition, the City recommends to VLI to consider including in its upcoming annual reports a basic income statement and balance sheet for the reporting year. Adding these financial statements to the report will provide the public and other stakeholders with the desired transparency and level of reporting to alleviate concerns of any misconduct. Alternatively, or in conjunction, VLI could also opt to list the detail of its annual expenditures so that any interested parties could verify that the TBID funds are being spent as specified in the agreement. The City supports VLI if it opts to utilize TBID funds budgeted for administrative costs to commission an independent financial audit of its financial statements. However, the City does not offer an opinion on the necessity of an independent financial audit.

Fiscal Impact:

More than 150 hours of staff and attorney time have been spent addressing this unsubstantiated issue since the initial allegations were brought against VLI. Preparation for the grand jury investigation, analysis of the grand jury report, analysis of VLI’s reported financial transactions, comparison of VLI’s annual reports, preparation of this and other related staff reports, and preparation of the response letter to the Grand Jury took time

away from staff's ability to work on other important City business. The total estimated fully-allocated cost of the staff time required for the aforementioned activities is over \$50,000.

Conclusion

After reviewing the 2024 Grand Jury Report and the attached proposed response letter presented, staff recommends the City Council approve the attached response letter and authorize the delivery of the response to the Grand Jury no later than June 16, 2024, in accordance with the Grand Jury instructions.

Respectfully submitted,

Christie Donnelly, Management Services Director

APPROVED FOR SUBMITTAL TO THE CITY COUNCIL:

Dean Albro, City Manager

- Attachments: 1) 2024 Grand Jury Report "Lompoc Tourism Improvement District Management Agreement 2019-2028"
2) City of Lompoc Response to the Grand Jury Report
3) VLI Agreement 2019-2028