

APPROVED MINUTES APPROVED ON 06/27/2019



**CITY OF SCOTTSDALE
AUDIT COMMITTEE
REGULAR MEETING**

Monday, May 20, 2019

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

PRESENT: Kathy Littlefield, Chair
Virginia Korte, Councilmember
Solange Whitehead, Councilwoman

STAFF: Sharron Walker, City Auditor
Kyla Anderson, Senior Auditor
Paul Christiansen, Senior Auditor
Lai Cluff, Senior Auditor
Shelby Trimaloff, Audit Department
Paul Basha, Transportation Department
Sharon Cini, Office of Diversity
Mel Galbraith, Fleet Management
Joyce Gilbride, City Treasurer Department
Bill Murphy, Assistant City Manager
Mike Murphy, Community Services Department
Lee Schnoor, Community Services Department
Brent Stockwell, Assistant City Manager
Philip Verver, Budget Office
Dan Worth, Public Works

GUESTS: Jill Shaw, Heinfeld Meech

CALL TO ORDER

The meeting was called to order at 3:58 p.m. A formal roll call confirmed the presence of all Committee Members as noted above.

PUBLIC COMMENT

There were no public comments.

REGULAR AGENDA

1. Approval of Minutes, Regular Meeting, March 18, 2019

COUNCILWOMAN WHITEHEAD MOVED TO APPROVE THE MINUTES OF THE MARCH 18, 2019 REGULAR MEETING AS PRESENTED. COUNCILMEMBER KORTE SECONDED THE MOTION, WHICH CARRIED 3-0 WITH CHAIR LITTLEFIELD, COUNCILMEMBER KORTE, AND COUNCILWOMAN WHITEHEAD VOTING IN THE AFFIRMATIVE.

2. Discussion and Possible Direction to Staff Regarding Human Relations Commission Sunset Review

Sharron Walker, City Auditor, stated that the Human Relations Commission purpose is to advocate and promote all dimensions of diversity. It serves as an advisory body to the Mayor, City Council and staff, making recommendations to encourage mutual respect and understanding, discourage prejudice and discrimination and work towards cultural awareness and unity. Ms. Walker noted that the Audit Committee is to evaluate whether the board or commission being reviewed is serving its intended purpose; whether its 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 expressed respect and praise for the Commission. Councilwoman Whitehead said she has particularly been interested in the dinner and dialogue events. Chair Littlefield commended the Commission for its fine work.

COUNCILWOMAN WHITEHEAD MOVED TO RECOMMEND TO CITY COUNCIL TO CONTINUE THE HUMAN RELATIONS COMMISSION. COUNCILMEMBER KORTE SECONDED THE MOTION, WHICH CARRIED 3-0 WITH CHAIR LITTLEFIELD, COUNCILMEMBER KORTE, AND COUNCILWOMAN WHITEHEAD VOTING IN THE AFFIRMATIVE.

3. Discussion of Scope and Timing for Report No. 2001, FY 2018/19 External Financial Audit

Paul Christiansen, Senior Auditor, stated that this is an existing City contract with Heinfeld Meech to perform the external financial audits. The attached letters are required by auditing standards to define expectations for both parties. Jill Shaw, Heinfeld Meech, reviewed the scope and timing of the audit. First, it includes an audit of the financial statements, where the auditors provide an opinion on whether financial statements, part of the Comprehensive Annual Financial report, are materially properly stated. Separate

audit opinions are issued on all five community facility districts as well as the SPA and MPC component units. The firm also issues an opinion on the expenditure limitation report, which is issued after the audit and demonstrates that the City is spending within statutorily defined limits. The audit encompasses a single audit as the City spends more than \$750,000 in federal awards. The auditors are required to rotate federal programs audited based on different risk factors. Internal controls are examined and an opinion on compliance is provided. As well, because of HUD grant programs the City participates in, the audit firm provides an agreed-upon procedures report based on HUD regulations and schedules. And, finally, the auditors are also required to look at expenditures compliance with Highway User Revenue Fund (HURF) statutes.

Ms. Shaw explained that the annual audit process begins now. Auditors will perform field work in the coming weeks, looking at internal controls and single audit federal programs. After the fiscal year ends on June 30th, the general ledger will close and the final numbers will be audited. The audit process wraps up in late October and final reports are presented to the Audit Committee in November.

COUNCILWOMAN WHITEHEAD MOVED TO ACCEPT THE ENGAGEMENT LETTER AS PRESENTED. COUNCILMEMBER KORTE SECONDED THE MOTION, WHICH CARRIED 3-0 WITH CHAIR LITTLEFIELD, COUNCILMEMBER KORTE, AND COUNCILWOMAN WHITEHEAD VOTING IN THE AFFIRMATIVE.

4. Discussion and Possible Direction to Staff Regarding Audit No. 1904 ActiveNet Application Controls

Lai Cluff, Senior Auditor, stated that this audit was performed to evaluate the effectiveness of the ActiveNet system's application controls, including management of its cloud-based recreation management software. The City contracted with IT specialists from Myers and Stauffer. The software is used primarily by Community Services for cashiering, facility reservations, membership management, program or class scheduling and registration. ActiveNet is a Software-as-a-Service application, which means that the vendor is responsible for hosting the application, storing and securing the City's data. ActiveNet also processes credit card payments made through the system. As staff and customers access the software through a web-based portal, we also asked the audit specialists to examine how staff is managing privacy and security risks associated with cloud-based applications.

Overall, the audit found that application controls were reasonably designed and implemented. Since our 2013 audit, the Technology Group has improved its technology controls, including establishing processes for provisioning users and creating a work order system for documenting requests for changes.

The audit identified several areas where the Technology Group can strengthen its practices. Policies and procedures regarding system access controls could be expanded and formalized to ensure system permissions are aligned with those established in the matrix, training is completed prior to access authorization, and generic and stale user accounts are deactivated if necessary. Also, it was recommended that policies be established regarding offsite uses of the application by staff and that procedures be reviewed for timely removal of access for terminated employees. Policies and staff training regarding handling of customer PII are needed. Vendor security compliance reports

should be regularly reviewed and contract requirements regarding report content should be enforced. Activity monitoring reports are needed and an incident response plan should be formalized and documented. The Division should also consider enabling system controls requiring supervisor approval of refunds over a specified dollar amount.

Councilwoman Whitehead asked if the credit card fee is typical. Bill Murphy, Assistant City Manager, confirmed that it is standard. In response to a question from Councilwoman Whitehead, Ms. Cluff stated that there is a 10 cent charge on credit card refunds.

Lee Schnoor, Community Services, stated that the action plan includes some items that the Division can act on relatively quickly. Some items will require coordination with both City IT and HR.

Chair Littlefield noted that there have been similar problems in other departments with access and removal of previous employees, which should be addressed on a timely basis.

COUNCILWOMAN WHITEHEAD MOVED TO ACCEPT AUDIT NO. 1904. COUNCILMEMBER KORTE SECONDED THE MOTION, WHICH CARRIED 3-0 WITH CHAIR LITTLEFIELD, COUNCILMEMBER KORTE, AND COUNCILWOMAN WHITEHEAD VOTING IN THE AFFIRMATIVE.

5. Discussion and Possible Direction to Staff Regarding Report No. 1916, National Transit Database (NTD) Financial Data Review

Paul Christiansen, Senior Auditor, stated that the City Transportation Department requested assistance with the federal reporting requirement regarding independent review of the Transportation Department's conformance with uniform reporting standards and their required data submitted to the NTD program. At the auditor's request, the Transportation Department requested and received an extension to submit the report by June 30. An agreed-upon procedures engagement means the auditors only perform the procedures that are specified and then report on them. AICPA guidance identified the specific procedures which were agreed to by the Federal Transit Administration (FTA) and, due to its program participation, by the City's Transit Program. Overall, the review found that the total reported expenditures were nearly \$500,000 higher than the total expenses in the accounting system. In addition, some non-cash depreciation expense items totaled \$151,000 more than the accounting system. This type of report does not contain recommendations. We also do not provide an opinion on the sufficiency of the process. Management did acknowledge the errors and provided a response to this effect.

Paul Basha, Transportation Department, noted the department will certainly make the adjustments that are needed in the future. They have learned that few transit agencies prepare this database by themselves; typically, it's done by an accountant or auditor. They intend to get assistance in the future.

Councilmember Korte noted improvements are needed. Chair Littlefield suggested a follow up on this report at a later date to ensure changes are working.

In response to Chair Littlefield's inquiry, Ms. Walker noted that a formal motion for approval was not required.

6. Discussion and Possible Direction to Staff Regarding Audit No. 1912 Fleet Parts Operation

Kyla Anderson, Senior Auditor, stated that the audit was conducted to assess management controls and cost effectiveness of Fleet parts inventory operations. Over the past five years, the department has spent between \$2.8 and \$3.5 million annually on parts inventory. Total program costs have been between \$3.3 and \$4 million. The year-end inventory balances increased from \$600,000 in July 2016, to about \$730,000 in March 2019. The audit found that the City paid 28 percent less on average for parts than the comparable retail prices. However, inventory controls are not effective to safeguard the Fleet parts inventory and operations could be improved.

There were discrepancies in the inventory. For a sample of 45 items reviewed, 6 did not match the quantity recorded in the system. Discrepancies discovered by staff during their weekly inventory counts are not fully evaluated for their causes and documentation is not retained. Instead, staff adjusts the counts in the system. In FY 17/18, inventory discrepancies totaled more than \$77,000. Inactive and obsolete parts totaling approximately \$16,000 were in stock. The parts inventory has a low turnover ratio and individual product turns. A low inventory turnover ratio indicates the inventory is overstocked, resulting in higher holding costs for the City. About 20 percent of parts purchased in FY 17/18 had a unit price of less than \$5, but these items comprised only about 6 percent of the total inventory value. Many of these low dollar items could be expensed as shop supplies and included in the Fleet overhead rate. Almost 400 items have not been issued in two or more years and 27 have not been issued in more than ten years. Trying to meet the established performance goal for service turnaround time could potentially result in overstocking parts inventory. Further, often parts vendors can deliver parts within 1 to 2 days, if not sooner. Auditors observed non-parts staff in parts rooms unattended and a backdoor unlocked. Several non-parts staff have keys. Adding keypad locks and cameras would increase security. Access to the computer system was not effectively restricted for former employees. Parts staff are not scheduled efficiently to balance workloads and supervision.

Councilmember Korte asked about the frequency of taking inventory. Mel Galbraith, Fleet Management, stated that 26 inventories are conducted throughout the year. Councilmember Korte stated that inventory management comes down to controlling the people in the Parts department, including who has computer access. Old parts should be written off and removed to alleviate storage costs. The figure of 18 percent reported losses is significant.

Councilwoman Whitehead asked about the process for obsolete parts. Mr. Galbraith said the first attempt is to return it to a vendor that will give them close to market value for the returned parts. If not possible, the part goes to public auction.

Chair Littlefield suggested exploring other options for sale of obsolete parts. It is a positive note that the Department is receiving lower than retail prices on the purchase of items, however the 18 percent loss eliminates the gain. Controlling access is critical. Items under a certain dollar amount should be put in supplies and written off. The department does not meet the standard in terms of inventory accuracy and this should be a goal. Physical security of the area should be addressed, including possibly the addition of electronic

keypads and surveillance, with adequate supervision provided. In addition, employees no longer with the City should not have access.

Councilmember Korte asked whether the department monitors lost sales. Mr. Gailbraith stated that everything is received as a special order part and there is attention to noting the number of times the part is ordered. The system will actually recommend graduation to an inventory status. If there is a part needed that is not in stock, this is also tracked as a special order item.

COUNCILMEMBER KORTE MOVED TO ACCEPT AUDIT NO. 1912. COUNCILWOMAN WHITEHEAD SECONDED THE MOTION, WHICH CARRIED 3-0 WITH CHAIR LITTLEFIELD, COUNCILMEMBER KORTE, AND COUNCILWOMAN WHITEHEAD VOTING IN THE AFFIRMATIVE.

7. Discussion and Possible Direction to Staff Regarding 3rd Quarter FY 2018/19 Follow Up on Status of Audit Recommendations

Ms. Walker said that that approximately 62 percent of audit recommendations have been implemented or partly implemented, with approximately 33 percent in progress, comparable to the totals from previous years. Not implemented recommendations total 3.5 percent for the quarter, compared to 3 percent for the same quarter a year ago. Three recommendations were evaluated as not applicable, because of changes in the agreement that was audited. Two findings were informational with no recommendations. The detailed report that's attached is only items updated during this quarter. At the June meeting, the annual report will detail all recommendations for the 3 previous years plus the current year. Also, a more detailed update on the Benefits Administration Audit, as requested by the Audit Committee, will be provided in June.

Councilmember Korte asked if any of the Not Implemented recommendations were red flags. Chair Littlefield indicated she had the same question. Ms. Walker responded that she believes that all the recommendations are completely valid and should be implemented, but if any of these were operationally critically, she would highlight those. These recommendations were directed at making sure information is complete, that the right information is available for decision making, and having controls in place to prevent issues. The annual report in June will have a separate attachment detailing the Not Implemented recommendations.

In response to Chair Littlefield, Ms. Walker recalled that one of the Not Applicable recommendations related to the McCormick Stillman Railroad Park agreement that was updated after the audit and it was no longer an issue. The other two may have been related to informational audits that did not have recommendations.

8. Informational Report Regarding 1st Quarter CY 2019 Taxpayer Problem Resolution Officer Report

Ms. Walker stated that this report is just provided for information.

9. Discussion and Possible Direction to Staff Regarding Preliminary Proposed FY 2019/20 Audit Plan

Ms. Walker stated under the carry-forward audits on the preliminary plan, there are a couple of additional items that were not on the draft provided in March. Public Works has requested a cost review of its landfill contract, as the contractor would like a cost rate increase. The audit has been added to the plan and will be a carry-forward. The Police Special Revenue is also now shown as a carry-forward audit. Contingency audits for facilities management contract administration and Museum of the West were to potentially begin this year, but were not started, so these have been added to the planned additional audits. Based on suggestions from the last meeting, the crime reporting statistics audit under Police admin and operations is proposed as another area. There were also suggestions to include areas that have not been audited in more than five years. Some of these include the ambulance services contract, and the code enforcement and housing rehab and repair programs, which were put on as contingency. Warehouse operations was also placed on the audit list. After any potential adjustments, the list will be presented again at the June meeting as the proposed audit plan for approval.

10. City Auditor Updates, Including Status of FY 2018/19 Audit Plan

Ms. Walker stated that the infrastructure condition assessment audit will be completed and presented in June. At this time, other agenda items include the annual report updates and the proposed audit plan.

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

Audit Committee members agreed with the next meeting date of Thursday, June 27, 2019 at 1:00 p.m. in the City Attorney's conference room.

Public Comment

There were no public comments.

Adjournment

The meeting adjourned at 4:51 p.m.

SUBMITTED BY:

eScribers, LLC