

**APPROVED MINUTES
APPROVED ON 6/22/2015**



**CITY OF SCOTTSDALE
AUDIT COMMITTEE**

MONDAY, MAY 18, 2015

**CITY HALL
KIVA CONFERENCE ROOM
3939 NORTH DRINKWATER BOULEVARD
SCOTTSDALE, AZ 85251**

REGULAR MEETING

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

STAFF: Fritz Behring, City Manager
Jim Flanagan, Purchasing
Joyce Gilbride, City Treasurer's Office
Anna Henthorn, City Treasurer's Office
Christy Hill, Neighborhood Planning
Jeff Nichols, City Treasurer
Brent Stockwell, City Manager's Office
Kyla Anderson, City Auditor's Office
Cathleen Davis, City Auditor's Office
Sharron Walker, City Auditor

GUESTS: Jill Shaw, Heinfeld, Meech & Co.
Brittney Williams, Heinfeld, Meech & Co.

CALL TO ORDER

Chair Klapp called the meeting to order at 3:29 p.m. A formal roll call confirmed the presence of all Committee Members as noted above.

1. Approval of Minutes, Regular Meeting, March 16, 2015

COUNCILMEMBER KORTE MOVED TO APPROVE THE MINUTES OF THE MARCH 16, 2015 REGULAR MEETING. COUNCILWOMAN LITTLEFIELD SECONDED THE MOTION, WHICH CARRIED BY A UNANIMOUS VOTE OF THREE (3) TO ZERO (0).

2. Discussion Scope and Timing of the City's FY 2014/15 Financial Audit

Kyla Anderson of the City Auditor's Office reported that staff conducted an RFP at the direction of City Council. Based on the results of the RFP, Heinfeld, Meech & Co. was selected to perform the FY 2014/15 financial audit. This is a locally based accounting firm that specializes in government and non-profits. Their contract has four one-year extensions available at Council's discretion. She noted that Ms. Jill Shaw and Ms. Brittney Williams from Heinfeld, Meech & Co. were in attendance.

Ms. Shaw said the Mayor has signed the engagement letter with the company, agreeing to the scope and timing of the audit. The scope is basically unchanged from previous audits. They will conduct a single audit looking at federal awards, select some programs to audit, and audit the financial statements of the City and component units, such as the Municipal Property Corporation, the Scottsdale Preserve Authority, the CFDs, and also the AELR. They will audit the HUD REAC attestation that has to be submitted, as well as the HURF expenditures. The biggest change this year is that the auditors will be looking at pension information because new accounting standards are taking effect.

The external auditors are currently gathering information. Work will start in May and they will complete the report in October.

Councilmember Korte inquired about the cost of the audit. Ms. Shaw said the cost is not typically mentioned in the engagement letter. If they are the successful bidder on an RFP, the fees for services will be as outlined in the proposal. Councilmember Korte asked what would trigger the clause on contingency fees. Ms. Shaw said in general the company's policy is not to bill for any scope changes unless they find something quite substantial that requires a lot of extra work.

Chair Klapp asked which other cities they audit. Ms. Shaw said they audit Tempe, Chandler, Peoria, Goodyear and Fountain Hills.

3. Discussion and possible direction to staff regarding Neighborhood Advisory Commission Sunset Review

City Auditor Sharron Walker outlined the Neighborhood Advisory Commission's purpose as presented in City Code and summarized the Audit Committee's charge to evaluate whether the intended purpose is being served, whether it should be maintained or modified and whether it has been served or is no longer required. Specifically the Audit Committee is to recommend to the Council whether to continue or terminate the Commission. Ms. Walker then introduced Ms. Christy Hill, Staff Liaison. Ms. Hill spoke of the work of the Neighborhood Advisory Commission. Its latest program is the Spirit of Scottsdale Award which was introduced this year in the McDowell Road corridor. The Neighborhood Enhancement Partnership Program awards matching funds to neighborhoods which carry out improvement projects. Ms. Hill noted that a presentation of these awards will be made at the Council's June 2 meeting.

COUNCILWOMAN LITTLEFIELD MOVED THAT THE NEIGHBORHOOD ADVISORY COMMISSION CONTINUE. COUNCILMEMBER KORTE SECONDED THE MOTION, WHICH CARRIED BY A UNANIMOUS VOTE OF THREE (3) TO ZERO (0).

4. Discussion and Possible Direction to staff regarding Audit No. 1506, Library Business Operations

Cathleen Davis of the City Auditor's Office presented the audit report on Library Business Operations, which was conducted to review the Library system's management controls over its business processes and operations.

The audit found that Library resource management does not appear to maximize public benefit. Library materials inventory is not periodically verified and the catalog system is not accurate regarding the availability of library materials. The auditors estimate the collection is worth between \$12.5 million and \$14.6 million. While a substantial amount of items are missing or lost each year, the Library does not perform periodic physical inventory counts of the material that should be available at the branches. Also, while staffing levels should be determined based on demand for library services, branch staffing is not currently scheduled based on specific service objectives supported by service drivers such as library material circulation or visitor count.

Library cash handling procedures do not ensure accuracy and minimize the risk of loss or theft. Daily cash receipts are not accurately and properly reconciled to Polaris, the Library's information system which tracks patron account activity. While Library staff calculates the difference in receipts recorded into the cash register and account payments recorded in Polaris, the differences are not always researched and resolved. The Library's cashiering practices are not effectively implemented nor consistently followed. Current procedures do not hold individual staff accountable for their cash transactions and physical controls to safeguard cash need to be strengthened.

Improvements to the Library's accounts receivables have not been made. Certain policies and procedures related to fines and fees are not consistently applied, and some related practices have not been submitted to Council for approval. Prior audit recommendations to improve the Library's accounts receivable and cash handling practices have not yet been implemented.

Stronger information technology controls are needed to ensure the confidentiality, accuracy and integrity of the Library's information system. Basic information security practices have not been implemented to safeguard the Library's information system. The Library does not issue individual login credentials to each authorized user. And the shared credentials are not regularly changed and are readily accessible. The Library does not ensure proper record retention for accountability and legal compliance purposes. For instance, at least 50 patron accounts with recent payment and/or waiver transactions have been permanently deleted since June 2014. The Library maintains its own network and applications on a separate domain and servers independent of the City's network. This is inefficient and has not been effective for establishing adequate security over the Library's information systems.

Ms. Davis noted that Library Director Ms. Kathleen Wade was in attendance.

Ms. Wade stated the Library has already addressed a number of the issues identified in the audit report. Procedures will become more rigorous and processes will be

documented. Library staff firmly supports this effort and she is confident this will be done in short order.

Council Member Korte inquired how far the audit went back and the longevity of these problems. Ms. Davis said the testing focused on the past 12 to 18 months. Ms. Walker said it appears that Library practices have remained unchanged for a while as prior accounts receivable and cash handling audits indicated some of the same areas that needed improvement. This audit was intended to take a more holistic look at the Library's business operations.

Ms. Wade thanked the auditors, saying that this audit will help her move things forward. She is committed to implementing the recommendations. Some procedures have already been changed. The Chief Information Officer does not want to take over the Library IT operations, so Library staff is working with the IT Department to plan some improvements. They are also considering the possibility of adjusting Library hours to enable Library staff to follow proper cash handling procedures. She cited a number of considerations, adding that it will take several months to plan the changes.

Chair Klapp said it is preferable to look at the Library system as a whole so that no single branch appears to be targeted for cuts. Chair Klapp also indicated that Council would likely be in favor of more efficient operations. It only makes sense to institute changes that will lead to better control of the Library inventory and operations.

Councilwoman Littlefield suggested that the hours of each branch do not necessarily have to be identical. She asked about the deletion of patron accounts that the audit had uncovered. Ms. Walker explained that this is what was also found during the accounts receivable audit. If patrons told the library staff they no longer wanted a library account, as long as they did not owe money and had returned all materials, their accounts were permanently deleted from the system. The disadvantage is that the patron's history was deleted. Further, this practice is not in accordance with records retention requirements. Chair Klapp inquired if a simple system change would prevent this. According to Ms. Wade, in the past an umbrella-like authority had been given to everyone, but this has changed so that most Library staff no longer have the computer access rights to delete patron accounts. Ms. Wade also noted that the records belong to the library system, not the individual patrons, and this authority should not have been allowed.

5 Discussion and possible direction to staff regarding Audit Report No. 1513.01, Controls Over Surplus Property Dispositions

Ms. Walker told the Committee that this audit was conducted as a result of information received through the fraud, waste and abuse hotline. They were told that specific items had been transferred from Police Property and Evidence had not been properly auctioned. Staff compared the records of the Police Property and Evidence Unit's transfer records with the warehouse auctions and could not find one of the specific items. The testing was expanded. Controls have been somewhat lax and records are limited. They were able to compare the records from Property and Evidence, the assets that IT transferred, as IT has an asset management system, and Fleet's vehicles and related equipment. Other departments can transfer items, but these are generally not recorded because it is mostly used furniture and surplus office supplies. Further, records are not kept to track items through to disposition, and some items are sold in lots. So the

audit focused on individually significant items. As the report identifies, the auditors could not determine the disposition of certain of these items. The report recommends improving the controls and the recordkeeping for the surplus items coming into the warehouse. She provided the City Manager the draft report, and his staff's response is included in this public report.

Chair Klapp noted that it appears the issues are being worked on. Councilmember Korte asked whether the problem lies in the fact that this crosses department lines and asked whether someone is overseeing all of this. Ms. Walker said the current audit focuses on when surplus items reach the warehouse how they are tracked through to final disposition. She is recommending that departments provide itemized listings of what they are sending to the warehouse, and its primarily going to be IT because Fleet items are larger and easier to track and Property and Evidence already sends a listing.

Purchasing Manager Jim Flanagan said that the warehouse manager is responsible for the surplus. The City is now conducting its own online auctions to sell items. This is considerably more profitable than using a private auction company as they had in the past. They are able to sell retired fleet vehicles and a variety of evidence from the police department.

Mr. Flanagan said since the audit began last fall they have been keeping more detailed records. Evidence is kept in sealed police evidence envelopes. However in the process of making lots of similar items such as used cell phones, the envelopes would be opened and then the tracking references would be lost. They have changed the procedure and each item remains sealed in its envelope. Mr. Flanagan added that some of the items they receive are worthless and have to be thrown out. They are planning to work with the Police Department to come up with more effective procedures.

Chair Klapp asked how they determine the value of items to be auctioned. Mr. Flanagan said they do not usually use an appraiser. Neither the police nor the warehouse staff has any expertise in jewelry. They want to develop a methodology to appraise items that may have significant value. Ms. Walker added that based on the records the auditors saw, the surplus property sales are \$200,000 to \$500,000 per year. Some spending on appraisal services for selected items would probably be a good investment. Chair Klapp commented that jewelry would probably be the most worthwhile, since vehicle appraisals are readily available online.

Mr. Flanagan noted that money from vehicle sales is channeled back into the fleet budget. Auctions are advertized through a company called Public Surplus. There is a link on the City website to the online auction.

6 Discussion and Possible Direction to Staff Regarding CY 2015 First Quarter Taxpayer Problem Resolution Officer Report

Ms. Davis reported that the survey results continue to be very positive. One Taxpayer Problem Resolution Officer appeal was received during the first quarter of calendar year 2015. The taxpayer's October 2014 return was received by the City on December 1st and penalties were applied. Based on review of the case, auditors found that the City had advised taxpayers in advance on the tax return forms of the City's holiday closure

and to submit their returns timely. Accordingly, the Taxpayer Problem Resolution Officer did not grant the penalty waiver.

7 Discussion and Possible Direction to Staff Regarding the FY 2015/16 Sunset Review Schedule

Ms. Walker said the proposed schedule covers sunset reviews from FY 2015/2016 through FY 2017/2018 and with the Audit Committee's approval, she will distribute the schedule to the boards and commissions.

The Committee members agreed that the proposed schedule is acceptable.

8 Discussion and Possible Direction to Staff Regarding:

- **Status of FY 2014/2015 Audit Plan**

Ms. Walker said the status report should have noted that the audit of the Fairmont Scottsdale Princess lease is also underway and they expect to present their findings at the June meeting.

Ms. Walker stated that because of many competing priorities, she had not prepared the quarterly audit follow-up status update. She double-checked the City Code, which simply states that the auditors are to provide periodic status reports to the Committee. It does not specify that these must be quarterly. Ms. Walker said that depending on what unexpected items may arise, the follow-up status updates may need to be provided semi-annually rather than quarterly, although the plan will be to provide them quarterly.

- **Preliminary FY 2015/2016 Audit Plan**

Ms. Walker reviewed the tentative plan for the next year. At this stage it is preliminary and includes the construction contract audit that was on the FY 2014/15 Audit Plan. The recurring section lists areas that are covered annually such as the external audit. Some of these are scalable, including E-Verify compliance and cash handling. Other recurring items are following up on audit recommendations, and investigating comments received through the integrity line.

Ms. Walker asked the Committee for their feedback on the additional items for her use in putting together the final Proposed Audit Plan. The list provided includes audits of various sizes in order to be able to use staff effectively. She cautioned that they will not be able to complete all the audits on the list.

An audit of development fees by an external auditor is mandated by the State. The auditors will be working with Water Resources in selecting an outside firm to conduct this audit and get the requirement met.

Related to item 12, Ms. Walker noted that a question that arose at the last meeting regarding fingerprinting of volunteers. The City fingerprints employees and volunteers. The Human Resources Director Donna Brown indicated an RFP is to be awarded for

background checks that will provide more timely information than the fingerprinting process does. She has also contacted Bill Murphy, Community Services Division Director, since his departments use a lot of volunteers. And he confirmed that Preserve volunteers provided by the McDowell Sonoran Conservancy are also fingerprinted.

The City Manager has requested that the Auditor's Office oversee the independent review of the police department staffing analysis.

The list of possible audits includes:

- Special event contracts
- The SCADA network audit, which would be contracted because it would require technical expertise
- Preserve operations
- Another Citywide IT contract audit
- Transit service contracts
- Preventative maintenance and repair
- Human Services information system controls
- Street overlay maintenance
- McCormick-Stillman Railroad Park
- Fleet inventory controls and office supply contract

Ms. Walker said there are many aspects of City operations that have never been audited. The office can realistically handle about 14 or 15 projects each year. The Committee members discussed which audits to eliminate from the proposed list. In response to Councilmember Korte's inquiry, Ms. Walker confirmed that the contract audits do not take as much staff time. On the other hand the Integrity Line may uncover new projects which need to be carried out. She outlined the function and process of the Integrity Line.

Councilmember Korte recommended that the audit of the McCormick-Stillman Railroad Park should be done and that the audits of the E-Verify program and the transit service contract could be taken off the list for the next fiscal year. Chair Klapp said auditing the preventative maintenance and repair program should be done too. Councilwoman Littlefield said the IT contract audit is important as it may help with the upcoming bond package. Ms. Walker confirmed that she will bring back the final Proposed plan for the Committee's vote in June.

9. Discussion and Possible Direction to Staff Regarding Agenda Items for Next Audit Committee Meeting (June 22, 2015)

Ms. Walker said the Library Board sunset review will be presented. The draft agenda also includes the Princess lease agreement audit, the IT network security assessment, photo enforcement contract, the peer review of the Auditor's Office and the annual update of the audit follow-ups.

Public Comment

No members of the public wished to address the Committee.

Adjournment

The meeting adjourned at approximately 4:43 p.m.

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