

**APPROVED MINUTES
APPROVED ON 03/19/2018**



**CITY OF SCOTTSDALE
AUDIT COMMITTEE**

Monday, January 22, 2018

**City Hall, Kiva Conference Room
3939 North Drinkwater Blvd
Scottsdale, AZ 85251**

REGULAR MEETING

PRESENT: Suzanne Klapp, Chair
Virginia Korte, Vice Mayor
Kathy Littlefield, Councilwoman

STAFF: Sharron Walker, City Auditor

Paul Christiansen, Senior Auditor
Lai Cluff, Senior Auditor
Cathleen Davis, Senior Auditor
Brad Hubert, Senior Auditor
Jennifer Bowley, WestWorld Management Analyst
Karen Churchard, Tourism and Events Director
Tim Curtis, Current Planning Director
Julie Dybas, Court Administrator
Brian Dygert, WestWorld General Manager
Ken Kung, Court Administrator Deputy
Joseph Olcavage, Presiding Judge
Rachel Smetana, Mayor's Chief of Staff
Brent Stockwell, Assistant City Manager
Steve Venker, PNT Manager

GUESTS: Jeff Beyersdorfer, Scottsdale Arts Board member
Shakir Gushgari, Development Review Board member

Sonnie Kirtly, Coalition of Greater Scottsdale
Sandra Schenkat
Mary Lundell, JP Morgan
Scott McDaniel, Director of Finance and Administration, Scottsdale Arts
Mike Miller, Interim CEO, Scottsdale Arts

CALL TO ORDER

Chair Klapp called the meeting to order at 4:00 p.m. A formal roll call confirmed the presence of all Committee Members as noted above.

1. Approval of Minutes, Regular Meeting, November 13, 2017

VICE MAYOR KORTE MOVED TO APPROVE THE NOVEMBER 13, 2017, REGULAR MEETING MINUTES AS PRESENTED. COUNCILWOMAN LITTLEFIELD SECONDED THE MOTION, WHICH CARRIED BY A UNANIMOUS VOTE OF THREE (3) TO ZERO (0).

Public Comment

Chair Klapp invited anyone who wished to speak on a topic not on the agenda to come forward at this time. Sandra Schenkat provided public comments, stating she would like to request another audit on Experience Scottsdale. She is interested in investigating the \$9.7 million in bed tax again. The results of her own research are pretty alarming in terms of salary increases over the past two years. Current tax returns are not available, but there are available tax returns from 2014 and 2015. The salary for the marketing vice president increased \$36,000 in a couple of years. The CFO salary increased by \$54,000. The CEO salary increased by \$46,000. Those who authorized the increase are the president and vice president of the Board of the Convention and Visitors Bureau. It is notable that the City Manager earns \$220,000 and the Executive Director of Experience Scottsdale earns \$539,000. Experience Scottsdale's CFO earns \$268,000 and the City's position earns less than \$200,000, while overseeing a budget of \$1 billion compared to Experience Scottsdale's \$13 million. The situation is egregious and warrants further audit.

2. Discussion and Possible Direction to Staff Regarding Development Review Board Sunset Review

Cathleen Davis, Senior Auditor, stated that the Development Review Board's purpose is to review all aspects of the proposed design of a development including, but not limited to, site planning and the relationship of the development to the surrounding environment and community, guided by the Development Review Board criteria. They establish design policies and guidelines that support the general plan. 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.

COUNCILWOMAN LITTLEFIELD MOVED TO RECOMMEND TO CITY COUNCIL TO CONTINUE THE DEVELOPMENT REVIEW BOARD. VICE MAYOR KORTE SECONDED THE MOTION, WHICH CARRIED BY A UNANIMOUS VOTE OF THREE (3) TO ZERO (0).

3. Discussion and Possible Direction to Staff Regarding Planning Commission Sunset Review

Ms. Davis stated that the Planning Commission's purpose is to hold public hearings as required by law and make recommendations to the City Council on all matters relating to General Plan amendments, zoning district map amendments, Zoning Ordinance text amendments, conditional use permits, municipal use master site plans and abandonments, and any other matters within the scope of the planning and zoning powers available to all cities in Arizona. They are also to act as an advisory board to the City Council on land use and zoning matters. 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.

COUNCILWOMAN LITTLEFIELD MOVED TO RECOMMEND TO CITY COUNCIL TO CONTINUE THE PLANNING COMMISSION. VICE MAYOR KORTE SECONDED THE MOTION, WHICH CARRIED BY A UNANIMOUS VOTE OF THREE (3) TO ZERO (0).

4. Discussion and Possible Direction to Staff Regarding Report No. 1811, City Court's Minimum Accounting Standards Review

Sharon Walker, City Auditor, noted that the Arizona Supreme Court, Administrative Office of the Courts requires this independent review. An agreed-upon procedures review, unlike a typical audit, is where the two parties have agreed on the procedures to be reviewed. The Administrative Office of the Courts has specific minimum accounting standards that courts in the State are to comply with. They have a guide for external reviews, and require a CPA to review the court's compliance. Auditors completed the extensive list of tests and procedures that are required. There was one minor exception noted and the Court indicated in its response that it is addressing this.

Councilwoman Littlefield commented that it was nice to see such a clean audit.

CHAIR KLAPP MOVED TO APPROVE REPORT NO. 1811. COUNCILWOMAN LITTLEFIELD SECONDED THE MOTION, WHICH CARRIED BY A UNANIMOUS VOTE OF THREE (3) TO ZERO (0).

5. Discussion and Possible Direction to Staff Regarding Audit No. 1807, Scottsdale Arts Contract

Ms. Davis stated that the audit was performed to evaluate contract compliance, effectiveness and administration. Scottsdale Arts was created in 1987 as a non-profit to provide advisory and management services for the City's art and cultural facilities. In 1988, the City entered into a management services agreement designating Scottsdale Arts as the principal organization managing arts and cultural activities for the City. Each year, an annual Financial Participation Agreement establishes the financial terms to pay for the agreement. The total amount of City funding has ranged from \$4.7 to \$5.2 million per year over the past five years.

The audit found that Scottsdale Arts underspent approximately \$202,000 of purpose-restricted City funding, and art maintenance funds have not increased in proportion to new art. The contract administrator has not ensured Scottsdale Arts appropriately spent the purpose-restricted funds. The agreements establish a requirement for some funding being provided for specific purposes, which includes specialty equipment and fixtures maintenance and repair, City artwork, conservation and restoration, the Community Art Grants Program, and Art in Public Places and Cultural Improvement programs' management and administration. Until recently, Scottsdale Arts did not separately track the purpose-restricted funding compared to the related expenditures. Also, in preparing its annual financial statements, the organization netted all purpose-restricted funding and expenses together to calculate a carryforward amount. This method results in understating the amounts not spent for the four specifically restricted purposes. Over the past three fiscal years, Scottsdale Arts has spent approximately \$202,000 less than specified for the restrictive purposes. Although more public art has been added, the purpose restricted funds for art maintenance have decreased. City funding to Scottsdale Arts through the agreement increased from \$4.2 million to \$4.6 million over the past ten years. During this same period, the purpose-restricted funds decreased from \$1 million to \$780,000. This funding reduction can have negative consequences for the maintenance and restoration of City-owned public art.

Additionally, Scottsdale Arts is not progressing in its efforts to become more independent of City funding. While the agreement requires Scottsdale Arts to maximize its revenues from other, non-City sources, its ratio of City funding to non-City funding has ranged as high as 47% during the past five years. Scottsdale Arts' strategic plan does not include specific, measurable and time-bound goals, as required by the agreement, for earned and contributed revenues or a target percentage for non-City funding. By spending \$0.45 to \$0.62 annually to raise each contributed dollar that it does not receive from the City, Scottsdale Arts does not raise funds efficiently in comparison to similar organizations nationally and locally. This is three to four times more than the national and Arizona average of \$0.14 per contributed dollar for comparable organizations. Scottsdale Arts spent 17.9% of its total expenses on administrative costs in FY 2015/16. While this percentage has decreased over the past decade, it is still about 3 percentage points higher than that of comparable Arizona and regional organizations.

The agreement requires Scottsdale Arts to provide the Contract Administrator with an annual comprehensive written operational plan and report. It also requires the organization's annual report to critically evaluate the organization's performance measures and satisfaction of its primary duties under the agreement. However, the Contract Administrator has not enforced this requirement. Scottsdale Arts has not established resident company relationships with local performing art organizations as many similar art and culture organizations have done.

Contract administrator oversight of program management and public transparency can be improved. The Contractor Administrator directly authorized almost \$140,000 in additional funds to Scottsdale Arts through the City's Community Arts Trust fund. This reduces the incentive to fund programs from its ongoing City funding. A public process to invite and improve the grant applications would be more transparent. The Contract Administrator does not have a list of public art installed by the City and by private developers to verify that Scottsdale Arts is fulfilling its annual inspection responsibilities. Tracking public art installed by the City and by private developers would help the Contract Administrator confirm whether Scottsdale Arts' annual inventory and maintenance evaluation includes all public art pieces. The Contractor Administrator does not monitor the timeliness of Scottsdale Arts' posting its board meeting notices and agendas. Tourism and Events generally agreed with the audit recommendations.

Chair Klapp noted that two people wished to speak on the audit, and that could be followed by any further discussion.

Mike Miller, Interim CEO for Scottsdale Arts, said they believe the audit process is a great process to help improve organizations, processes and procedures. While there are some disagreements with some findings, Scottsdale Arts values the audit process and is committed to work with City staff on the audit findings. Scottsdale Arts endeavors to be as transparent as possible because it is entrusted with a lot of City money. He did not want to address each audit comment other than a couple points. First, Public Art under the Financial Participation Agreement has specific dollar amounts, which are segregated. If they underspend in one year, they book that as deferred revenue and roll it forward to the following year. The funds are accounted for and 100 percent spent on public art. As far as the Community Arts Grant Program, there was significant confusion as to how it was to be administered in that one given year, and Scottsdale Arts is committed to working with City staff to resolve that. Scott McDaniel, the Scottsdale Arts CFO, was also available if the Committee had any questions. Committee members thanked them for attending.

Chair Klapp recognized Sandra Schenkat who also wished to speak on this item. Ms. Schenkat referred to the type of marketing materials used to advertise for the family affair held on Sundays.

Ms. Walker commented that there has been a lot of change in the CEO position and the CFO position in the last few years, which has contributed to lack of clarity regarding the requirements of the agreement. Audit staff will continue to work with them to clarify specific contract requirements, particularly relating to these earmarked funds. A contract provision cites there will be allocations for the four specific purposes, and a provision states that earmarked monies have to be spent for the earmarked purpose. The practices have changed since the last audit in 2010-2011, to where the four "buckets" are viewed as a group rather than for each individual purpose. We will continue working with them to clarify these audit points.

Vice Mayor Korte expressed concern regarding the trend of inadequate, independent fundraising and the cost of fundraising. As the auditor pointed out, leadership in some roles has been liquid. She looks forward to stability over the next couple years. Another concern is that the audit referred to two months of working capital. In non-profit language, this is customarily referred to as reserves. The audit reflects that comparable

arts groups average of 1.4 years, which is a lot of capital reserve. In the general non-profit world, it is anywhere from three to five months.

Mr. Miller recognized that they spend a fair amount of money in fundraising and that greater understanding is needed. He believes that there is work done by the Development staff that is not actually development and they do not make significant efforts to separate out those pieces. They raised \$2.3 million last year and are committing to doing better in terms of the ratios. His quick estimate, looking at last year's spending by the development department and the dollars raised, came up with 33 percent. In terms of reserves, they are torn between using the money to advance the purpose of the organization as opposed to putting it in the bank to ensure they have reserves. While two months is slim, they are able to do that because they have credit they can draw on and the partnership with the City provides consistent cash flow. They are not reliant on ticket sales that may fluctuate from year to year.

Councilwoman Littlefield expressed concern regarding the fundraising cost per dollar raised and the reserve totals. Another concerning factor is the CEO and administrative compensation totals are significantly higher than the average in Arizona. Additionally, there should be a focus on maintenance of existing art, so that deterioration does not occur. Mr. Miller stated that they are aware of this need and that funding resources will increase to address this.

Councilwoman Littlefield asked about methodology for keeping track of what is owned. Mr. McDaniel said that for the art purchased directly by the City, there is a very accurate list. The audit found that the private development funded art is the area in need of more work. Brent Stockwell, Assistant City Manager, said that in October 2017 in preparation for a presentation to the CIP Subcommittee, a request was made to Scottsdale Public Art for a listing of all art, including the art in private development. A link was received to a Google map site that had all the information. The data was reconciled with the City's geographic information systems. In response to the audit, a process is being set up for reconciliation on an annual basis. He noted that the listing was comprehensive of public art and art in private development. Ms. Walker clarified that the information auditors were given did not match up, but it sounds like they are working to get that cleaned up.

Chair Klapp noted that the audit process is actually between the City and the contract administrator. It is intended to look at the contract and whether or not it is being followed. It is not necessarily to audit everything that Scottsdale Arts or any other organization does. This is an established 30-year relationship and things do change over 30 years. Things that might have been implied 30 years ago need to be in written form so that they are better understood. Regarding disagreements on whether Scottsdale Arts should be moving towards financial independence, she commented that over time, the less the organization depends on City funding and more on other sources, the easier it would become for all parties. Providing City Council with greater clarity on the processes would also be helpful.

Mr. Stockwell commented that in terms of Community Arts Grant funds, the same agencies that are directly asking City Council for funds are also applying through the Community Arts process. There were only limited funds available in many of these years, meaning that the need was greater than what was able to be contributed. He and Karen Churchard will continue to work with Scottsdale Arts on revisions to the Management Services Agreement and are planning on bringing it back for a work study session and approval.

6. Discussion and Possible Direction to Staff Regarding Audit No. 1806, WestWorld Marketing and Concession Contracts

Lai Cluff, Senior Auditor, stated that the audit was performed to evaluate the marketing and concession contracts for contract compliance, effectiveness and administration. In December, 2013, the City awarded both the Food & Marketing agreement and the Monterra agreement to National Western Capital Corporation. The food and alcohol license for both WestWorld and Monterra were sublicensed by NWCC to M Culinary Concepts. Marketing services are currently provided by NWCC. Although the marketing vendor has been successful at increasing event-related revenues, results have not met the targets established in the Food & Marketing agreement. Some factors that may help reduce this gap are:

- Including more research and analysis in developing marketing strategies
- Addressing identified marketing challenges and private use restrictions on TNEC and WestWorld
- Including additional stakeholder review of the marketing plan
- Ensuring contract-required marketing activities are addressed

In terms of concession fees, the audit found that food and alcohol revenues were generally reported correctly, however WestWorld sometimes had the subcontractor pay event producers on the City's behalf. Resulting changes to revenues were not transparent in the accounting records. Reports to City Council do not estimate the impact of the negotiated terms. Certain use fees do not appear to be applied consistent with contract terms, and additional terms are needed to guide contractor produced events. Also, some aspects of contract administration need improvement. These include avoiding any perception of conflict of interest and ensuring contractual requirements are applied. Information provided to City Council was not always accurately presented. The vendor's use of the WestWorld name and ownership of the WestWorld website and social media sites do not appear to comply with requirements.

Councilwoman Littlefield commented that the Audit Committee is finding the same problem throughout many departments with contract administration. There is a common issue regarding how to maintain and write contracts, what kind of terminology to use, how to enforce it and how to ensure that the City and contracted party are both working in conjunction with the contract terms. Perhaps a training program needs to be established. Mr. Stockwell said this is an excellent comment. The City Manager has made similar observations and it has been discussed between the City Manager and the City Auditor. There is a focus on improving contract administration this fiscal year. Discussions convened with the City Treasurer, City Auditor, City Attorney, Purchasing Director and himself last fall to discuss this issue. The most immediate course of action is a refresher training. The class was prepared and ready to go and then the Purchasing Director retired. They will continue to work on this, and it will also be a key point in the recruitment of a purchasing director. There is also consideration to reallocate some resources in the Purchasing department to help with higher dollar, higher risk contracts.

Vice Mayor Korte said that WestWorld is an \$80 to \$90 million asset. The management of such a diversity of events is a challenge, and perhaps the model where City Council

must approve every contract is inhibiting WestWorld's success. She would like to recommend to City Council a real evaluation of the business model to determine whether it is inhibiting success. It is difficult to respond in a timely manner to customer requests with the current process. Ms. Walker noted the audit does not address those higher level concerns but City staff is working on getting a business plan for WestWorld. The audit identified some other things that might actually hamper marketing WestWorld, like the limitations on private use of the facility. Mr. Stockwell confirmed that they put out a request for proposals for a business plan. The RFP anticipates that the work will be done within this fiscal year.

Councilwoman Littlefield cited comments made in the audit: "Concession revenue exceptions were not documented, but the terms were unclear." She questioned how the contract can be monitored and administered when the terms are unclear. Chair Klapp stated that she is a member of the WestWorld Subcommittee, and some of the findings in the report are things that should have come before the WestWorld Subcommittee for discussion. Maybe the WestWorld Subcommittee could be used as a passthrough to forward concerns to the Council. There is confusion as to how incoming revenues are handled, and the charges do not always seem to be consistent or transparent.

Chair Klapp also said her understanding of the 2013 contract was that the management company would have to hit certain targets. If they were made, they would receive a bonus. Apparently bonuses have been paid, even though the targets have not been hit. Her assumption was that the targets established were not achievable and staff decided to pay the bonuses anyway. That is something that should have come to the Council. Ms. Walker stated that based on the way the contract is written, it is a bifurcated process. The contract set up a marketing target for performance measurement, and a separate amount was established for bonus payment. The 2013 Council presentation suggested that the bonuses would not get paid unless they hit the marketing target, when actually those things are separate. Chair Klapp said that is something that should be clarified. Chair Klapp agreed that there needs to be a holistic examination of the issues, including better utilization of the WestWorld Subcommittee. There is agreement on a commitment to make improvements. She is hopeful that the business plan will address some of the issues, providing better understanding of where there are opportunities for improvement.

7. Information Regarding CY 2017 Annual Taxpayer Problem Resolution Officer Report

This was provided as an information item. No questions were posed.

8. Discussion and Possible Direction to Staff Regarding 2nd Quarter FY 2017/18 Follow Up on Status of Audit Recommendations

Ms. Walker stated that categories include: implemented, partly implemented, those in progress. To keep it shorter, the linked detail report includes only items still open. The annual report will include all the audits that have been followed up on in this fiscal year.

9. Discussion and Possible Direction to Staff Regarding Status of FY 2017/18 Audit Plan

Ms. Walker said that staff was asked to provide updates on the progress of the last couple of open items for the financial audit. The annual expenditure limitation report that goes to the State has been reviewed by the CPA firm, and they are in the process of getting the letters and reports signed. The final report should be available by the next Audit Committee meeting. The other open item is related to the federal housing funds. That database opened up this past Friday, so that the Housing staff could get the information put in. The CPA firm still needs to do its review. Both open items should be closed by the next meeting.

As a general update, the City Auditor's Office is on track with where they planned to be at this time. For the next meeting, they are expecting to provide three audits. The Miscellaneous Expenses audit will be narrowed down to small tools and equipment and office supply expenses. The E-Verify Compliance audit should be ready for March, unless the contractors need more time. Progress is also being made on the ITS contracted audit.

10. Discussion and Possible Direction to Staff Regarding Agenda Items for Next Audit Community Meeting

Committee members asked about the two dates on the draft agenda. Ms. Walker explained there was uncertainty about when the WestWorld report would be completed. Since it did make this meeting, the Audit Committee will next meet on March 19th. A February meeting will not be needed. Besides the three audits mentioned before, the next meeting will include discussion of preliminary topics for the FY 2018/19 plan.

Public Comment

There were no further comments.

Adjournment

The meeting adjourned at approximately 5:04 p.m.

SUBMITTED BY:

eScribers, LLC