

**APPROVED MINUTES  
APPROVED ON 10/24/2016**



**CITY OF SCOTTSDALE  
AUDIT COMMITTEE**

**Monday, September 19, 2016**

**City Hall, City Attorney's Conference Room  
3939 North Drinkwater Blvd  
Scottsdale, AZ 85251**

**REGULAR MEETING**

**PRESENT:** Suzanne Klapp, Chair  
Virginia Korte, Councilmember  
Kathy Littlefield, Vice Mayor (arrived 3:02 p.m.)

**STAFF:** Sharron Walker, City Auditor  
Lai Cluff, City Auditor's Office  
Cathleen Davis, City Auditor's Office  
Brian Biesemeyer, Acting City Manager  
Gina Kirklin, Water Resources  
Dave Lipinski, Public Works  
Jeff Nichols, City Treasurer  
Lorelei Oien, Human Resources  
Dan Worth, Public Works

**GUESTS:** Sandra Schenkat, Judicial Appointments Advisory Board Member

**CALL TO ORDER**

Chair Klapp called the meeting to order at 3:01 p.m. A formal roll call confirmed the presence of all Committee Members as noted above.

### **1. Approval of Minutes, Regular Meeting, June 20, 2016**

**COUNCILMEMBER KORTE MOVED TO APPROVE THE MINUTES OF THE JUNE 20, 2016, REGULAR MEETING. CHAIR KLAPP SECONDED THE MOTION, WHICH CARRIED BY A VOTE OF TWO (2) TO ZERO (0). VICE MAYOR LITTLEFIELD HAD NOT YET ARRIVED.**

### **2. Discussion and Possible Direction to Staff Regarding Human Services Commission Sunset Review**

Cathleen Davis, Senior Auditor, noted that as provided in the Scottsdale Revised Code, the Human Services Commission's purpose is to advise City Council on improving the City's human services and the planning and development of human services to address Scottsdale citizens' needs. The Commission assists coordination with private agencies and also reviews and makes recommendations to Council on funding applications for various funding sources.

Vice Mayor Littlefield arrived at 3:02 p.m.

Ms. Davis stated that the action required by the Audit Committee is to evaluate whether the board or commission being reviewed is serving its intended purpose; whether the board or commission purpose should be maintained or modified; and whether the purpose has been served or is no longer required. Specifically, the Audit Committee is to recommend to the City Council whether to continue or terminate the board or commission.

Councilmember Korte and Chair Klapp spoke in favor of the Human Services Commission, noting that it serves a critical role for the City, such as allocation of CDBG funds. Vice Mayor Littlefield agreed.

**COUNCILMEMBER KORTE MOVED TO RECOMMEND TO CITY COUNCIL THE CONTINUATION OF THE HUMAN SERVICES COMMISSION. VICE MAYOR LITTLEFIELD SECONDED THE MOTION, WHICH CARRIED BY A VOTE OF THREE (3) TO ZERO (0).**

### **3. Discussion and Possible Direction to Staff Regarding Judicial Appointments Advisory Board Sunset Review**

Ms. Davis stated that the Judicial Appointments Advisory Board's purpose is to recommend to the City Council the best qualified persons to become full-time City judges. The Board last met in 2013 and at that time the current presiding and associate judges were reappointed to four year terms starting in 2013 and 2014. Their next need for a meeting will be in 2017.

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recommend to the City Council whether to continue or terminate the board or commission.

Vice Mayor Littlefield asked whether the Board is required by law. Ms. Walker stated that she has not looked at this recently, but if so, this may be one of the boards that either the City Council serves as or appoints, as an alternative for how the responsibility is handled. Vice Mayor Littlefield noted that the annual report of 2013 has not yet been approved. Lorelei Oien, Human Resources, confirmed this, noting that the Board meets as needed and the next round of judicial appointments starts in the spring of 2017. The Board consists of three judges, an attorney and three citizen members. In respect of the members' time, a meeting is not called just to approve the annual report.

Ms. Walker noted that the Council approved the change to a four-year term for reappointed judges, although the initial appointment is for only two years. All the current judges were reappointed to four-year terms around the same time, so that's why the Board will not need to meet until 2017.

Sandra Schenkat, JAAB member, noted she has not seen the draft annual report and will ask that it be distributed to the members. She further noted that their last meeting was five hours long. She would like to have the reviews occur every two years despite the four year terms as a good check and balance and so the public knows they are getting the best.

In response to Vice Mayor Littlefield's question, Ms. Walker noted the timing of these particular judges' terms all happened to occur during the same four year cycle.

Chair Klapp commented that if one of the judges was to retire, there would be a meeting to appoint a new judge and his or her first term would be for two years. With the Board's specific duties, there's not a reason for them to meet unless they are discussing appointments.

**COUNCILMEMBER KORTE MOVED TO RECOMMEND TO CITY COUNCIL THE CONTINUATION OF THE JUDICIAL APPOINTMENTS ADVISORY BOARD. VICE MAYOR LITTLEFIELD SECONDED THE MOTION, WHICH CARRIED BY A VOTE OF THREE (3) TO ZERO (0).**

**4. Presentation and Discussion of Report No. 1602, Biennial Certified Audit of the City's Land Use Assumptions, Infrastructure Improvement Plans and Development Fees**

Sharron Walker, City Auditor, stated that the consultant will be at the October 10 Council meeting for the public hearing on this report, so she will only summarize the highlights now. State legislation changed the requirements regarding municipalities' responsibilities related to development impact fees. One of the requirements was to either have an advisory committee or a biennial audit, and the City opted for the biennial audit. The statute is very specific that the audit cannot be performed by an official or employee of the City, so the work was contracted out to Raftelis Financial Consultants. The audit concluded that there were no inequities in how the plans were implemented or in how the development fees were imposed. The statute requires that the report be posted to the City's website with the public hearing within 60 days.

Vice Mayor Littlefield stated that she was impressed with the audit conclusions.

In response to question from Chair Klapp, Ms. Gina Kirklin, Water Resources, stated that she and her staff spent approximately two weeks providing the necessary data for the audit. Mr. Brian Biesemeyer, Acting City Manager, added that, while it is an additional burden, much of this work must be done anyway in order to set fees correctly.

**VICE MAYOR LITTLEFIELD MOVED TO ACCEPT THE AUDIT REPORT AND TO DIRECT STAFF TO POST THE REPORT TO THE CITY'S WEBSITE AND SUBSEQUENTLY PROCEED WITH A PUBLIC HEARING. COUNCILMEMBER KORTE SECONDED THE MOTION, WHICH CARRIED BY A VOTE OF THREE (3) TO ZERO (0).**

#### **5. Presentation and Possible Direction to Staff Regarding Audit No. 1615, Northsight Boulevard Extension Construction Contract**

Lai Cluff, Senior Auditor, stated that the audit of the Northsight Boulevard Extension Construction Contract was added to the FY 2015/16 audit plan after completion of a prior construction contract audit. For the project, Capital Projects Management contracted a construction manager at risk (CMAR) and approved a guaranteed maximum price (GMP) of approximately \$7.9 million to complete the work. A CMAR is hired during the design phase of a project to review plans, provide design input, create a construction plan and put together a GMP cost proposal. With a GMP contract, the CMAR assumes the risk of delivering the construction project on time and within the agreed upon contract amount. Auditors reviewed the City's project management files as well as the contractor's project files, vendor invoices and job cost ledgers.

The audit found overpayments of approximately \$147,000 resulting from sales tax overpayments, overstated labor rates and subcontractor costs that were not fully supported. Also, some items with uncertainties were negotiated as lump sum, but would have been more appropriate as allowances to better control costs. For example, the City paid a total of approximately \$525,000 in lump sum for traffic control costs, including off-duty police officers. However, the actual amounts paid to subcontractors totaled only \$207,000. Also, subcontractor costs were not consistently identified in the GMP documents, making verification more difficult. Sometimes the CMAR itself performed work that was identified in the GMP as subcontracted, or the CMAR subcontracted work that was included as self-performed. These changes were not clearly identified in the CMAR's cost records for comparison to the GMP pricing or in the GMP pricing for comparison to actual costs. Additional clarification to contract language regarding payment for subcontracted work is recommended as well as more consistency between projects in how the construction fee is handled.

The audit also commented on several aspects of contract administration and project management that could be improved, including more consistent documentation of project files, approval of changes to scope or cost and execution of all pertinent contract documents.

Vice Mayor Littlefield commented that the audit findings are similar to issues identified in last year's project management report, with little evidence of improvement. She cited the lack of an adequate review process for payments. A standardization of procedures

is needed. Some paperwork is missing, which would verify that the work has been signed off by the City. Paperwork, including change orders and contracts, should be attached to the original contract. The name of responsible persons from the City and the contractor should be clear in case there are questions. All the documentation should be confirmed before payment is made. She agreed with the audit recommendations to tighten up the controls.

Mr. Worth commented that this project was done concurrently with the Scottsdale Road project. The Scottsdale Road project audit identified necessary changes in procedure. These changes have been implemented, but the changes occurred subsequent to the Northsight Boulevard project. He wrote the management response to this audit and agreed with many of the findings, particular in regards to procedures and documents. In all cases, if the Scottsdale Road audit identified a problem, it was fixed. He stated that it was unfair to include comments referring to the Scottsdale Road audit in the Northsight Boulevard audit. If the point was to point out inconsistencies, there were inconsistencies but this one was done right. Where there were failures in documentation, actions have been taken based on the Scottsdale Road audit to fix them.

Now that the new procedures have been implemented, the results will be different. For example, the audit made conclusions based on available documentation. In the case of questionable costs from using lump sum instead of allowance, both are acceptable methods of paying for work items that cannot be quantified. With an allowance, the contractor must keep all documentation and submit it to the contract administrator for verification prior to payment. A lump sum is like a low bid contract. An amount is agreed upon for payment of the work in the contract, no more, no less. Lump sum does not require documentation of all costs. This is being changed to require documentation.

The audit looked at subcontractor invoices. However in some cases, CMAR performed some of the work themselves. This is a legitimate way of measuring and paying costs and was documented according to the practice in place at the time. The practice has since been modified and improved. He did not think the questioned costs are questionable because the contractor would behave differently if those items had been negotiated as allowances. With dirt hauling, there was a negotiated price in the GMP of approximately \$250,000. There were subcontractor invoices totaling much less. The difference between the two was included as a questionable cost, but it was self-performed work. The department verified that the work was completed. If the sum of those subcontracts was \$75,000 less than the GMP amounts, that variance was a very small percentage of the contract value and it represents work that the contractor self-performed. The department does not have documentation for that because it did not collect it back then and it is difficult to expect the contractor to maintain that documentation for three years. The bottom line for the subcontracts is that quantities were verified and the City got what it paid for. In some cases the City got less than what was in the GMP, but overall, the project was completed on time and well within budget. He agreed that there were some questionable costs and overpayments. For some cases, they will go back to the contractor to settle this with a repayment from the contractor. Those have been identified in the report. He created a modified summary of overpayments and questionable costs which total approximately \$107,000, representing 1.3 percent of the total value of the GMP.

Chair Klapp stated her concern that Mr. Worth's written comments, which were not as well explained in the management response as those provided in person today, show

that there is a difference of opinion but the response did not indicate how the issues would be resolved. The Audit Committee is charged with looking at the operations of the City to improve processes where possible, and that is why they wanted to review another construction contract. It just so happened that this contract occurred at the same time as the Scottsdale Road contract. However, the management response did not seem to state how those issues were being addressed, but instead offered a disagreement with the findings. She suggested further efforts between the audit team, the City Manager and Mr. Worth to provide better answers to address the issues in the audit report prior to it being published. She stated that in business, a negotiated allowance seems preferable to a lump sum because that the expenditures are evidenced by back-up documents. On the alternative, a low-figure lump sum would be a feasible approach. But if there is not enough information to make that determination, it seems the best approach is to err on the side of doing an allowance. Chair Klapp further suggested that the changes Mr. Worth is stating are being made ought to be addressed in the department's response.

Councilmember Korte commented that among the many conspiracy theories is the idea the government entities tend to mismanage funds. She noted that in three different areas the City Auditor commented on the management response that CPM is assuming the self-performed work equals the cost difference between subcontractor payments and City payments. Councilmember Korte recognized that CPM is working to make improvements but expressed concern with the response. She also stated that prior to approval of the report, some different approaches need to be made in the management action plan.

Ms. Walker stated that at the time the Audit Committee discussed the Scottsdale Road audit, the department said they had never had any problems with CMAR contracts and this was an isolated instance, and that the contractor did not understand or did not do the buyouts right. The reason why she chose another CMAR contract from the same period of time was to address whether it was an isolated instance as was represented to the Audit Committee. This contractor kept better, more detailed records. In this case, the recoverable costs are much lower because they did generally bill in accordance with what was in the GMP. The questioned costs are not costs that auditors believe the City should go back to the contractor to recover. These are costs where it does not appear the department made the right choice in how the contract was negotiated. Ms. Walker cited the contract terms quoted in Finding 1 of the audit report, which describes that Project Requirements, including traffic control, is an allowance to be verified by billed expenses. This is why the audit questions these costs, because the contract states that it was to be handled one way, but instead it was negotiated to be paid as a lump sum. In another example, the department allowed the construction fee to be applied to General Conditions although the contract says it is not to be. So the audit report distinguishes between recoverable costs, where there are some instances of overbilling, and questioned costs, where the department was inconsistent with what this contract says. The auditors do not think the contractor owes the questioned costs back to the City. Ms. Walker noted that she added the Auditor comments to clarify the issues in the management response. Further, if the Audit Committee wants a better management action plan in the report, she will hold the audit report so that one can be developed.

Committee members expressed agreement with this approach.

**6. Presentation and Discussion of 2nd Quarter CY 2016 Taxpayer Problem Resolution Officer Report**

Ms. Walker stated that the results of the TPRO report are generally the same as they typically are, with high ratings for the tax and license, services and billing side. Staff will follow up with the department manager to determine whether further tax audit surveys will be sent out next year.

**7. Discussion and Possible Direction to Staff Regarding Status of FY 2016/17 Audit Plan**

Ms. Walker stated that a meeting will not be needed in December, based upon the anticipated timing of the Plan. The Preventative Maintenance and Repair audit was pushed to October to keep this meeting shorter since there is a Council meeting at 5 p.m.

**8. Discussion and Possible Direction to Staff Regarding Agenda Items for Next Audit Committee Meeting**

Ms. Walker said that for the October agenda, there will be two sunset reviews: the Transportation Commission and the Paths & Trails Subcommittee. In addition to the Preventative Maintenance and Repair audit, a review of the Destination Marketing audit is planned, but that one may be pushed to November. There will be another quarterly update for the TPRO.

**Public Comment**

No members of the public wished to address the Committee.

**Adjournment**

The meeting adjourned at approximately 3:45 p.m.

SUBMITTED BY:

eScribers, LLC