

**APPROVED MINUTES
APPROVED ON 6/26/2017**



**CITY OF SCOTTSDALE
AUDIT COMMITTEE**

Monday, May 8, 2017

**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
Kyla Anderson, Sr. Auditor
Cathleen Davis, Sr. Auditor
Donna Brown, Human Resources Director
Lauran Beebe, Human Resources Manager
Rachel Smetana, Mayor's Chief of Staff
Jim Thompson, City Manager
Dan Worth, Public Works Director

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, March 20, 2017**

COUNCILMEMBER KORTE MOVED TO APPROVE THE MINUTES OF THE MARCH 20, 2017 REGULAR MEETING AS PRESENTED. COUNCILWOMAN LITTLEFIELD SECONDED THE MOTION, WHICH CARRIED BY A UNANIMOUS VOTE OF THREE (3) TO ZERO (0).

2. Discussion and Possible Direction to Staff Regarding Audit No. 1707, Benefit Claims Processing

Cathleen Davis, Senior Auditor, said that the audit was performed, using a contracted specialist, to evaluate the accuracy of medical and pharmacy claims process by the third-party plan administrator, Cigna Health and Life Insurance Company. Scottsdale has three self-funded medical plans, each which includes prescription benefit coverage. Almost 2,200 employees and retirees are enrolled in the medical plans. Medical and prescription benefit claims paid through Cigna totaled approximately \$21.8 million in FY 2014/15 and \$25.7 million in FY 2015/16. In December 2016, the City contracted with Wolcott & Associates to audit Cigna's processing of the City's medical and prescription benefit claims.

Wolcott concluded that Cigna achieved a high accuracy rate for medical claim processing, but prescription claim processing was not within the range of industry standards and should be improved. Wolcott tested 300 medical and 300 prescription benefit claims processed by Cigna. In summary, Wolcott stated that Cigna achieved a degree of accuracy for medical claim processing with rate ranging from 98.7 percent to 99.9 percent for the tested sample. These rates are within or above the industry standards, according to Wolcott. For prescription claims processing, Wolcott determined that Cigna achieved 94 percent to 97.4 percent accuracy for the tested sample. According to Wolcott, these rates are below the 98 to 99 percent that is industry standard.

Wolcott also found that the City's Summary Plan Descriptions (SPDs) can be clarified. SPDs are the basis for determining eligibility for coverage and claim payment. Wolcott identified three instances where medical claim processing was not specified in the City's SPD and two instances where prescription claim processing was not specified.

Performance guarantee monitoring and other aspects of contract administration can be improved. The City's agreement with Cigna contained ten performance guarantees, however the agreement does not require Cigna to periodically report to the City, and the contract administrator had not obtained performance guarantee results for the first two plan years. Based on the audit calculations, Cigna owes the City \$22,000 to \$38,000 per year for the pharmacy-related guarantees. In addition, while the original agreement was Council approved, it provides for the contract administrator and Purchasing Director to approve the one-year extensions. An extension for the plan's second year, FY 2015/16, was not executed. Human Resources generally agreed with the audit recommendations.

Councilmember Korte commented that Cigna is seeing this one way and the City is seeing it another. Ms. Walker said that the auditor took the City's summary plan descriptions and compared it to a number of transactions. In some cases, it looked like Cigna was processing claims based on how they typically do things, rather than consulting with the City or following what was indicated in the plan. In response to Councilmember Korte, Ms. Davis confirmed the reported overpayment was \$22000 one

year and \$38000 the second year based on audit calculations. Ms. Walker added that these amounts were for performance guarantees rather than for claims. In response to Councilmember Korte, Ms. Walker commented that the audit recommendation is that the HR department work with Cigna to review and resolve the differences identified and clarify the Summary Plan Description where required. The department has agreed to do that.

Councilmember Korte asked about the prospects of reaching a negotiated conclusion. Lauran Beebe, Human Resources Manager, said that staff has met with Cigna once and has asked for additional information. Ms. Beebe commented that the way they offset pharmacy guarantees is industry standard and that with Aetna, the City only received 25% of rebates and now we're up to 100%. More discussions will be necessary to reach a conclusion.

In response to Chair Klapp, Ms. Walker agreed that auditors thought the performance guarantees in the contract were clear, and noted the audit was based on the contract and did not compare Cigna's performance guarantees to industry standard.

Councilwoman Littlefield commented that there is a difference of opinion regarding 90-day prescriptions versus 30-day prescriptions and asked for clarification. Ms. Beebe said that one issue is that participants could visit a Cigna medical group and get a 90-day prescription supply at a 30-day price. Another issue involved specialty drugs, which can only be given in 30-day supplies. When Cigna received a 30-day prescription through mail order, the (participant) paid a 30-day price, not the 90-day price. There are discrepancies in what the SPD is, what Wolcott found and how she would interpret it. A new option will be implemented for the plan, where certain contracted pharmacies (CVS, Frys, Sam's Club, Walmart and Cigna medical group) will fill 90-day prescriptions so that they can be filled walk-in rather than mail order. Ms. Davis clarified that Cigna had been processing based on its own practice rather than contract language. Ms. Walker commented that the auditors were comparing claims processing to the SPD. The auditor was not making a call on which way it should be in the City's plan.

Chair Klapp asked if Cigna agreed that the plan document was accurate. Ms. Walker noted that what Cigna said in its response was claims were being processed according to Cigna's own procedures. Cigna didn't disagree with the audit comment. Chair Klapp asked if there normally is agreement that the procedures follow the plan document not necessarily their typical procedures. Ms. Beebe responded yes. Ms. Walker commented that having the audit look at claims processing is a good opportunity to clarify the SPD and Cigna should be checking with the City on those that are not addressed since it's not possible to have every option in the document.

3. Discussion and Possible Direction to Staff Regarding Audit No. 1706 Commercial Solid Waste Operations

Kyla Anderson, Senior Auditor, said the audit was performed to evaluate the efficiency and cost-effectiveness of the commercial solid waste operations. Unlike residential customers, commercial customers can choose their service provider, putting the City in competition with private haulers. The commercial program is a small portion of the department's operations. In 2015, the City contracted for a solid waste cost of service

study. This found that the commercial program was losing money and recommended rate increases. The audit made the following findings:

- The FleetMind Vehicle Management System has not been successfully implemented. Even if it is eventually implemented, the expected return on investment may not be as great as anticipated.
- The sudden commercial solid waste increase made in-house services seem non-competitive.
- Despite recommendations in the 2010 audit report, commercial solid waste increases were not requested and the program's under-recovery was not disclosed to Council until the most recent fiscal year.
- The program's new multiple container discount may not be effective for operational or market-based purposes.
- The contracted cost of service study could have been more relevant.
- The solid waste department already had a financial analysis model that showed the commercial program was losing money. This model could have served as the basis for new rates. The study did not include demand elasticity, market rates, a fixed variable analysis or discussion of all the benefits of recycling.
- Operational Improvements can be made, such as increasing internal controls, analyzing customer density, accurately reconciling landfill bills, establishing goals for the commercial program, requiring private waste hauler reports and maintaining documentation.

The solid waste department generally agreed with the audit recommendations.

Councilwoman Littlefield commented that a basic business tenet is not to throw good money after bad. She asked whether the vehicle management system could be implemented to a fuller degree and if not the implementation should be stopped. Dan Worth, Public Works Director, said that the original contract has been terminated. Some additional services have been purchased from the vendor for a modest amount. However, as part of the original contract, the department obtained equipment, such as sensors, cameras and tablets mounted in each vehicle. The department has achieved some capabilities and still has automation goals for providing services to 85,000 customers. Until about three years ago, this was all tracked through spreadsheets. Ideally, the department would like the capability to use an automated system to analyze routes and perform verification of service. Some of the objectives outlined in the report have been achieved; however there is still work to do. This is being done through working with IT to leverage the City's GIS program rather than through the FleetMind vendor.

Councilwoman Littlefield asked if the department has determined it is competitive with commercial businesses. Mr. Worth replied that the City is competitive, having lost only six percent of its commercial customers. The department is particularly competitive in the Downtown area for some smaller customers. Councilwoman Littlefield recommended closer year-by-year cost control so there isn't a large increase again like was experienced for this year and making sure the City is competitive on pricing.

Councilmember Korte asked about the multiple container discount. Mr. Worth confirmed that there is a multiple container discount for the front loaders. The first container is full price with additional containers at ten percent discount where previously there were

additional discounts on the second, third, fourth container. Mr. Worth added they are going to continue monitoring that and determine with some specificity what the costs are for servicing multiple containers versus single container accounts.

Chair Klapp asked whether other commercial service providers are offering customer loss leader discounts. Mr. Worth said that other providers typically offer introductory discounts for new customers only.

Councilmember Korte noted that in FY 2015/16, a consultant was paid to conduct the cost service and rate design study. She asked whether it was money well spent. Mr. Worth said it absolutely was. The department was under-recovering, which is why the consultant was hired. One of the benefits was the development of a model that allocates costs. In response to a question from Councilmember Korte, Mr. Worth said that the model does not take market rates into account, and they will have to look at that through other means, such as customer response.

Councilmember Korte noted that customers were undercharged for services in 2016 to the tune of \$73,000 and asked whether this would be recouped. Ms. Walker stated that in one instance, a smaller amount has been negotiated with the customer. Mr. Worth added that there were multiple years of incorrect billings and the department went back as far as the code allows to recover for underbilling, which he believed was 2 years. Councilmember Korte inquired about the landfill bills being overpaid for some time. Ms. Anderson noted that the department's reconciliation showed that the City was being overbilled, however when the analysis was redone correctly the City was not being overbilled. However, because the department thought a discrepancy was normal, the staff didn't catch a recent actual error that did occur. They have since requested a refund from the landfill. Auditors have explained the corrections to the department staff so they can perform more accurate analysis.

Councilmember Korte asked about operational efficiencies and formulating the solid waste vision that encompasses the green vision for Scottsdale. Mr. Worth that the department has already reduced two out of ten drivers from the commercial program, which accounts for loss of accounts as well as right-sizing the routes to be more efficient. Department staff has been comparing container pick-ups to the service frequency the customer requested and is paying for. A solid waste and recycling strategic plan is currently in development. Mr. Worth has engaged the planning department to help with this. The Environmental Quality Advisory Board has taken the lead, drafting portions of that plan. Mr. Worth has presented to them four times now, talking about the different concepts and the outreach being done. They have also talked with other boards and commissions, City staff, and industry providers. The plan is based on the City's General Plan and statement of the community's values.

Chair Klapp said that in the final recommendation on operational improvements, there was a recommendation to require private waste haulers to provide quarterly reports, however this was not included in the department's response. Mr. Worth responded that the lack of a response was an oversight. He is meeting tomorrow with the City Treasurer, who administers business licenses, including private solid waste haulers. The discussions will include determining the right person to contact license holders to request the information and what leverage they have to insure it is provided. In response to Chair Klapp, Mr. Worth agreed that the license requirement for private waste haulers does require the submission of regular reports.

4. Discussion and Possible Direction to Staff Regarding Audit No. 1704 Pavement Operations

Ms. Davis said the audit was performed to evaluate the efficiency and cost effectiveness of the pavement overlay and maintenance program, including use of the voter approved bond funding. Scottsdale has nearly 900 miles of roadway maintained by the Pavement Management program. Funding comes from the 0.2 percent transportation sales tax, which has funded annual program expenses ranging from \$6.2 to \$10.8 million over the past four fiscal years. In November 2015, Scottsdale voters approved a \$12.5 million bond to be used for pavement improvement. Roadway quality and condition is assessed through a nationally recognized numerical measure, the Pavement Condition Index (PCI), with a scale of 0 to 100. In June, 2015, a consultant assessed the City's roadways at an overall average of 72, which fell at the low end of the "Very Good" range.

The audit found that City's staff has not provided the City Council with PCI standards, comparisons or cost information to allow a policy discussion on the City's PCI goal. The citywide PCI has remained above 70 for the past 12 years. The Public Works Director's current goal to achieve PCI of 80 by 2020 is 5 to 10 points higher than the goals of most other Valley cities. The City's pavement consultant evaluates a PCI rating of 70 to 85 as "Very Good", which is similar to the ASTM standard PCI scale, which described the same range as "Satisfactory". However, this and other related information has not been presented to Council for its policy decision or direction regarding the PCI goal.

Improved communications and coordination with other departments can maximize effective resource use. Departments with related responsibilities are not coordinating work and communicating necessary information to each other regarding upcoming street cuts and completed road improvements.

Pavement Management policies and procedures should be developed and certain operational practices improved. Specifically, Pavement Management has not developed written policies and procedures related to the pavement overlay and treatment program. The program does not have defined record retention policies for its PCI-related records and does not maintain copies of documents, such as previous Pavement Management Analysis reports or Annual Paving Plans. Pavement Management inspectors are on a single project full-time, which limits the amount of work that can be performed unless more inspectors are added. Management oversight was lacking and necessary planning for the City's FY 2017/18 paving plan had not occurred due to department and program vacancies. Public Works generally agreed with the audit recommendations.

Councilmember Korte asked about the cost of maintaining PCI at 80 versus 75. Ms. Walker said the records were not complete enough to do this analysis. The consultant's study said spending at a certain level is needed to prevent deterioration and spending at a level above that to raise the PCI. Councilmember Korte opined that cost per PCI point is not the same at lower levels as it is at upper levels. Mr. Worth said there is a spending level at which one holds steady. Above that level is an increase and below is a decrease. Mr. Worth said that the City was investing \$10 million per year before the bond to keep conditions steady. The City was investing significantly less than this prior to 2015. Getting to the \$10 million level stopped the decline. The bond allows the City to get back to levels from 2007 and 2008.

Councilwoman Littlefield commented that she would like more information with more clarity brought forward. In addition, when permits for utilities come through the City, the information is not going to the pavement staff and she recommended better coordination. When streets are repaved then the utilities come tear it up, that frustrates a lot of people and it's expensive. Chair Klapp agreed, noting Councilmembers hear about that.

5. Discussion Regarding FY 2016/17 3rd Quarter Follow Up on Status of Audit Recommendations

Ms. Walker said that for this quarter, approximately 73 percent of audit recommendations have been implemented or partly implemented. Another 25 percent are in progress. This compares favorably with what it was a year ago.

6. Discussion Regarding CY 2017 1st Quarter Taxpayer Problem Resolution Officer Report

Ms. Walker said this was an informational item and was available for questions. Councilmember Korte noted that the report remains about the same.

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

Ms. Walker said that the schedule is slightly behind, as some extra time is being invested on some of the audits. Two audits will carry forward to next year. The third listed item, the recycling contract operating cost rate audit, will be removed from the list. The contractor is only willing to provide a summary spreadsheet of costs, which Mr. Worth has indicated he will review. They are not offering their records for audit and since there is no audit clause in the agreement, this will not be pursued as an audit.

8. Discussion and Possible Direction to Staff Regarding Potential FY 2017/18 Audit Plan

As the Committee requested, the list now includes when the program was last audited as well as a rating or ranking. In response to Chair Klapp's question as to about how many can be done, Ms. Walker said the cutoff number is generally 15.

Chair Klapp asked about combining the two WestWorld-related audits. Ms. Walker said this is a possibility, to plan the audit as marketing and concession agreements. She does not recall how many concession agreements there are, but auditors could do a sample of them if there is a large number.

In response to Chair Klapp, Ms. Walker explained that the contracted IT audit (number 8 on the list) could look at Water technology or the Intelligent Transportation System. That would address one of those potential audits that are now lower on the list.

Councilwoman Littlefield asked about the recycling contract. Ms. Walker explained that was on the current plan. Dan Worth told her that due to the minimum wage increase, the contractor handling recyclables wanted to increase their operating cost rate. The recycling contract provides for shared net revenues after deduction of the operating cost rate. Mr. Worth said he told the contractor that unless they agree to have their operating cost records audited, he would not feel comfortable bringing forward a proposed rate increase to Council. There is no audit requirement in this particular contract and the contractor apparently is not offering to provide detailed records. Mr. Worth plans to review the operating cost worksheet they will provide.

Councilmember Korte referred to police special revenues and noted that RICO funds and donation accounts have not been audited for quite some time. She asked about the possibility of prioritizing this audit. Ms. Walker agreed that it should be looked at, however the City Auditor's Office has limited staffing. So it could be moved above the line if something else is moved down. Councilmember Korte asked that it be kept in mind for audit. Ms. Walker added that even though she draws the line at 15 audits, sometimes she does put two to three on a contingency list and this one can be added there.

Councilwoman Littlefield referred to the police on-body camera audit and compliance with policy. Since it is a new policy area, this would be an opportune time to address any issues that need to be addressed before they become embedded. Ms. Walker agreed, noting it is number four on that list.

Chair Klapp commented that, as Ms. Walker reviews the list an additional time, consider Committee comments and whether anything should be moved up. Then the plan will be brought back for approval at the next meeting.

9. Discussion and Possible Direction to Staff Regarding Agenda Items for the Next Audit Committee Meeting (June 26, 2017)

Ms. Walker said that June 26th is the next Audit Committee meeting. The agenda will include the Tourism Development Commission sunset review, the financial audit, patrol operations audit, year-end annual report on follow-ups, annual report on the integrity line and other closeout updates. There will be no meeting in July. A tentative meeting date is scheduled for August 28th.

Public Comment

No members of the public wished to address the Committee.

Adjournment

The meeting adjourned at approximately 5:10 p.m.

SUBMITTED BY:

eScribers, LLC