

**APPROVED MINUTES
APPROVED ON 08/24/2015**



**CITY OF SCOTTSDALE
AUDIT COMMITTEE**

MONDAY, JUNE 22, 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: Sharron Walker, City Auditor
Kyla Anderson, City Auditor's Office
Cathleen Davis, City Auditor's Office
Christy Alonzo, Police Department
Brian Biesemeyer, Acting City Manager
Derek Earle, Capital Projects Management
Laurel Edgar, Capital Projects Management
Ryan Freeburg, Fire Department
Brad Hartig, IT Department
Teresa Martin, Fire Department
Alan Rodbell, Police Chief
Kathy Schoepe, Library Department
Rachel Smetana, Mayor's Office
Brent Stockwell, City Manager's Office
Kathleen Wade, Library Department
Martha West, Capital Projects Management

GUESTS: Peggy Chamberlain, Library Board
Mary Wilber, Library Board

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, May 18, 2015

COUNCILWOMAN LITTLEFIELD MOVED TO APPROVE THE MINUTES OF THE MAY 18, 2015 REGULAR MEETING. COUNCILMEMBER KORTE SECONDED THE MOTION, WHICH CARRIED BY A UNANIMOUS VOTE OF THREE (3) TO ZERO (0).

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

City Auditor Sharron Walker reviewed the mandate of the Library Board and the Audit Committee's charge, which is to evaluate whether the board being reviewed is serving its intended purpose; whether the 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 being reviewed. Ms. Walker noted that Library Director Kathleen Wade and representatives were in attendance. Chair Klapp invited them to comment. Ms. Wade commended the Library Board, saying she appreciates their support. Chair Klapp thanked the Board for all the work it does. Councilmember Korte noted that Board Chair Mary Wilber was present and thanked the Board. Ms. Wilber said that she is proud of the work of the Library and the Board. Councilwoman Littlefield expressed her appreciation of the Library Board.

COUNCILMEMBER KORTE MOVED TO RECOMMEND TO THE COUNCIL THE CONTINUATION OF THE LIBRARY BOARD. COUNCILWOMAN LITTLEFIELD SECONDED THE MOTION, WHICH CARRIED BY A UNANIMOUS VOTE OF THREE (3) TO ZERO (0).

3. Discussion and possible direction to staff regarding Audit No. 1504, Network Security Assessment

Ms. Walker explained that an independent consultant, Terra Verde, LLC was hired to conduct a technical review of the City's network security. Compared to best practices, Terra Verde found that 83 percent of the recommended administrative controls were in place, 95 percent of the physical security controls were in place, and technical controls were rated at 92 percent. The consultants worked closely with IT and the City Auditor's Office.

The public report is at a high level for information security purposes. Detailed reports related to physical security of network assets have been distributed under password protection to the applicable directors and the City Manager. Ms. Walker noted that Chief Information Officer Brad Hartig and Acting City Manager Brian Biesemeyer were in attendance.

Mr. Hartig said he is very proud of his team. The consultant told them that Scottsdale is one of the best municipalities they have worked with. He looks forward to working with the auditors and Terra Verde on resolving some of the issues. Ms. Walker added that the contract with Terra Verde includes some retesting, which will take place in a couple months.

Mr. Hartig stated that one of the biggest areas of vulnerability for the department is third party applications and their patches. Programs such as Java and Adobe are constantly being patched, and people need to understand the need for virus protection for their personal equipment as well.

Councilmember Korte asked whether the City is able to achieve 100 percent control given today's resources. Mr. Hartig said the IT landscape is constantly changing so this is a lofty goal. Staff will continue to strive to achieve this, but he believes there will always be room for improvement.

Regarding the physical control of door key cards, Chair Klapp said it would be helpful to have a number to call in an emergency, as she had personal experience of being locked out of the building after hours.

4. Discussion and Possible Direction to staff regarding Audit No. 1505, Fairmont Scottsdale Princess Lease Agreement

Senior Auditor Cathleen Davis presented the audit report on the Fairmont Scottsdale Princess Lease Agreement, which was conducted to review compliance with contractual requirements and contract administration. In December 1985, the City entered into a ground lease agreement with the Scottsdale Princess Partnership to develop a major resort on City-owned property. The initial 99-year agreement required the Princess to develop and operate a full-service, first-class resort hotel facility. In return, the Princess was to pay the City an annual rent of two percent of gross sales. Since that time Council has approved four amendments, the most recent in March 2012.

The auditors found former City staff did not collect about \$134,000 in rent due from the Princess for calendar year 2011. Beginning on July 1, 2011, the fourth amendment changed the rent calculation. However, the Princess continued making monthly rent payments based on two percent of gross sales through the end of 2011 and into 2012. While the fourth amendment was being negotiated, Princess staff provided a rent calculation that calculated annualized rent due under the terms of the original agreement and under the terms of the fourth amendment. They proposed using fifty-percent of each amount to calculate the total amount due for calendar year 2011. Former Community & Economic Development Division staff agreed to the Princess' proposed rent calculation. As a result, the City did not receive approximately \$134,000 in rent revenue that would have been collected under the terms of the fourth amendment. The decision to accept the Princess' proposed calculation for the 2011 rent was not disclosed in the Council Action Report for City Council approval.

Contract administration and oversight of the lease agreement can be improved. Although the Public Works Division's Real Estate section carries out most of the contract administrator duties, a contract administrator has not been formally assigned to monitor and enforce this agreement. Compliance with contract terms, including ensuring timely payments, identifying when additional rent payments are required, and obtaining sinking fund and insurance documentation can be improved. Staff designated as the contract administrator should direct all payments to the City's Remittance Processing section to maintain proper segregation of duties.

Ms. Davis noted that Mr. Derek Earle, Ms. Martha West and Ms. Laurel Edgar from Public Works (Capital Project Management) were in attendance.

Councilwoman Littlefield inquired whether staff is allowed to modify a Council-approved contract without notifying Council. Chair Klapp said the recommendation is that going forward no changes would be permitted without Council approval. Her understanding of the report is that there was an agreement between the City and the Princess but Council was unaware of it. The Princess followed this agreement, so it would not be possible to recoup the underpaid rent.

Councilwoman Littlefield asked if a contract administrator has been assigned. Ms. Davis confirmed there has been.

5 Discussion and possible direction to staff regarding Audit Report No. 1510, Photo Enforcement Contract

Senior Auditor Kyla Anderson said the audit was conducted to review compliance with contract requirements and administration for the City's photo enforcement contract with American Traffic Solutions. She reviewed the cameras in place in the City. In FY 2013/14 payments to the photo enforcement vendor totaled about \$1.3 million. After City, state and county surcharges and operating costs are deducted from the Photo Enforcement revenue; the City's general fund netted about \$437,000 last year. The auditors found vendor billings were generally accurate, but there are some areas for improvement. Some contract terms have not been monitored or enforced. Images and videos for violations that were rejected by the vendor were only retained for 30 days instead of one year as required by the contract. Without the original images and videos it is difficult to evaluate whether the vendor appropriately rejected the violations. The vendor has also not complied with the processing time requirement within the contract, which is five days. The auditors found that 28 percent of all violations exceeded the five-day requirement. However they did not observe any specific instances where a citation could not be issued because of the delay. Further the contract administrator did not maintain documentation that would assist with effective contract administration as required by administrative regulation.

The auditors recommended that the Police Department work with the vendor to identify other methods of classifying criminal violations and monitoring repeat offenders and other types of traffic violations that are not enforceable through the photo enforcement process. Ms. Anderson noted that Chief Rodbell was in attendance.

Chief Rodbell acknowledged that the contract administrator and the vendor made some changes to the agreement that Council had approved without notifying anybody else. The contract administrator has since resigned and the Department is hiring a replacement. He has personally met with ATS staff to assure them that the Department will take a serious look at contract requirements and will hold the company to them. Any adjustments will have to be approved by City Council. The Police Department is taking decisive action to ensure this does not reoccur in the future. Councilwoman Littlefield asked if the contract goes out for bid or if the City just renews it. Chief Rodbell responded there is more than two years left on the present five-year contract. He apologized to Council for what had happened but noted that, with the exception of that change, the department has had a good relationship with the vendor.

Chair Klapp commented that the audit has a good observation about habitual offenders driving company cars and getting 44 tickets without having to pay for them, and the City has to find a way to rein that in. Chief Rodbell noted the department will be working with ATS to deal with that.

In response to a question from Councilwoman Littlefield, Chief Rodbell said the state legislative session ended this year without photo enforcement being further limited.

6 Discussion and Possible Direction to Staff Regarding Audit Report No. 1515, Review of Super Bowl/ Open Overtime

Ms. Walker said the actual Super Bowl/Open overtime exceeded department estimates so the City Manager had asked her to review the overtime. The Police Department also conducted an internal analysis to determine why their estimates had been so different from the actual. This analysis is summarized in Table 3 of the report. Multiple factors were not taken into consideration when estimating, including other smaller events related to the Super Bowl, such as those around the mall. Also, the original estimate was based on the direct hours involved in Super Bowl 2008 activities. At that time the additional hours spent in planning, scheduling and technology were not tracked. In 2015, the Department was tracking more types of activities.

Other observations included that several officers worked more than 80 hours of on-duty overtime or off-duty hours. The Department has policies to limit overtime, but due to the peak staffing for all the events, a few officers worked more than 130 hours in an eight-day period. Several officers were allowed to use a total of more than 1,500 vacation hours to work in off duty positions. Traditionally this has been allowed. This year because of the extremely busy event period, the Department had to pay other officers overtime to backfill for those staff members.

Ms. Walker said she found that generally the timesheet data and overtime costs did support the amount of overtime reported for Super Bowl and Phoenix Open related overtime. She elaborated that the Police Department had asked officers to volunteer for off duty assignments. Because not enough people volunteered, the Department had to assign officers to those positions and, because they were assigned, pay them at the overtime rate. The off duty billing rate does not fully recover police overtime costs.

The Fire Department attributed its staffing increase to the growing attendance at the Waste Management Phoenix Open. The auditors found a few minor discrepancies with regard to the Fire Department overtime. Ms. Walker noted that Chief Rodbell and Chief Freeburg were also present and available to answer questions.

Councilmember Korte noted it seems like a lot of money. Chief Rodbell said this was a perfect storm, as there has never been a Pro Bowl, Super Bowl and Phoenix Open in the same week. The City has 21 fewer officers than the last time and borrowed 50 officers from other jurisdictions to help out. During the week in question, this was a 24/7 city with events happening from early morning to the late evening. Fifty-three special event permits were issued. Plus there were outside impacts, such as the federal government setting up operation centers monitoring information in relation to terrorism. There were many moving parts, including a huge increase in population over the time frame.

Chief Rodbell said this was the first year the Department had a “no leave” policy during the event period. In the past, officers were always granted leave to work inside the gates at the Open and were paid the off duty rate by the Thunderbirds. The department has responsibility for security outside the gates and traffic management. The Police Department had to assign some officers to work unfilled off-duty positions at the Open and pay them the overtime rate. The Thunderbirds were reimbursing the City but it did not equal the overtime. In the future, the overtime restriction policy will apply during the Phoenix Open. If officers do not volunteer for the off duty assignments, schedules will be adjusted in advance so no one will be working overtime at the Open.

Ms. Christy Alonzo noted that the overtime report includes overtime incurred prior to the events to attend meetings with the federal government and other officials. Chief Rodbell added that a large contingent of observers came from California to prepare for the 2016 Super Bowl in Santa Clara and the Police Department was largely responsible for facilitating their visit.

In response to Chair Klapp’s question, Chief Rodbell assured the Committee that the Police and Fire Departments had a number of contingency plans in the event an emergency occurred. In fact, the planning was area-wide, not just for Scottsdale. Executive Assistant Fire Chief Ryan Freeburg said they were part of the area command and met with federal officials on a daily basis. The regional partnership meant the City had access to federal resources. The City’s Emergency Operations Center was connected to the Phoenix EOC where the federal agencies were hosted. Chief Rodbell said the City benefited from huge support from Valley cities that were not hosting events, for example Mesa, Gilbert and Chandler. Chief Rodbell said the Waste Management Phoenix Open is the City’s signature event and he wanted to ensure that outside officers conformed with the way the Scottsdale Police Department deals with the public.

Chief Rodbell said he is extremely proud of all the work done by City employees during the event period, where everything came together in the city with no major incidents. He further noted that he knows there is a price to pay and it was a fair audit. He promised that if he is still with the City for the next Super Bowl, he will try to do a better job of estimating overtime.

Councilwoman Littlefield suggested that in future contracts for reimbursement, the department might take a closer look and better match the reimbursement charges to the costs. Chief Rodbell said this year was so atypical. In addition to the off-duty officers contracted by the Thunderbirds, the Police Department sends undercover officers and officers to enforce the liquor laws, and those costs are not reimbursed by the Thunderbirds.

Councilwoman Littlefield said she was impressed when she toured the Emergency Operations Center.

7 Discussion and Possible Direction to Staff Regarding Audit Report No. 1512, External Review of City Auditor's Compliance with Auditing Standards

Ms. Anderson said that as required by government auditing standards, an external peer review was conducted in May to review their work from January 2012 through December

2014. The Association of Local Government Auditors operates this peer review program. The City pays the travel costs for the peer reviewers, whose regular salary is paid by their employer. As this program is reciprocal, Ms. Walker will be participating in a week-long peer review in Los Angeles in the fall. The department will take part in at least one more review within the next three years.

The peer reviewers determined that the office is in full compliance with government auditing standards. They suggested more complete documentation of the evaluation of independence threats when conducting nonaudit services. This relates to services such as Ms. Walker serving as the City's Taxpayer Problem Resolution Officer.

The reviewers also noted several areas in which they felt that the office excels, including the sharply focused and well written audit reports, the organization of working papers and the highly motivated and well trained staff that is the direct result of the professional and supportive work environment provided by Ms. Walker. The reviewers noted that the staff have and meet rigorous project goals. Ms. Anderson noted the reviewers requested some of Office's templates for their home offices in Honolulu and Milwaukee. Both are looking to implement electronic work papers as used by the City Auditor's Office.

Ms. Walker shared that she plans to formalize the independence documentation for the Taxpayer Problem Resolution Officer reports. As this work totals about 80 hours of the 12,000 hours in a year, it had been informally documented before.

The Committee members congratulated staff on such an excellent review. In response to a question, Ms. Walker noted that the office was one of the first cities in Arizona to post all audit reports on the City website, although many Valley cities have recently followed suit.

8 Discussion and Possible Direction to Staff Regarding Audit Report No. 1513, FY 2014/2015 Annual Report on City Auditor's Integrity Line

In reviewing this report, Ms. Walker said the Association of Certified Fraud Examiners has found that having an integrity hotline reduces the impact of fraud dramatically. The duration of fraud is reduced by about 50 percent, and the financial loss is reduced by approximately 40 percent.

This year the hotline received five unique reports. The Committee already heard about the surplus property issue that was previously reported.

Another concerned personal use of a City vehicle. The City Manager plans to have the executive team review the policy on City vehicle use this summer and clarify what is acceptable. Commuting value is supposed to be reported as a taxable benefit. The employee concerned had an assigned parking spot closer to home than to the regular workplace and had been using the City vehicle for commuting from there. The City Manager responded that the employee and the supervisor have been counseled, the practice has been stopped and the information has been forwarded to the City Treasurer for a review of the tax implications.

Ms. Walker said she forwarded one concern to the Parks and Recreation Department and one to the Police Department. In response to Councilwoman Littlefield's question, Ms. Walker noted that the former Director of the Parks and Recreation Department committed to work with the Transportation Department on how to resolve the issue of equestrian use of the greenbelt.

The fifth complaint alleged employee misconduct but was not specific enough to investigate and there was no contact information provided. This is not unusual for hotline reports.

Ms. Walker concluded that the situations they were able to address show the value of having a hotline. Chair Klapp asked if it was mostly employees using it or the public also. Ms. Walker responded that contact information was usually not provided. Councilmember Korte asked if the hotline has been in place for a year. Ms. Walker said the Committee was talking about it this time last year as the hotline was on the 2014/15 audit plan. But the hotline webpage, phone number and email address were reported as established in November 2014. Apparently because people were aware of the planning, some tips were received before the official launch.

During the next fiscal year, Ms. Walker plans to complete documentation of the policies and procedures.

9. Discussion and Possible Direction to Staff Regarding Audit Report No. 1514, FY 2014/2015 Annual Follow-Up on Status of Audit Recommendations

Ms. Davis said that more than 90 percent of audit recommendations made since July 2009 have been substantially addressed. Sixty-seven percent were implemented, eighteen percent were in progress, and seven percent were partially implemented. These statistics remain steady with last year's results. Since this Audit Committee-requested program began, management action on audit recommendations has increased by thirteen percentage points, from about seventy-seven percent in September 2009.

During this fiscal year, auditors identified potential cost savings or revenue enhancements totaling approximately \$3 million. Additionally, the audits identified process and control improvements, which are not as easily measured, in areas such as application access controls, contract clarification, and compliance.

Chair Klapp said sometimes recommendations are not implemented and asked whether the auditors are comfortable with the items on this list that have not been implemented. Ms. Walker stated that sometimes recommendations are not implemented because of changes or additional information that the auditors were unaware of. She does not agree with the decision of some departments not to implement certain recommendations, but these do not rise to the level of concerns she needs to raise to City Council. Ms. Walker noted that the auditors bring a fresh perspective to operations, and managers who are involved in day-to-day operations may not immediately see the benefits of their recommendations. She assured the Committee members that she would bring any concerns regarding critical non-implemented items to their attention. In addition, while performing follow ups the auditors have an opportunity to emphasize the importance of recommendations made.

10. Discussion and Possible Direction to Staff Regarding Status of FY 2014/2015 Audit Plan

Ms. Walker shared that completing 16 audit reports stretched their resources, and this is not a sustainable level for staff. Staff has worked hard over the past few months, as some of the audits turned out to be more complicated than anticipated. She complimented her staff on their results in getting reports completed. Committee members agreed.

11. Discussion and Possible Approval of Proposed FY 2015/2016 Audit Plan

Ms. Walker said they have made the adjustments discussed at the last meeting. The City Manager's Office had continued to move forward on the police staffing study, so she has removed that from the audit plan. This allowed other proposed audits to move up onto the plan.

She invited the Committee members to make any changes they wish and to recommend the Audit Plan to City Council. Chair Klapp inquired if the contingency audits are listed in priority order. Ms. Walker responded that they are not necessarily. If she needs to add a project from the contingency list, the size of the project and available time is also taken into consideration. The IT contracted audit is at the top of the contingency list because Mr. Hartig has advised that a federal audit may include Scottsdale's SCADA water resources control network. If this materializes, the SCADA audit will be removed from the audit plan and replaced with the IT contracted audit.

Councilwoman Littlefield inquired about recurring audits on the plan and whether they automatically recur. Ms. Walker explained that the contracted financial audit and the follow up on audit recommendations are required, and now the integrity line report will occur every year. But the cash handling audit is something that she puts on the plan every year or two as it is good to review these controls regularly.

COUNCILMEMBER KORTE MOVED TO APPROVE THE PROPOSED FY 2015/16 AUDIT PLAN AND FORWARD IT TO CITY COUNCIL AS PRESENTED. COUNCILWOMAN LITTLEFIELD SECONDED THE MOTION, WHICH CARRIED BY A UNANIMOUS VOTE OF THREE (3) TO ZERO (0).

12. Discussion and Possible Direction to Staff Regarding Agenda Items for Next Audit Committee Meeting (August 24, 2015)

Ms. Walker announced staff will present a couple of sunset reviews, the quarterly Taxpayer Problem Resolution Officer report, an update of the audit plan, and possibly the construction contract audit but it may be in September.

She added that the meeting in September will not take place on September 21, as she will be conducting the peer review audit for the Los Angeles Unified School District. Ms. Walker will work with Kathy Cross to reschedule that meeting.

Public Comment

Acting City Manager Mr. Brian Biesemeyer said he had seen some of the audit reports as they have crossed his desk. In general he felt they have done very well. Directors appreciate the information gleaned from audits and are committed to taking prompt actions on issues. It reflects well on the auditors and City staff in general that people care and want to do a good job.

Ms. Walker appreciated Mr. Biesemeyer's help and his willingness to take action when he was thrust into his position on short notice.

Adjournment

The meeting adjourned at approximately 5:15 p.m.

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