

**APPROVED MINUTES  
APPROVED ON 11/13/2018**



**CITY OF SCOTTSDALE  
AUDIT COMMITTEE**

**Monday, September 24, 2018**

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

**REGULAR MEETING**

**PRESENT:** Suzanne Klapp, Chair  
Virginia Korte, Councilmember  
Kathy Littlefield, Councilwoman

**STAFF:** Sharron Walker, City Auditor  
Paul Christiansen, Senior Auditor  
Lai Cluff, Senior Auditor  
Cathleen Davis, Senior Auditor  
Brad Hubert, Senior Auditor  
Michael Clack, Development Services Director  
Bryan Cluff, Senior Planner  
Laurel Edgar, Real Estate Management Specialist  
Dave Lipinski, City Engineer  
Robert Schoepe, Purchasing Director  
Rachel Smetana, Mayor's Chief of Staff  
Phillip Verver, Senior Budget Analyst  
Dan Worth, Public Works Director

**GUESTS:** Scott Rothman, Building Advisory Board of Appeals

**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, June 25, 2018**

COUNCILWOMAN LITTLEFIELD MOVED TO APPROVE THE MINUTES OF THE JUNE 25, 2018 REGULAR MEETING AS PRESENTED. VICE MAYOR KORTE SECONDED THE MOTION, WHICH CARRIED 3-0 WITH CHAIR KLAPP, COUNCILMEMBER KORTE, AND COUNCILWOMAN LITTLEFIELD VOTING IN THE AFFIRMATIVE.

**2. Discussion and Possible Direction to Staff Regarding Board of Adjustment Sunset Review**

Cathleen Davis, Senior Auditor, stated that the Board's purpose is to hear all applications for variances from the Zoning Ordinance provisions. They also hear appeals of the zoning administrator's ordinance interpretations or other decisions as well as the general manager's interpretations and decisions made on appeal. The zoning ordinance also provides that a Board decision may be appealed to the Superior Court within 30 days of the decision. The Audit Committee is to evaluate whether the board or commission being reviewed is serving its intended purpose, whether the board or commission's 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. Ms. Davis noted that Bryan Cluff, Senior Planner, is present if the Audit Committee has questions regarding the Board.

There were no questions by the Audit Committee members.

COUNCILWOMAN LITTLEFIELD MOVED TO RECOMMEND TO CITY COUNCIL THE CONTINUANCE OF THE BOARD OF ADJUSTMENT. COUNCILMEMBER KORTE SECONDED THE MOTION, WHICH CARRIED 3-0 WITH CHAIR KLAPP, COUNCILMEMBER KORTE, AND COUNCILWOMAN LITTLEFIELD VOTING IN THE AFFIRMATIVE.

**3. Discussion and Possible Direction to Staff Regarding Building Advisory Board of Appeals Sunset Review**

Ms. Davis stated that the Board's purpose is to hear and decide appeals of orders, decisions or determinations made by the building official related to the building code interpretations. Ms. Davis noted that Michael Clack, the Chief Development Officer, and Scott Rothman, Vice Chair of the Board, are present.

There were no questions by the Audit Committee members.

COUNCILMEMBER KORTE MOVED TO RECOMMEND TO CITY COUNCIL THE CONTINUANCE OF THE BUILDING ADVISORY BOARD OF APPEALS. COUNCILWOMAN LITTLEFIELD SECONDED THE MOTION, WHICH CARRIED 3-0 WITH CHAIR KLAPP, COUNCILMEMBER KORTE, AND COUNCILWOMAN LITTLEFIELD VOTING IN THE AFFIRMATIVE.

#### **4. Discussion and Possible Direction to Staff Regarding Audit No. 1902, E-Verify Compliance**

Brad Hubert, Senior Auditor, stated that since 2010, Arizona government entities are required by state law to randomly verify that contractors and subcontractors use the federal E-Verify system in order to confirm the employment eligibility of their employees. This audit is for FY 17-18 in fulfillment of the requirement for the past fiscal year. The audit found that the selected city contractors and subcontractors are generally using the E-Verify program for their workers on the City of Scottsdale contracts. The audit reviewed five City contractors and seven subcontractors. Of them, 30 employees were randomly selected for review. The E-Verify documents from one contractor and two subcontractors (10 employees) was dated after contact for the audit, rather than when they originally hired the employees. Overall, the selected contractors and subcontractors did provide the requested documentation for the sampled employees. Audit staff recommended that the Purchasing department continue to advise contract administrators to emphasize the E-Verify contract requirements at the start of each contract. Purchasing agreed with the recommendation and will add the reminder to the internal contract award notification and the annual contract renewal notice.

Councilwoman Littlefield asked if was possible to have the documentation collected at the point where larger contracts are executed. Ms. Walker said when signing the contract, contractors are required to certify compliance. Contractor subs may not be known at the time the contract is signed, and contractor employees may be changing during the contract. To try to encourage compliance, we are recommending notification upfront. Councilwoman Littlefield commented that obtaining compliance ahead of time would ease the problems.

COUNCILMEMBER KORTE MOVED TO ACCEPT AUDIT NO. 1902, E-VERIFY COMPLIANCE. COUNCILWOMAN LITTLEFIELD SECONDED THE MOTION, WHICH CARRIED 3-0 WITH CHAIR KLAPP, COUNCILMEMBER KORTE, AND COUNCILWOMAN LITTLEFIELD VOTING IN THE AFFIRMATIVE.

#### **5. Discussion and Possible Direction to Staff Regarding Report No. 1909, Southwest Gas Franchise Agreement**

Lai Cluff, Senior Auditor, stated that the audit was conducted to evaluate the franchisee's compliance with the franchise agreement terms, focusing primarily on the franchise-related fees. In March 2012, Scottsdale voters approved a utility franchise agreement with Southwest Gas Corporation. The agreement allows the utility to construct, maintain and operate its natural gas system in the City-owned public rights-of-way. In exchange, the agreement requires Southwest Gas to pay the City a 2 percent franchise fee and a 0.5 percent Capital Expenditure Fund fee based on the gross revenues derived from its sales and/or delivery of natural and artificial gas in the City. To evaluate its compliance with the franchise agreement, staff reviewed the billing system and accounting reports provided by Southwest Gas.

The audit found that Southwest Gas did not include approximately \$75,000 in ancillary-type revenues when determining its franchise fees due. These are revenues such as fees

for service changes, late payments and maintenance fees. Although the franchisee does not believe that these revenue types fall under the gross revenue definition, the contract language seemed to widely encompass all revenues resulting from the sale or delivery of natural gas within the City. As well, certain customer revenues were not charged franchise fees and Southwest Gas representatives could not identify the specific reasons why these were excluded. In total, these ancillary and other excluded revenues amounted to about \$90,000 in unpaid franchise fees since the inception of the franchise agreement and an estimated \$56,000 in accumulated late payments and interest charges. Audit staff recommends that the Real Estate Group work with the City Attorney's Office to further evaluate franchise fee terms and recover any amounts due to the City.

In addition to verification of recorded Scottsdale revenues, auditors also selected a sample of three zip codes that encompass multiple jurisdictions to evaluate how accurately the utility is coding its accounts as being in Scottsdale. With the assistance of IT's GIS department, it was determined that in these zip codes, about 3 percent of the service addresses mapped to Scottsdale were not coded to Scottsdale. About 5 percent of the addresses mapped outside of Scottsdale were coded to Scottsdale. Staff also sampled capital expenditure fund reimbursements to Southwest Gas and found that they were adequately supported by invoices and other documentation. These reimbursements also appeared to reduce expenses for the utility's Arizona region rate base, which is in line with the contract's requirement to exclude reimbursed costs from the utility's rate base. However, it was noted that direct benefits to jurisdictions varied based on differences in franchise terms, actual capital expenditures and the way that any reimbursement offset the whole region's rate base.

Councilmember Korte asked Mr. Worth for his thoughts. Dan Worth, Public Works Director, stated that the audit was requested because it was suspected something like this might be occurring, based on some communications with Phoenix personnel about items that Southwest Gas was not counting in their calculations of franchise fees. He was not surprised by the results, as they were anticipated.

Councilwoman Littlefield inquired as to the types of revenues excluded from the franchise fee. Mr. Worth stated that the audit report indicated Southwest Gas did not have any comment on some of them. They had some customers that were not being charged a franchise fee and they had no explanation. The other language is not precise in the franchise agreement; however he feels it is fairly straightforward: "Any revenues deriving from the sale of natural or artificial gas in the City of Scottsdale."

Councilwoman Littlefield said she was in support of the recommendation for periodic verification of jurisdiction coding of selected service areas.

COUNCILWOMAN LITTLEFIELD MOVED TO ACCEPT AUDIT NO. 1909, SOUTHWEST GAS FRANCHISE AGREEMENT. COUNCILMEMBER KORTE SECONDED THE MOTION, WHICH CARRIED 3-0 WITH CHAIR KLAPP, COUNCILMEMBER KORTE, AND COUNCILWOMAN LITTLEFIELD VOTING IN THE AFFIRMATIVE.

## **6. Update and Discussion Regarding Status of Implementing CPM Audit Recommendations**

Dave Lipinski, City Engineer, provided a walkthrough of the latest job order contract audit. Job order contracting is used for quick work. It is an up to five-year master contract approved by City Council. In this case for Water Resources, there is a \$5 million cap per year with a \$1 million cap on an individual job order. The JOC contracts are solicited by need and the type of work performed. The City works with the contractors on a regular basis and relies heavily on the Water Resources JOC contractors who work on specific City facilities. In terms of audit recommendations, the first was for cost controls and proposal valuation. CPM has gone back and revised the chapter in the project management handbook that relates to the JOC program. They have worked with auditors and staff to streamline the process to capture and document information.

A subset of the first finding was to address the review of proposals and how this is done. There currently is a vacant estimator spot. This position is relied upon to provide necessary information, if available. In FY 17/18, there were 194 job order contracts or adjustments. If the estimator is not available, the engineers who do the design provide the estimate. The partner department who requests the work reviews the proposal. It is also reviewed by the inspector, the construction administration supervisor and the project manager. There are 7 to 8 layers of review in the process. CPM has adjusted the forms to make sure they are getting those signatures and sign-offs for the proposals as they are moving through.

The second finding was to obtain and evaluate the contractor's subcontractor selection plans. The Water Resources subcontracts tend to be electrical heavy. Two contractors actually submitted with their electrical subcontractor as part of the project team. These subcontractors have worked for the City for years and do quality work. The third contractor self-performs electrical work. The City's construction supervisor and inspectors will review the subs that come in on the projects. It is typically the same subcontractors in a facility. They have knowledge of the facility and can quickly turn around estimates. The department does not require a subcontractor list for every project because they know who will be used most of the time. There are sometimes specialty contractors requested by the department.

The third finding was to develop cost proposal evaluation guidance or standards. This goes to overhead and fee rates. They have started reaching out to other municipalities. There have been discussions with two of three contractors already to determine what they are seeing across the Valley. It varies; some work on a sliding scale. The fee may be allowed to go up for smaller projects and down for larger ones. Staff will work to develop a system that works for the City. They will start with the three contractors and discuss how the department would like to see the proposals, the percentages that could apply and whether this would fit their needs. Mr. Lipinski believes that they will get to a fixed fee that will be easier for staff to manage and keep costs fixed if the project grows, or a percentage that will better cover the contractor and protect for overpayment of fees. Once they have nailed down the process with these 3 JOCs, they will work with the other JOCs to make sure the process is consistent across the board.

For approvals needing to be obtained prior to creating a job order or adjustments, forms have been adjusted to capture the signature approvals. Staff is ensuring partner department approval is obtained. With Water Resources, they typically need approvals from both the division director and the CIP manager. Staff is going to be retaining the back and forth documentation on contract negotiations. It is reviewed at the PM level, the construction admin level, partner department level, CIP coordinator for funding verification,

and the City Engineer is the final review. Anything over or approaching \$500,000 also needs City Manager approval.

The department has been doing a better job of asking whether there is any further work at the project sites. They do not want to give the impression of splitting a project to avoid process but what happens is that sometimes work is added on by the partner departments and projects get split among the 8.75 project managers and it is sometimes hard to bring them back together later. Staff is reviewing their project list more holistically to avoid any perceived wrong doing.

Regarding the documentation of contractor pay requests, in the past, when pay requests were submitted by a contractor, the inspector received it first. They would review it with the contractor and mark it up to reach agreement. Then the contractor would submit a clean request. The department is no longer having the contractor submit a revised version. They now keep the handwritten version as the backup to the final pay application. Staff has developed a database that allows inspectors to do reports and track quantities on a daily basis. This generates a monthly report, which is attached with the redline documents to the pay application. The database is on mobile tablets and they are expanding this to the entire inspector pool.

In terms of bond certificates to maintain sufficient bond coverage, the individual managing the JOC contracts now has a checklist that includes verifying coverages. Some contractors buy for the maximum amount, others buy bond coverage in pieces.

Regarding calculation errors, with over 190 contracts a year, there have been a few and most of the time these are caught. Required close-out documents have been added to the JOC manual. Also, the project coordinator will not provide the final pay application until she has confirmed the required documentation has been received and filed.

On documentation retention, CPM has been approved to store their documents electronically and has instructed staff to upload all documents to the Document Management system except for as-builts and right-of-way documentation, which have to be stored in hardcopy. This is a big change to get everyone comfortable using the system.

Mr. Lipinski concluded his comments on the JOC audit and stated that he could also walk through the other construction audits or answer any specific questions the committee has. Chair Klapp expressed appreciation for the comprehensiveness of the review and noted the auditors were nodding in agreement that the changes have been made. Ms. Walker clarified that it was agreement that these sound like good changes, but they have not been tested yet. Also, as the Audit Committee previously noted, the recommendations in this audit sounded like those in the previous construction audits. With the comprehensive approach described, she hopes that future audits are not going to be finding the very same issues.

## **7. Informational Report Regarding 2nd Quarter CY 2018 Taxpayer Problem Resolution Officer Report**

Ms. Walker noted that this was an informational report and she was available to answer any questions.

**8. Discussion and Possible Direction to Staff Regarding Status of FY 2018/19 Audit Plan**

Ms. Walker stated that an October meeting will not be necessary as the one audit will be pushed back to the November meeting. Even though there are a couple of reports listed for February and for March, these will likely be combined into a March meeting but she will wait until it's closer to verify that. Generally, meeting every other month works during most of the year except the May and June meetings are usually both needed.

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

Ms. Walker noted that, rather than the time and location noted on the draft agenda, the next meeting will be held on November 13th at 3 p.m. in the City Attorney's conference room. Because there is a City Council meeting the same day, the meeting will be earlier than usual and it will not be in the Kiva Conference Room.

Ms. Walker stated that she plans to tweak one of the two agenda items, update on the audit plan or the discussion of next agenda items, to include general updates so that is easier to share information that does not directly relate to the scheduled agenda items. Two audits on the planned November agenda include the external financial audit, as well as, the fire marshal inspections audit.

**Public Comment**

There was no public comment made.

**Adjournment**

With no further business to discuss, the meeting adjourned at 4:37 p.m.

SUBMITTED BY:

eScribers, LLC