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Audit Report

ARAMARK CONTRACT AUDIT

April 26, 2011

Office of the City Auditor
Austin, Texas

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City of Austin



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Date: April 26, 2011
To: Mayor and Council
From: Kenneth J. Mory, City Auditor
Subject: Aramark Contract Audit

I am pleased to present this audit report on the Aramark Contract Audit. This audit was conducted as part of the Office of the City Auditor's FY 2011 Strategic Audit Plan. The Austin Convention Center Department (ACCD) contracts with Aramark for catering and concession services and the City receives 100% of Aramark's net profits, around \$1.7 million in FY 2010.

We found that ACCD does not fully comply with contractual and City requirements for internal controls. This reduces transparency and accountability, and as a result, the City cannot assure the validity of the revenues received from Aramark. Based on our work, we recommend that the ACCD Director ensure that ACCD adheres to contractual requirements and controls, and adopt an organizational structure and assign job duties to ensure a segregation of duties that aligns with City policy.

We appreciate the cooperation and assistance we received from staff in the Austin Convention Center Department during this audit.

cc: City Manager
Assistant City Managers
Austin Convention Center Director
Public Information Officer

COUNCIL SUMMARY

This report presents the results of the Aramark Contract Audit. By agreement, Aramark receives, disburses, and maintains the accounts for all funds from Concession and Catering operations, providing the Austin Convention Center Department (ACCD) the net profit from operations. In return, Aramark receives a fixed fee and is eligible for an annual productivity reward.

We found that that ACCD does not fully comply with contractual and City requirements for internal controls, which reduces accountability for funding decisions and transparency of operations.

- The City cannot reasonably assure the validity of the revenues received from Aramark. Despite contract requirements, annual financial audits of Aramark's operations have not been provided to the City since 2003. Additionally, ACCD performs limited review of financial information received from Aramark.
- Controls over reimbursements to Aramark are not always enforced. We sampled reimbursements made to Aramark from the Marketing and Repair and Replacement funds and although we did not identify any inappropriate expenditure, we observed that expenditures from these funds do not always comply with the approval procedures established by the contract.
- Stronger controls are needed over ACCD payments to Aramark from the ACCD Operating fund. We reviewed payments made to Aramark out of the operating fund and identified anomalies, such as payments unrelated to the agreement (linen services) and payments made from the operating fund instead of the marketing fund.

We made two recommendations which involve establishing appropriate segregation of duties and strengthening controls over the Aramark contract and ensuring that contract controls intended to safeguard City funds are consistently applied.



ACTION SUMMARY ARAMARK CONTRACT AUDIT



| Recommendation Text | Management Concurrence | Proposed Implementation Date |
|---|-----------------------------------|---|
| 01. The Director of the Austin Convention Center Department should adopt an organizational structure and assign job duties in such a manner as to ensure an appropriate segregation of duties and delegated authorities comparable to that outlined in Administrative Bulletin 08-01 "Roles and Responsibilities for Financial Management." | Concur | June 2011 |
| 02. The Director of the Austin Convention Center Department should ensure that contractual requirements and controls intended to safeguard City funds are properly adhered to. | Concur | Summer 2011 |

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BACKGROUND

The Austin Convention Center Department (ACCD) contracts with Aramark for catering and concession services. Per the contract, the City receives 100% of Aramark's net profits, which in FY 10 amounted to approximately \$1.7 M.

OBJECTIVES, SCOPE, AND METHODOLOGY

The Aramark Contract Audit was conducted as part of the Office of the City Auditor's FY 11 Strategic Audit Plan, as presented to the Council's Audit and Finance Committee.

Objectives

The objective for this audit was to evaluate compliance with contract terms, including verification of allowed expenses for the catering and concession services vendor.

Scope

The scope for the audit included the 1997 Agreement with Fine Host Corporation, later acquired by Aramark, and related Amendments, as well as net profit received by ACCD from Aramark, and payments from ACCD to Aramark made during FY 10 and the first quarter of FY 11.

Methodology

Methodologies for the audit included:

- Interviews of applicable departmental and management staff.
- Analysis of contract administration procedures and internal controls.
- Analysis of records and documentation of exceptions to procedures.
- Testing samples of transactions.
- Tracing expenditures.
- Confirming adherence to control processes as well as reviewing policies and procedures.

We conducted this audit in accordance with Generally Accepted Government Auditing Standards (GAGAS). Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

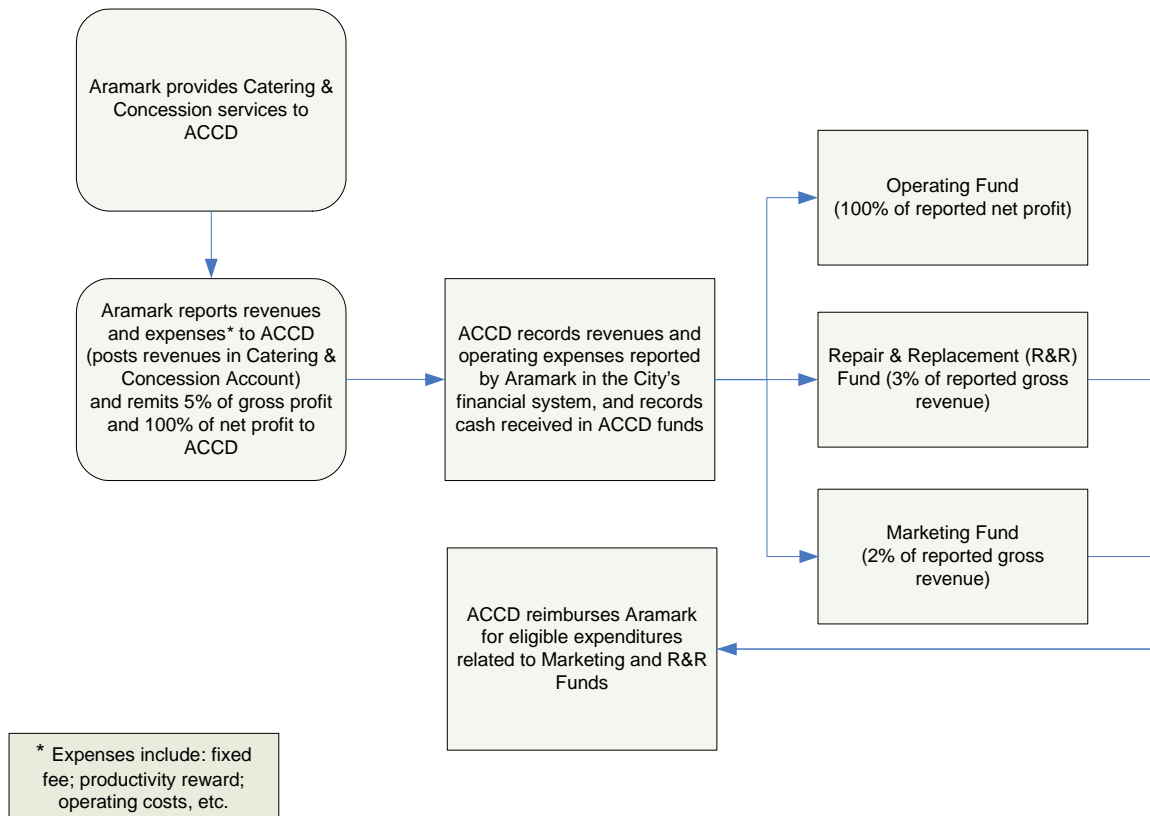
AUDIT RESULTS

In our review of the Aramark contract we found that the Austin Convention Center Department does not fully comply with contractual and City requirements for internal controls, which reduces accountability for funding decisions and transparency of operations.

Finding 1: Without audits of Aramark's operations or compensating controls, the City cannot reasonably assure the validity of net profit received from Aramark.

By agreement, Aramark receives, disburses, and maintains the accounts for all funds from Concession and Catering operations, providing the Austin Convention Center Department (ACCD) the net profit from operations. In return, Aramark receives a fixed fee and is eligible for an annual productivity reward. In FY 10, net profit remitted to the City from Aramark amounted to approximately \$1.7M, while the fixed fee retained by Aramark was reported as \$400,000 and the productivity reward as approximately \$21,000. Exhibit 1 shows how funds move between Aramark and ACCD.

**EXHIBIT 1:
Flow of Funds between Aramark and ACCD**

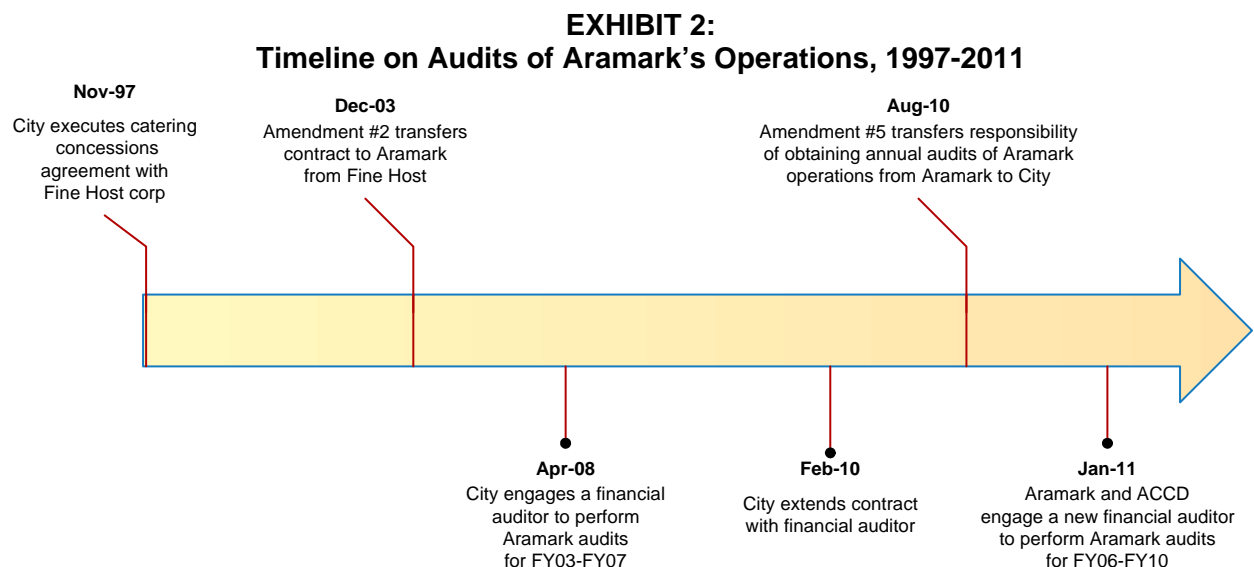


Source: OCA analysis of 1997 Catering and Concession Services Agreement and related Amendments, March 2011.

The contract between Aramark and the City requires an annual, independent, certified audit of Aramark’s catering and concession operations for ACCD; however, financial audits of Aramark’s operations have not been provided to the City. The contract establishes the requirement for annual certified, independent audits of Aramark’s operations to be submitted to ACCD by April 30 of each accounting year. However, Aramark has not submitted such audits to the City since 2003, when with the acquisition of the operations of Fine Host Corporation, Aramark assumed responsibilities over the catering and concession contract with the City.

In April 2008, the City contracted with an independent financial auditor to obtain audits for FY 03 through FY 07, starting with FY 06; however, the auditor engaged by the City has recently indicated they cannot rely on the financial records of Aramark, and therefore cannot complete the FY 06 audit. In January 2011, Aramark and ACCD hired a new independent financial auditor to complete audits for FY 06 through FY 10. The new auditor has yet to complete the five outstanding audits for the respective years.

The exhibit below summarizes the sequence of events regarding audits of Aramark’s operations to date.



Source: OCA analysis of Catering and Concession Services Agreement and documentation related to audit requirement, March 2011.

Without sufficient assurance about Aramark’s reported revenues and expenses, ACCD cannot ensure the validity of the net profit due to the City under the contract.

Additionally, ACCD performs limited reviews of financial information from Aramark, insufficient to assure that Aramark’s revenues and expenses are reported correctly. ACCD management and staff indicated they do not perform reviews of Aramark’s submitted monthly bank statements, financial statements and accompanying support, and balance sheets. Staff primarily review Aramark information as part of the

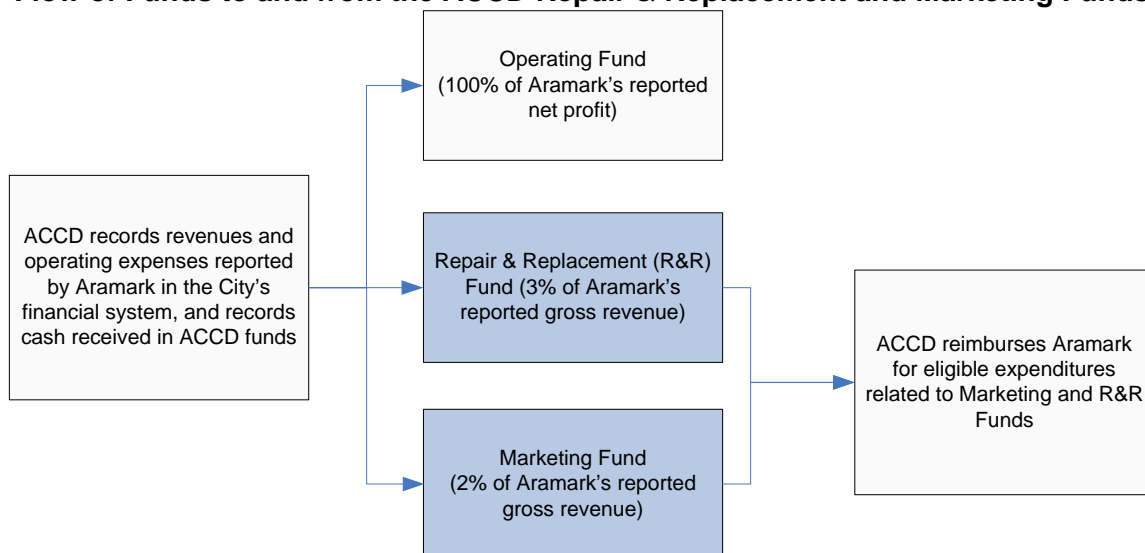
budgeting process, looking at such items as revenue trends and forecasting, rather than as a part of contract monitoring and review. Also, staff verify the accuracy of calculations submitted by Aramark, such as the 5% remittance for the Marketing and Repair and Replacement funds, as well as the calculation of the productivity reward. However, staff approved the productivity reward without verifying whether a third party conducted the customer satisfaction surveys on which the reward is based, as required by contract. Also, we have observed that Aramark has not provided to ACCD all financial information required by the contract, such as a statement of cash flows and a statement of the number, type, and location of Minority and Women Owned businesses contracted for each event.

Without regular, proper review of Aramark's financial information, and adequate management oversight, ACCD cannot ensure that contract requirements are adhered to and that the City is receiving the appropriate funds due per contract.

Finding 2: Controls over ACCD reimbursements to Aramark from the Repair and Replacement (R&R) and Marketing funds are not consistently applied.

ACCD has an agreement for Aramark to provide catering and concession services, with an ACCD Marketing Fund financed by Aramark to pay for the promotion of services, an ACCD Repair and Replacement (R&R) Fund to pay for equipment, and a prescribed set of controls over expenditures from these two funds. In our review of expenditures from the Repair and Replacement and Marketing funds, we did not identify any inappropriate reimbursements made by ACCD to Aramark from these two funds, but determined that controls over these two funds are not consistently applied.

**EXHIBIT 3:
Flow of Funds to and from the ACCD Repair & Replacement and Marketing Funds**



Source: OCA analysis of 1997 Catering and Concession Services Agreement and related Amendments, March 2011.

Repair & Replacement Fund

The contract establishes controls over the Repair and Replacement (R&R) fund, requiring Aramark to notify the ACCD Director in writing prior to incurring expenditures to be paid from this fund; this notification should include information on the basis for acquisition or repair of the equipment. In addition, the contract requires that Aramark comply with City purchasing policies, including requirements for competitive bidding and limits on petty cash expenditures.

We sampled two months of reimbursements for a total of 30 invoices amounting to approximately \$39,000 (which represents around 27% of the \$146,000 reimbursed from the R&R Fund in FY 10) and found that expenditures did not always comply with the procedures established by the contract. As shown in Exhibit 4, we found that 80 percent of reimbursed invoices sampled lacked evidence of prior notification. ACCD has written procedures that incorporate contract terms to guide staff review of invoices submitted by Aramark for reimbursement. However, all of the sampled reimbursements were approved by financial staff for payment even though they did not comply with contract requirements. Further, ACCD does not have procedures in place to confirm that Aramark complies with competitive bidding requirements.

**EXHIBIT 4:
Sampled Expenditures from Repair & Replacement Fund
Not in Compliance with Approval Procedures**

| Exception Type | # of exceptions | % of sample (exception) | % of sample \$ | % of sample (value) |
|------------------------------------|------------------------|--------------------------------|-----------------------|----------------------------|
| no prior notification | 24 | 80% | \$27,237 | 69% |
| no evidence of competitive bidding | 1 | 3% | \$11,066 | 28% |
| exceeded petty cash limit | 1 | 3% | \$285 | 1% |

Source: OCA analysis of documentation related to FY 2010 reimbursements from R&R Fund.

Marketing Fund

The contract also establishes controls over the Marketing fund, requiring prior approval by the ACCD Director and the City Manager, or designee, for all expenditures out of this fund. In addition, the contract requires that Aramark comply with City purchasing policies, including requirements for competitive bidding and limits on petty cash expenditures.

We identified expenditures within our scope period which did not comply with the established controls over this fund.

- One expenditure of \$10,608 appeared to have been initially approved out of ACCD operating funds and later reallocated to the Marketing fund without prior approval from the City Manager's designee.
- One expenditure was approved as a \$6,000 expense but was reimbursed for \$20,000 without prior approval from the City Manager's designee.

While the contract establishes specific controls over reimbursements to Aramark from the R&R and the Marketing funds, the application of these controls needs improvement, as inconsistent enforcement of these controls could result in the misuse of City funds. City policies assign to the department financial manager the responsibility to ensure adequate controls are in place to monitor contracts and financial relationships with third parties; however, the ACCD Director functions as the contract administrator for the Aramark contract, which includes approving services, expenditures, and initiating and approving contract changes which may create a conflict of interest. Separation of duties is a cornerstone of best practice internal controls. The current structure for internal controls, contract administration, and contract monitoring within the department does not establish sufficient segregation of duties to provide proper oversight of compliance over the contract.

Finding 3: Internal controls over ACCD Operating fund expenditures need to be consistently applied.

In addition to reviewing payments to Aramark from the dedicated ACCD Repair & Replacement and Marketing funds, we reviewed payments to Aramark from the ACCD Operating fund and identified the following anomalies:

- Payments to Aramark from Operating fund instead of the Marketing fund:
In order for the City to accurately account for costs assignable to the Aramark contract and to ensure the appropriate operation of controls over marketing expenditures, payments for items related to marketing need to be made from the dedicated Marketing fund established by the contract. In our review, we identified payments, which if the required pre-approval of the City Manager's designee had been received, could have been paid through the Marketing Fund. According to ACCD staff, the Department experiences problems with applying the right code to expenses to ensure payment from the appropriate account, and training and standardized processes are needed to ensure that expenses are allocated to the appropriate fund. Also, if ACCD has not obtained prior approval for marketing expenditures, the Director authorizes payment out of the Operating fund. In FY 10, expenditure from the Marketing Fund was below available funds set at \$202,383, with \$153,863 spent.
- Payments to Aramark for linen services which bypassed City purchasing rules:
Our review revealed that ACCD uses Aramark to procure repetitive purchases for linen services. Per City purchasing policies, repetitive purchases should be conducted by the City's central Purchasing Office, following competitive bidding requirements. However, in our review we identified approximately \$12,000 in payments to Aramark for linen services during the scope period (FY 10 and first quarter of FY 11) which were not made in accordance with City purchasing rules.

RECOMMENDATIONS

The recommendations listed below are a result of our audit effort and subject to the limitation of our scope of work. We believe that these recommendations provide reasonable approaches to help resolve the issues identified. We also believe that operational management is in a unique position to best understand their operations and may be able to identify more efficient and effective approaches and we encourage them to do so when providing their response to our recommendations. As such, we recommend the following:

1. The Director of the Austin Convention Center Department should adopt an organizational structure and assign job duties in such a manner as to ensure an appropriate segregation of duties and delegated authorities comparable to that outlined in Administrative Bulletin 08-01 "Roles and Responsibilities for Financial Management."

MANAGEMENT RESPONSE: Concur

We concur with the assessments made within the audit. Based on the findings, we will be implementing the following improvement plan:

- A. The ACCD Assistant Director over contracts has already begun the process of creating specific procedures and a template for staff and Aramark to ensure all contractual requirements are met, including all of the items identified in this audit. Additionally, a new position will be created, which will report to the Assistant Director, to provide direct oversight and management of the Aramark contract. **Anticipated hiring date for the new contracts position: June, 2011.**
 - B. Monthly financial statements will now be submitted to the newly created contracts employee. This employee will verify that Aramark has provided all financial information and deliverables required by the contract; including statement of cash flows, Minority and Women Owned business documentation, and other contractual obligations. They will also coordinate the EARR Fund and all of its components. Added emphasis will be placed on verifying approvals, monitoring petty cash use, and securing competitive bidding.
 - C. After reviewing all items included in the Monthly Financial Submittals, the contracts employee will verify the document with the Convention Center's Chief Financial Manager and Contract Manager. After this review, a cover letter (with signatures from all aforementioned parties) will be placed on top of the packet prior to getting final approval from the Department Director (Contract Administrator).
 - D. The Chief Financial Manager will take a more active role in the supervision of our Food and Beverage Contractor. After quarterly reviews of the caterer's financial operations, the Chief Financial Manager will analyze the results and make recommendations. **Anticipated start date: 1st Quarter, FY 2011-2012.**
 - E. The Chief Financial Manager will also be required to monitor expenses from the Operating Fund and direct appropriate expenditures to the EARR Fund. **Anticipated completion date: Ongoing.**
-

2. The Director of the Austin Convention Center Department should ensure that contractual requirements and controls intended to safeguard City funds are properly adhered to.

MANAGEMENT RESPONSE: Concur

We concur with this statement. The Director of the Austin Convention Center is committed to safeguarding City of Austin funds and following contractual requirements.

As mentioned in the audit, the COA and Aramark recently hired an independent financial auditor to complete the catering audits for FY 06 through FY 10. Upon receiving the results of those audits, the Convention Center Department will assess the findings and determine the future relationship with the contractor.

Anticipated completion of 2006-2010 audits: Summer, 2011.

The Aramark contract with the Convention Center Department expires in September, 2012. The Department has the option of extending the contract based on audit findings. In either case, a Directive Memo will be needed to clarify some of the generalities found within the contract and list some of the newly created internal policies and procedures.

If the findings of the audit are determined to be unacceptable, then the Department will follow City of Austin procurement procedures and select a Food and Beverage provider through the competitive bidding process.
