



CITY AUDITOR'S OFFICE

Cultural Council Contract Compliance

December 12, 2011

AUDIT REPORT NO. 1204

CITY COUNCIL

Mayor W.J. "Jim" Lane

Lisa Borowsky

Suzanne Klapp

Robert Littlefield

Ron McCullagh

Vice Mayor Linda Milhaven

Dennis Robbins



December 12, 2011

Honorable Mayor and Members of the City Council:

Enclosed is the audit report, *Cultural Council Contract Compliance*. The City has a 10-year Management Services Agreement with the Scottsdale Cultural Council (SCC), which began on July 1, 2008. A related annual Financial Participation Agreement specifies the amount the City pays to the SCC for this service, including certain earmarked funds.

This audit determined that the SCC generally complies with agreement terms. However, certain contractual requirements can be strengthened or further enforced, such as earmarking a greater portion of the management service fees and requiring the SCC to develop more informative performance measures and a refined open meeting policy and practices to better align with the City's. Additionally, City staff can improve the exchange of financial information with the SCC, and consistent Contract Administrator oversight is needed to monitor compliance and identify opportunities for continued improvements.

We would like to thank City staff from the Community & Economic Development, Finance & Accounting, Community Services, and Public Works divisions and the SCC staff for their cooperation throughout this audit.

If you need additional information or have any questions, please contact me at (480) 312-7867.

Sincerely,

Sharron Walker, CPA, CFE
City Auditor

Audit Team:

Lisa Gurtler, CPA, CIA — Assistant City Auditor
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EXECUTIVE SUMMARY

This audit of *Cultural Council Contract Compliance* was included on the Council-approved FY 2011/12 Audit Plan. The audit objective was to review compliance with contractual requirements of the current Management Services and Financial Participation Agreements.

Since 1988, the City has entered into a series of agreements with the Scottsdale Cultural Council (SCC), a private non-profit organization, to manage Scottsdale's art and cultural facilities and related programs. Currently, the City is in the fourth year of a 10-year Management Services Agreement (MSA) with the SCC. A related annual Financial Participation Agreement specifies the amount the City pays to the SCC for these services, including certain earmarked funds.

The SCC generally complies with agreement terms; however, contractual requirements can be strengthened or further enforced by:

- Earmarking a greater portion of the management services fee to ensure City funds are directed to programs and services and limit the amount used for administrative purposes. Only about \$1 million, or 25%, of funds the City paid to the SCC in each of the last four years was earmarked for specific purposes.
- Requiring more informative performance measures, including budgeted amounts for the coming year and historical trends of past years, to help City management measure SCC accountability.
- Improving alignment of existing SCC open meeting policy and practices with City policy and practices as required by the MSA. This would include more timely agenda postings, inclusion of documents related to the agenda items, clarification of appropriate executive session subject matter, and increased review of meeting minutes for clarity, particularly related to budget cuts and transfers.
- Establishing a policy or guideline to address restrictions on catering vendors who provide services at City-owned facilities. Currently, to become an SCC preferred caterer, a business is required to pay a fee and make an in-kind contribution,

Additionally, City staff sometimes provided incomplete or inaccurate financial information to the SCC regarding arts-related funds. For example, the actual balance of the Art in Public Places Fund is overstated due to expenses not being specifically tracked. As well, previous City management decided to use the Community Arts Trust Fund to pay \$300,000 of the FY 2009/10 Financial Participation Agreement even though this was not specified in the accompanying Council Report. Typically, the City's General Fund pays for SCC services. Further, the process used to coordinate City payment of certain SCC art-related invoices is inefficient, and invoices to bill the SCC for Mall repairs do not include the City's indirect costs.

Appropriate resources should be directed to contract administrative duties to ensure the agreement is properly monitored as required by Administrative Regulation 215 - Contract Administration.

BACKGROUND

Since 1988 the City has entered into a series of agreements with the Scottsdale Cultural Council (SCC), a private non-profit organization, to manage Scottsdale's art and cultural facilities and related programs. Currently, the City is in the fourth year of a 10-year Management Services Agreement (MSA) with the SCC, which began on July 1, 2008. An annual Financial Participation Agreement (FPA) specifies the amount the City pays for these services. The Economic Vitality department's Strategic Programs Manager is the City's designated Contract Administrator who acts as the liaison between the City and SCC management and is responsible for monitoring all aspects of the contract.

The City's Art and Cultural Facilities and Programs

The following City art and cultural facilities and programs are included in the Management Services Agreement:

Scottsdale Center for the Performing Arts (SCPA) – located at Drinkwater Boulevard and Second Street, the Center includes;

- The Virginia G. Piper Theater – a newly renovated, fully-equipped professional theater that seats 853;
- Stage 2 – a smaller theater with a raised stage and projection screen;
- The Dayton Fowler Grafman Atrium – with 6,200 square feet, the Center's main entrance provides space for events or receptions;
- The Mezzanine Conference Room – a smaller space for gatherings of up to 120; and
- The Young @ Art Gallery – a 1,700 square foot gallery devoted to the creative artwork of students.

Scottsdale Museum of Contemporary Art (SMoCA) – located beside the SCPA, the Museum was founded in 1999. Dedicated to presenting exhibitions on contemporary and modern art, architecture, and design, SMoCA offers a variety of exhibition-related programs and special events.

Scottsdale Public Art (SPA) – in 1985, the City adopted a one percent for art ordinance and established the SPA program. Spread throughout the City's 184-square miles, SPA features a diverse range of free art, community events, exhibitions, and permanent art. The SPA staff manages the following:

- *Art in Public Places (AIPP)* – funded by 1% of each City capital improvement project meeting the definition of “publicly-visible public works projects: city buildings, structures, drainage projects, parks, transportation streetscapes, multi-use pathways, transit and pedestrian amenities (such as bus shelters, sidewalks and shade structures)”. The funding can be used for art acquisition, project management, installation design services and electrical, mechanical or other utility equipment necessary for the operation of the public art. (Scottsdale Revised Code §20-121 through 20-123)
- *Art in Private Development (AIPD)* – developers in the Planned Block Development of the Downtown District are required to place art work onsite that costs 1% of the

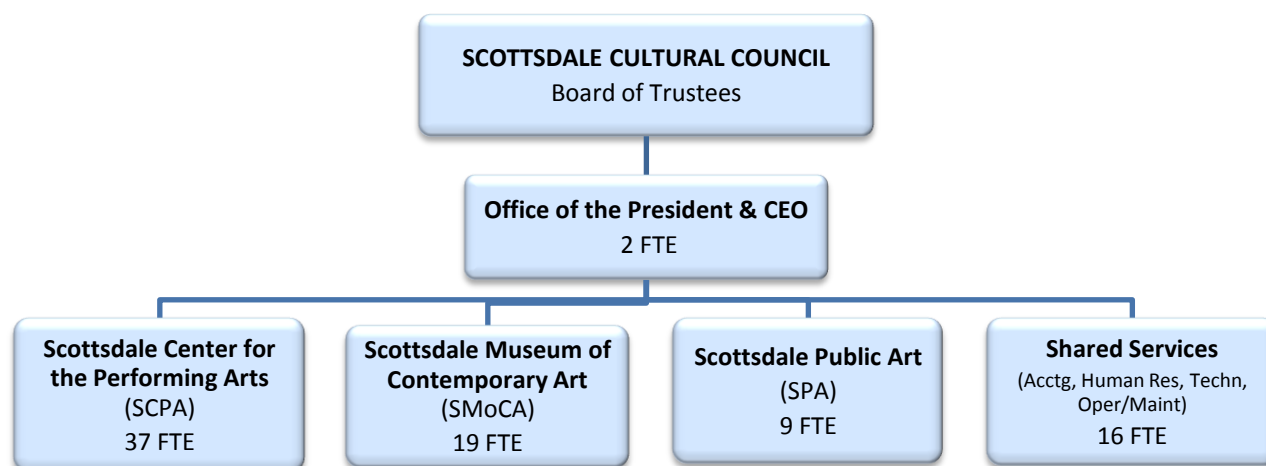
building improvement or valuation, or pay that amount into the City's Downtown Cultural Trust Fund. This fund is used exclusively to purchase art to be placed in the Downtown District. (Scottsdale Revised Code §5.3083)

- *Community Arts Grant Program* – this program provides funding for Scottsdale-based arts and cultural organizations as well as valley arts organizations for projects that take place in Scottsdale. MSA Section 5.5 – *Arts Grant Program*, states the SCC shall establish and implement a community arts grant program to support independent, non-profit arts organizations. The program may also provide Scottsdale-based, non-profit arts and culture organizations with technical assistance (e.g., board development, strategic planning, and marketing).

Scottsdale Cultural Council

As shown in Figure 1, a Board of Trustees governs the SCC, and a President/Chief Executive Officer manages it. The organization is comprised of 3 operating divisions, each managed by a Vice-President/Division Director, and a Shared Services group, managed by the Vice President/Chief Financial Officer, and has 83 budgeted full-time equivalent employees (FTEs). Although not shown in the figure, each operating division has an Advisory Board whose purpose is to represent the community's interests.

Figure 1: Organizational Structure of the Scottsdale Cultural Council



SOURCE: Auditor analysis of the SCC organizational structure as of October 2011 and fiscal year 2012 adopted FTE budget.

Budget Process

The SCC's annual budget process begins in December with the divisions submitting preliminary budgets that are reviewed and approved by the Board of Trustees, and then consolidated into the SCC operating budget sometime in May. After the City adopts its operating and capital budgets in early June, the annual Financial Participation Agreement (FPA) is developed specifying the amount of City funding; the FPA is then reviewed and approved by the City Council in late June. The MSA specifies that the City does not approve the SCC's budget.

As shown in Table 1, the annual management service fees have been more than \$4 million in each of the most recent four years. Approximately \$1 million is earmarked for managing the Art in Public Places (AIPP) and Art in Private Development (AIPD) programs; conservation and restoration of the City's public art; the Community Arts Grant Program; and maintenance and repair of City-owned specialty equipment of the SCPA, SMOCA and SPA.

Table 1. Financial Participation Agreement Funding

(in thousands)

	FY 2008/09 (a)	FY 2009/10	FY 2010/11	FY 2011/12
General performance of Agreement obligations	\$3,135	\$3,349	\$3,435	\$3,267
Earmarked Funds:				
Management and administration of Art in Public Places and Art in Private Development Programs	815	658	698	657
Conservation and restoration of the City's public art	140	130	130	130
Management, administration and awards for the Community Arts Grant Program	59	59	59	59
Maintenance and repair of specialty equipment/fixtures	12	18	18	17
Earmarked Funds Total	1,026	865	905	863
Total Funding	\$4,161	\$4,214	\$4,341	\$4,130

(a) Excludes supplemental funding of \$1.2 million due to renovation of the SCPA.

SOURCE: Financial Participation Agreements, fiscal years 2008/09 through 2011/12.

Performance Measures

Section 5.2 of the MSA requires the SCC's Annual Report to the City to include performance measures. The SCC has chosen to report current year attendance, number of volunteers, and earned and contributed revenue, but without comparison or trend data. (See Finding 1 on page 11 for more information.) The following are auditor-developed measures using the SCC's audited financial statements from fiscal years 2008/09 through 2010/11.

Revenue Ratio Analysis

Revenue ratios measure an organization's dependence on each type of revenue. As shown in Table 2 on page 6, during the last three fiscal years, SCC's total annual revenues have increased from \$8.7 million to \$10.9 million, with the City-provided share of 60% in FY 2008/09 declining to 48% in FY 2010/11.

The SCC's earned revenues have increased from a low of \$2.3 million in FY 2008/09, when the SCPA was being renovated, to \$2.9 million in FY 2010/11. Contributed revenues have declined from \$2.1 million to \$1.8 million, coinciding with decreased fundraising costs (see Table 3 on page 6 in the *Expense Ratio Analysis* section). And the City-provided Art in Public Places (AIPP) monies have declined from about \$1.1 million to \$.9 million as available City capital project funding has decreased.

Table 2. SCC Revenue Ratios

(amounts in millions)

	Actual FY 2008/09 (a)	Actual FY 2009/10	Actual FY 2010/11
Earned Revenues	\$2.3	\$2.6	\$2.9
% to Total Revenues	26%	25%	26%
Contributed Revenues	\$2.1	\$1.8	\$1.8
% to Total Revenues	24%	18%	17%
Other Revenue (investments, etc.)	(\$0.9)	\$0.6	\$1.0
% to Total Revenues	-10%	6%	9%
City Provided Revenues			
Contract Revenues	\$4.2	\$4.2	\$4.3
AIPP Fund	\$1.1	\$1.0	\$0.9
City Provided Revenues	\$5.2	\$5.3	\$5.2
% to Total Revenues	60%	51%	48%
Total SCC Revenues	\$8.7	\$10.3	\$10.9

(a) Fiscal year 2008/09 Contract Revenues excludes \$1.2 million supplemental funding due to renovation of the SCPA.

SOURCE: SCC audited financial statements, fiscal years 2008/09 through 2010/11.

Expense Ratio Analysis

Expense ratios are analyzed to determine the comparative costs of operating various aspects of the organization. Table 3 illustrates that total expenses have declined from \$11.2 million in FY 2008/09 to \$10.3 million in FY 2010/11. During this time, a greater percentage of funds have been directed to Program costs (a favorable trend), while Administrative costs have decreased. Special Events & Development (fundraising) costs have declined, which coincided with a corresponding decrease in Contributed Revenues as noted in the preceding *Revenue Ratio Analysis*.

Table 3. SCC Expense Ratios

(amounts in millions)

	Actual FY 2008/09	Actual FY 2009/10	Actual FY 2010/11
Programs	\$6.9	\$6.6	\$6.9
% to Total Expense	62%	64%	67%
Administrative	\$2.9	\$2.6	\$2.5
% to Total Expense	26%	25%	24%
Special Events & Development	\$1.4	\$1.1	\$0.9
% to Total Expense	12%	11%	8%
Total Expense	\$11.2	\$10.3	\$10.3

SOURCE: SCC audited financial statements, fiscal years 2008/09 through 2010/11.

Efficiency Ratio Analysis

Efficiency ratios help measure the effectiveness of fundraising and program spending. Fundraising efficiency is measured by the amount of contributions received for every \$1 spent on fundraising. Table 4 shows that the SCC's fundraising efficiency ratio has continually improved from \$1.55 in FY 2008/09 to \$2.12 in FY 2010/11. During the same period, the cost per program attendee has increased from \$22.11 to \$26.39. In FY 2010/11 Program costs increased, but attendance has declined. SCC management explained that attendance declines are largely attributed to the overall economic conditions.

Table 4. SCC Efficiency Ratios

	Actual FY 2008/09	Actual FY 2009/10	Actual FY 2010/11
Contributed Revenues (in millions)	\$2.1	\$1.8	\$1.8
Fundraising Expense (in millions)	\$1.4	\$1.1	\$0.9
Revenue Contributed for \$1 Spent	\$1.55	\$1.64	\$2.12
Program Expense (in millions)	\$6.9	\$6.6	\$6.9
Attendance	313,434	262,514	261,744
Cost Per Attendee	\$22.11	\$25.29	\$26.39

SOURCE: SCC audited financial statements, fiscal years 2008/09 through 2010/11, and fiscal year 2010/11 attendance information provided by SCC management.

OBJECTIVES, SCOPE, AND METHODOLOGY

This audit was conducted in accordance with the Council-approved fiscal year 2011/12 audit plan. The objective was to review compliance with contractual requirements of the Management Services and Financial Participation Agreements in effect from fiscal years 2008/09 through 2011/12.

To gain an understanding of the agreements, we reviewed:

- Management Services Agreement (MSA), 2008-048-COS, effective July 1, 2008, and the related Council Report.
- Annual Financial Participation Agreements and the related Council Reports.
- City Code sections applicable to the Scottsdale Center for the Arts and the Scottsdale Mall (§20-71 and §20-106 through 20-120); sections applicable to Public Art (§20-121 through 20-123), and Appendix B–Basic Zoning Ordinance, section 5.3083, *Cultural Improvements Program*.
- Prior City audit reports related to the Scottsdale Cultural Council and earlier agreements: Report 0508, *Compliance with City Code Provisions for Public Art*, January 2006; Report 510A, *Sculpture Pad Program*, June 2006; Report 0510B, *Controls over the Art Collection*, October 2006; Report 510C.1, *Cultural Council Contracts, Compliance with Section 2.10 - Utilities*, October 2007; Report 0510C.2, *Compliance with Section 5.1 - Scottsdale Mall*, April 2008; Report 0510D, *General & Financial Requirements*, June 2008. Some recommendations from these reports were incorporated into the current MSA, designed to further clarify responsibilities and increase City staff oversight.
- City Administrative Regulation (AR) 215 – *Contract Administration*, and AR 121 – *Standards for Public Notices and Agendas, Marked Agendas, Minutes and Legal Publications*.

To gain an understanding of the Scottsdale Cultural Council (SCC), we reviewed:

- SCC bylaws, including those establishing the Board of Trustees, committees of the Trustees, operating divisions, and Advisory Boards.
- SCC Strategic Plan and other publicly available information on the SCC website.
- The SCC update made to the City Council on February 22, 2011.

In addition, we interviewed staff from various City divisions involved in different aspects of the agreements, including Finance & Accounting, Community Services, Community & Economic Development and Public Works. We also interviewed various SCC staff, including the President/Chief Executive Officer, Vice President/Division Directors of the Scottsdale Center for the Performing Arts (SCPA) and Scottsdale Public Art (SPA), and the Director of Operations and the Controller as the Chief Financial Officer position was vacant.

To assess contractual compliance and SCC performance measures, we:

- Analyzed prior years audited financial statements and reported annual accounting of earmarked funds. Additionally, we tested a sample of expenditures to ensure compliance with the contractual purpose.
- Analyzed applicable City and SCC reports for the Arts in Public Places (AIPP), Downtown Cultural Trust, and Community Arts Trust funds' activity and balances.
- Tested a sample of AIPP expenses to determine whether they complied with the purpose of the fund. We also reviewed the process used by SCC and City staff to prepare invoices for payment and exchange accounting information.
- Reviewed SCC reported performance measures in the SCC Annual Reports and, using SCC audited financial statements, developed performance ratios to review revenues, expenditure and efficiency trends.
- Compared the SCC's approved budget with the Financial Participation Agreement to determine whether required MSA budget documentation was included (i.e., estimated funding sources, direct and indirect expenditures, and city allocation plans for earmarked funds). This included matching the Financial Participation Agreement's earmarked funds to the SCC budget and accounting records.
- Reviewed SCC developed policies and procedures for existence and compliance to terms of the Agreement. We also compared the SCC's open meeting policy and practices to those of the City, and tested the SCC's compliance with posting meeting notices, agendas, and minutes.
- Verified the existence of selected items on the FY 2010/11 artwork inventory list. We also confirmed that the required 10-year Conservation and Restoration Plan was provided to the City's Contract Administrator.
- Reviewed the list of free community events and temporary art (i.e. traveling exhibits), and selected a sample to verify whether they were advertised as required by the Agreement. As well, we reviewed grant recipients of the SCC Community Arts Grant Program to determine if they were Scottsdale-based or were organizations whose projects primarily served Scottsdale residents.

Based on these audit procedures, we determined that the SCC generally complies with agreement terms. However, certain contractual requirements could be strengthened, such as earmarking a greater portion of the management service fees and requiring more informative performance measures and refined open meeting policy and practices to better align with the City. Additionally, City staff can improve the exchange of financial information, and consistent Contract Administrator oversight is needed to monitor contractual compliance and identify opportunities for continued improvements.

We conducted this audit in accordance with generally accepted government auditing standards as required by Article III, Scottsdale Revised Code, §2-117 et seq. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Audit work took place from August through November 2011, with Lisa Gurtler and Joanna Munar conducting the work.

FINDINGS AND ANALYSIS

1. Some Management Services and Financial Participation Agreement requirements can be strengthened or further enforced.

The Agreements could be further strengthened by earmarking additional City funds, identifying specific performance measures to be monitored, and requiring the SCC to more closely align its open meeting policy and practices with the City's. Additionally, the City Council may want to establish a policy or guideline addressing restrictions on catering vendors that provide services at City-owned facilities.

- A. A fundamental measure of a non-profit organization's performance is a comparison of program versus administrative and fundraising costs. According to the Better Business Bureau, the suggested minimum that a charitable organization should spend on program activities is 65% of total costs.¹ Similarly, the U.S. Office of Personnel Management suggests that a maximum of 35% of a charitable organization's total costs should be spent on administration and fundraising.² As shown in Table 5, SCC Program costs as a percentage of total expense favorably exceeded 65% in FY 2010/11 for the first time in the last three fiscal years. Correspondingly, Administrative and Fundraising costs also dropped below 35%.

Table 5. Key SCC Expense Ratios

(amounts in millions)

	Actual FY 2008/09	Actual FY 2009/10	Actual FY 2010/11
Total Expenses	\$11.2	\$10.3	\$10.3
Program	\$6.9	\$6.6	\$6.9
Target - 65% or greater	62%	64%	67%
Administrative and Fundraising	\$4.3	\$3.7	\$3.4
Target - 35% or less	38%	36%	33%

SOURCE: Fiscal years 2008/09 through 2010/11 audited financial statements; Program and Administrative & Fundraising targets suggested by the Better Business Bureau (BBB) and U.S. Office of Personnel Management (OPM).

Only about \$1 million, or 25%, of the \$4.2 million the City annually pays to the SCC is earmarked for a specific purpose. The remaining \$3.2 million, or 75%, is for general performance of Management Services Agreement (MSA) obligations. Earmarking a greater portion of the management service fees could ensure City funds are directed toward programs and services and limit the amount used for administration and fundraising to the recommended level of 35% or less.

¹ The Better Business Bureau's *Wise Giving Alliance Standards for Charity Accountability* was developed to assist donors in making sound decisions and to foster public confidence in charitable organizations.

² The U.S. Office of Personnel Management's *Ten Questions from Donors about Combined Federal Campaign Charities* reports the percentage of administration and fundraising expenses for participating charities in the federal employees' charitable campaign.

By requiring this type of performance measure and similar ones, the City's Contract Administrator can improve the availability of meaningful information. Section 5.2 of the MSA requires the SCC's Annual Report to include specific, measurable, attainable, realistic and timely (SMART) performance measures. The SCC chooses to report current year attendance, number of volunteers, and earned and contributed revenue; however, budget amounts and historical trend information is not provided to evaluate the reported data. Additional performance measures, along with stated goals, would serve to better measure accountability. Some commonly used ratios that measure nonprofit or charitable organizations include the following:

Revenue Ratios

- Earned Revenue/Total Revenue
- Contributed Revenue/Total Revenue
- City-Provided Revenue/Total Revenue

Expense Ratios

- Overhead Expense/Total Expense
- Program & Services/Total Expense

Efficiency Ratios

- Fundraising Expense/Contributed Revenue
- Program Expense/Units of Service (i.e., performances, customers, etc.)

B. The SCC's policy and practices do not closely align to the City's open meeting policy and practices. Specifically, section 5.7 of the MSA states SCC open meeting practices will align with the City's policies and procedures, to the greatest extent possible in keeping with the spirit of transparency and public disclosure. However, we noted the following situations in which this did not occur:

- At least one division advisory board meeting was held without the minimum 24 hour advance public notice. Most SCC meetings were posted 24 hours in advance of the meeting, which is the minimum requirement of Arizona Open Meeting Law. However, the City's policy and practice is to post agendas 10 calendar days prior to the meeting.
- The SCC meeting agenda's supporting documents, such as budgets and monthly financial reports, are not linked to the meeting agenda. The City's policy and practice is, with limited exceptions, to post supporting materials with the agenda 10 days prior to the meeting.
- Minutes for a recent Board of Trustees meeting were not posted within 2 business days of being approved.
- Minutes are not prepared for Board executive sessions. Additionally, while SCC's policy states that executive sessions are held to discuss "potential donors" and "programming plans," we found additional types of items such as: Facility Needs Assessment, Facility Feasibility Study, Public Communication Policy, and Audit Management. Because the term "programming plans" is somewhat vague, it is not clear if these topics complied with the SCC policy. However, such items would

not appear to align with the City's policy and practices for executive sessions, which are restricted by the Open Meeting Law.

- The SCC Board of Trustees has established 5 committees that do not post meeting agendas or minutes. Further, at least 2 of the committees do not prepare a record of meeting minutes.
- We reviewed Scottsdale Public Art (SPA) meeting minutes for the period of December 2010 through April 2011, and found some minutes were not clear. For example, minutes related to budget cuts and transfers do not make clear that the changes were occurring during the preliminary stages of budget development when the division was proposing its desired budget. The budgetary adjustments were made before the SCC Board of Trustees finalized and approved the SCC budget, and before the City adopted the annual Financial Participation Agreement establishing the amount of City funds to be provided for public art. As a result of unclear language, there was public concern about City earmarked funds being misdirected.
- All divisions post the most recent advisory board agenda and approved minutes to the SCC website. However, only the SPA additionally provides the meeting agenda and minutes on the division website, including as many as 3 prior months of meeting activity.

As a result, SCC meeting information is not readily available and public participation is limited, which does not align with the intent of the MSA requirement. Additionally, the content of some meeting minutes can be easily misunderstood by the general public.

- C. To become an SCC preferred caterer that can provide services at City owned/SCC-operated facilities, a business is required to pay the SCC an upfront fee and make an in-kind contribution.

When clients rent the City facilities managed by the SCC, such as the SCPA atrium, they are required to use a "Preferred Caterer" if providing food or beverages at the event. For a business to become a preferred caterer, the Preferred Catering Agreement specifies that the business must pay the SCC an annual \$1,250 President's Club Membership fee and provide a \$5,000 in-kind contribution. In addition, the caterer pays 15% of food service gross receipts at the event plus 10% of off-premise services for any clients acquired from its association with the SCC.

In contrast, catering services provided at other City owned facilities are not required to pay the City an upfront fee or provide free services. For example, WestWorld caterers pay 20% of gross receipts to the City, but do not pay additional fees to get listed.

According to SCC management, a Preferred Caterer policy is standard practice in the arts and culture industry to ensure a quality level of product and customer service. Management also explained that becoming a President's Club member entitles the caterer to waived ticket fees, free admissions to SMOCA and the annual Arts Festival, invitations to VIP receptions, and a tax deduction equal to their membership level

less \$102.50. Additionally, the caterer determines the value of the in-kind catering service they provide.

The City Council may want to establish a policy or guideline addressing restrictions on vendors that provide services at City owned facilities. For the SCC-operated/City-owned facilities, this could be done through an amendment to the MSA or through the annual Financial Participation Agreement.

Recommendations:

A. The Contract Administrator should:

- Propose increased earmarking of management service fees in the FY 2012/13 Financial Participation Agreement. The proposed earmarks should be developed in cooperation with SCC management and should emphasize support for the desired City programs and services and limit amounts available for administrative purposes.
- Work with SCC management to enhance existing performance measures by including both historical and projected trend information and to establish additional performance measures for financial results.

B. The Contract Administrator should work with the City Attorney and SCC staff to clarify how the SCC's open meeting policy and practices should more closely align with City policy and practices, which may include:

- A requirement for minutes to be prepared for all SCC meetings, including executive session and committee meetings. Clarification could also address whether minutes, except for those from executive session, are to be posted to the SCC website within 2 business days of being approved.
- A requirement that all meeting minutes be reviewed for completeness and accuracy prior to their approval and public posting. For example, references to budget adjustments should clearly identify whether the discussion relates to the divisions' proposed budgets, the SCC Board's approved budgets, and/or the City's earmarked funds.
- Clarification of the expected timeframe for posting meeting agendas. At a minimum, there should be clarification that posting meeting agendas 24 hours in advance of the meeting is a minimal, rather than expected, level of compliance. Also, clarify whether adopting the City's 10-day requirement is expected.
- Clarification of the subject matter considered appropriate for executive sessions.
- A requirement for a consistent policy on whether meeting information will be posted at the division or SCC website and period of time for which approved meeting minutes will remain available on the website.

C. The Contract Administrator should work with City Attorney and City Manager staff to develop a proposed policy for City Council approval regarding requirements for caterers that provide service at City-owned facilities.

2. Reporting and processing of the City's art-related funds can be improved.

The balances of some art-related funds were reported inaccurately and an art trust fund was used to pay \$300,000 of the annual Financial Participation Agreement without specific Council approval. Additionally, the process for minor AIPP expenditures is inefficient, and City invoices to the SCC do not recover indirect costs.

A. Some City-provided accounting information for arts funds is erroneous or lacking.

In addition to funds provided through the annual Financial Participation Agreement (FPA), the City maintains three Council-established funds that pay art-related costs on behalf of or in conjunction with the SCC: the Art in Public Places (AIPP), the Downtown Cultural Trust and the Community Arts Trust funds.

Arts in Public Places (AIPP) Fund – According to City Code section §20-123 (a) and (e), 1% of designated capital improvement projects' budgets will be used for the commission and acquisition of public art. Furthermore, the funds are to be deposited into the designated capital account, Art in Public Places. Review of the fund transactions found:

- Even though Finance & Accounting reported a fund balance \$1.6 million as of June 30, 2011, this balance is overstated. In fiscal years 2009/10 and 2010/11, there was not an accounting method in place to specifically identify the art-related costs. As a result, some expenses charged to capital projects during that time period have not been identified as AIPP expenses and are, therefore, not included in the report.
- In FY 2009/10, Accounting staff discontinued use of the designated capital fund when they determined that public art expenditures no longer met the definition of capital acquisition or construction.³ At that time, the remaining AIPP balance was transferred to a new account within the General Fund and all subsequent art-related activity is now charged within designated capital improvement projects. Accounting and Public Works staff is in the process of developing what the final method will be to consolidate and report AIPP activity. At that time, the applicable City Code will need to be aligned with this accounting-based change.
- The AIPP Fund rather than the General Fund was erroneously used to pay management and administration costs of the AIPP and AIPD programs numerous times throughout FY 2010/11. These errors totaling more than \$280,000 have since been corrected by Accounting staff.

Downtown Cultural Trust – This fund accounts for the AIPD program monies received when a developer pays the 1% rather than installing an equivalent artwork. The City holds the monies, but the SCC's SPA division directs their use. City staff provided SCC management with an erroneous balance of \$37,225 when the fund's actual balance was only \$12,225 as of June 30, 2011.

Community Arts Trust – Lease revenues from City-owned property known as the

³ Effective June 30, 2010, Governmental Accounting Standards Board (GASB) 54 clarified the definition of a capital project fund.

Loloma School are deposited to the Community Arts Trust Fund to be “dedicated to the Arts within the community”.⁴

In FY 2009/10, previous City management decided to use \$300,000 from this fund to pay part of the annual FPA. Although this was described as having been approved as part of the City’s FY 2009/10 budget, the accompanying Council Report does not mention this use of the Community Arts Trust Fund.

Additionally, Economic Vitality department policy and procedures require City staff to meet with SCC management annually to discuss possible uses of this fund to supplement the Community Arts Grant program. However, accounting reports have not been provided to the SCC and meetings have not been held to discuss potential uses of the fund. As of June 30, 2011, City accounting records showed that the Community Arts Trust Fund had a balance of \$281,000 and the Loloma School tenant owed an additional \$137,000 in past due rent.

Finance & Accounting staff noted several contributing factors, including the Economic Vitality department’s restructuring and related accounting changes and the new method of recording AIPP expenditures, have made it difficult to properly account for these art-related costs. In addition, the Contract Administrator stated that conflicting priorities have resulted in limited time available to devote to the contract. As a result, financial information used by City and SCC management for reporting and strategic planning purposes has been lacking or inaccurate.

B. The City and SCC processes used to approve AIPP expenditures are inefficient.

During fiscal years 2009/10 and 2010/11, the City processed more than 307 invoices totaling \$2.2 million for the AIPP fund. Of these invoices, 127, or 41% were incidental art-related costs for less than \$500 each. Economic Vitality staff estimated it takes about 30 minutes to process each invoice, which includes creating a check requisition, obtaining proper approval, making copies, sending approved copies to the SCC, and reconciling payments to month-end accounting reports. Similarly, SCC management stated this process has resulted in the need to hire a part-time employee to process and coordinate invoices with the City, and it has occasionally delayed payments by as much as 45 days. In lieu of the current process, SCC management has agreed with the concept of paying the low dollar art-related invoices and submitting a single monthly invoice for reimbursement from the City.

Additionally, testing determined that some expenditures paid by the SCC from FPA funds were erroneously submitted to the Contract Administrator for review and approval. At least one invoice for the purchase of alcohol totaling \$73.24 was paid with funds earmarked for Public Art. According to SCC management, this particular invoice was an oversight as their stated practice is to not use City-provided funds for alcohol purchases.

C. City invoices to SCC for Mall repairs do not include indirect costs. The City’s Community Services Division invoices the SCC for Mall repairs after SCC events.

⁴ Lease agreement #930027 and the accompanying Council Report dated March 15, 1993 state the Loloma property was leased for 10 years and can be extended for up to 30 years.

However, the invoices do not include recovery of the City's indirect costs. Council-adopted financial policies for non-enterprise rates and fees state that charges and fees will be examined annually to determine the direct and indirect cost of service recovery rate, and the City Council will approve the acceptable recovery rate. The Finance & Accounting Division staff develops the indirect cost rate, and the City Treasurer provides advice and guidance on its application.

Recommendations:

A. The City Treasurer should:

- Establish the current balance of available AIPP funds and propose an update to City Code §20-123 (e) – *Arts in Public Places Capital Account*, to align with GASB 54 and the current accounting practice.
- Ensure that appropriate procedures for recording AIPP expenditures are developed and communicated to applicable City staff.

The Contract Administrator, in conjunction with Finance & Accounting staff, should:

- Ensure that the balances and activity of designated art-related funds are communicated to SCC management. Also, the City's record of activity and fund balances should be regularly reconciled with the SCC's.
- Determine if the General Fund should reimburse \$300,000 to the Community Arts Trust Fund for its FY 2009/10 funding of the annual Financial Participation Agreement. If the monies are not to be reimbursed, specific City Council authorization should be sought for this use of the fund.
- Comply with or revise the existing Economic Vitality policy requiring annual meetings with the SCC to discuss use of the City's Community Arts Trust Fund.

B. The Contract Administrator should:

- Work with SCC management to develop an efficient method to process, review and approve expenditures from the AIPP fund.
- Request training from Finance & Accounting to ensure appropriate processing of transactions, including clarification of the applicable account numbers and titles and the various earmarked funds and City-held designated funds.

C. Community Services management should work with the City Treasurer to evaluate the related indirect overhead costs associated with the services in accordance with Council-adopted financial policies.

3. Consistent contract oversight is needed.

As previously noted, certain terms of the MSA appear to have not been fully enforced, such as the requirement for SCC's open meeting practices to align with City's as much as possible and the development of meaningful performance measures. Also, the Contract Administrator appears to have had minimal involvement with some contract-related functions, such as invoice processing and communicating art-related fund balances and activity.

While the Contract Administrator has an internally developed *Master Agreement Matrix* that includes major SCC requirements and applicable dues dates, it does not appear that the document was used to monitor compliance. For example, while the SCC developed several policies and procedures for Contract Administrator review, we were unable to determine when they were delivered or whether the Contract Administrator had reviewed them timely.

Finally, some internally written policies and procedures are incomplete or lacking. Specifically, the *CIP Payment Procedure for the 1% AIPP funds* was developed to assist staff's understanding, but it does not include the basis for calculating the 1% nor how it is monitored or reported. Also a procedure has not been developed for the related AIPD payment process.

Since July 2008, four Contract Administrators have been assigned to the SCC Agreements. According to the current Contract Administrator, lack of continuity, staff reductions and conflicting priorities has resulted in diminished oversight. Appropriate resources should be directed to contract administrative duties to ensure the agreement is properly monitored as required by Administrative Regulation 215 - *Contract Administration*.

Recommendations:

The Economic Vitality Director should:

- Review the scope of the Contract Administrator's oversight and administrative duties and assign sufficient resources to ensure key elements of the Agreement are met. Specifically, the Contract Administrator should be required to maintain a file of contract-related procedures, update the *CIP Payment Procedures* to include calculation, processing and reporting of the 1% for the Art in Public Places and Art in Private Development programs.
- Ensure the Contract Administrator is monitoring the status of key contract requirements, such as with the existing *Master Agreement Matrix*. The Contract Administrator should record dates when information was requested and received along with any related SCC communications.

MANAGEMENT RESPONSE

Date: November 30, 2011

TO: Sharron E. Walker, City Auditor

From: Rob A. Millar, Strategic Programs Manager

Subject: Scottsdale Cultural Council Contract Compliance Audit No. 1204

Thank you for the opportunity to respond to Scottsdale Cultural Council Contract Compliance Audit No. 1204.

As stated in the City Auditor's audit report, page 9 "Objectives, Scope, and Methodology", the objective of the audit was "to review compliance with contractual requirements of the Management Services and Financial Participation Agreements in effect from fiscal years 2008/09 through 2011/12."

Audit No. 1204 has found the Scottsdale Cultural Council to be in compliance with Management Services Agreement 2008-048-COS and corresponding annual Financial Participation Agreements enacted during the contract period.

Staff is pleased to provide the following Management Action Plan designed to:

1. Increase communication of account and fund balances.
2. Streamline accounting and invoicing processes.
3. Clarify SCC guidelines and procedures.
4. Enhance existing contract oversight.

While the audit report cites opportunities for increased performance measures, accountability, and efficiencies, the report does not indicate contract compliance deficiencies as stated in the audit objectives and scope.

Respectfully,

Rob Millar

Cc: David Richert, City Manager
David Smith, City Treasurer
Paul T. Katsenes, Executive Director, Community and Economic Development
Jim Mullins, Director Economic Vitality
Bill Murphy, Executive Director Community Services
Dan Worth, Executive Director Public Works
William Banchs, President & CEO, Scottsdale Cultural Council

MANAGEMENT ACTION PLAN

- 1. Some Management Services and Financial Participation Agreement requirements can be strengthened or further reinforced.**

Recommendation:

A. The Contract Administrator should:

- Propose increased earmarking of management service fees in the FY 2012/13 Financial Participation Agreement. The proposed earmarks should be developed in cooperation with SCC management and should emphasize support for the desired City programs and services and limit amounts available for administrative purposes.**

MANAGEMENT RESPONSE: To be determined (TBD)

PROPOSED RESOLUTION: The SCC is in compliance with existing contract earmark requirements. Earmarking funds for Public Art is done to insure a minimum level of support for a program that receives no other financial support (from ticket sales and/or private contributions). It is unclear how further earmarks to City funding will insure a level of support for other programs any greater than current experience. A requirement that 100% of City funding be applied to programs cannot insure overall administrative costs will be less than 35% considering 60% of SCC funds come from non-City sources. Further guidance from Council and analysis between the Contract Administrator and SCC Board of Trustees and management is needed before a determination of agreement or disagreement can be stated.

RESPONSIBLE PARTY: Contract Administration and SCC Board of Trustees and Management.

COMPLETED BY: APRIL 1, 2012

- Work with SCC management to enhance existing performance measures by including both historical and projected trend information and to establish additional performance measures for financial results.**

MANAGEMENT RESPONSE: Agree

PROPOSED RESOLUTION: The SCC is in compliance with existing contract performance reporting requirements. Contract Administrator will work with SCC Management in developing enhanced performance measures to be implemented with the 2012/13 Financial Participation Agreement.

RESPONSIBLE PARTY: Contract Administrator and SCC Management

COMPLETED BY: APRIL 1, 2012

B. The Contract Administrator should work with the City Attorney and SCC staff to clarify how the SCC's open meeting policy and practices should more closely align with City policy and practices, which may include:

- **A requirement for minutes to be prepared for all SCC meetings, including executive session and committee meetings. Clarification could also address whether minutes, except for those from executive session, are to be posted to the SCC website within 2 business days of being approved.**
- **A requirement that all meeting minutes be reviewed for completeness and accuracy prior to their approval and public posting. For example, references to budget adjustments should clearly identify whether the discussion relates to the divisions' proposed budgets, the SCC Board's approved budgets, and/or the City's earmarked funds.**
- **Clarification of the expected timeframe for posting meeting agendas. At a minimum, there should be clarification that posting meeting agendas 24 hours in advance of the meeting is a minimal, rather than expected, level of compliance. Also, clarify whether adopting the City's 10-day requirement is expected.**
- **Clarification of the subject matter considered appropriate for executive sessions.**
- **A requirement for a consistent policy on whether meeting information will be posted at the division or SCC website and period of time for which approved meeting minutes will remain available on the website.**

MANAGEMENT RESPONSE: TBD

PROPOSED RESOLUTION: The SCC may be aligned with the City's open meeting policies and procedures, to the greatest extent possible (as contractually required in section 5.7 of the MSA). Contract Administrator will work with SCC Board of Trustees and Management and the City Attorney's Office in reviewing the existing SCC Open Meeting Policy in conjunction with City practices to determine if further alignment may be reasonably made.

RESPONSIBLE PARTY: Contract Administrator, City Attorney's Office, SCC Board of Trustees and Management

COMPLETED BY: APRIL 1, 2012

C. The Contract Administrator should work with City Attorney and City Manager staff to develop a proposed policy for City Council approval regarding requirements for caterers to provide service at City-owned facilities.

MANAGEMENT RESPONSE: Disagree

PROPOSED RESOLUTION: The existing MSA does not address SCC catering policies. The Contract Administrator will work with SCC management in evaluating the existing SCC Preferred Caterer Request for Proposal process to ensure it is competitively aligned with similar cultural facilities managed by non-profit organizations. The contract administrator does not, however, agree with the recommendation that the development of a comprehensive citywide catering policy falls within the realm of SCC contract administration.

RESPONSIBLE PARTY: Contract Administration and SCC Management

COMPLETED BY: N/A

2. Reporting and processing of City financial information can be improved.

Recommendations:

A. The City Treasurer should:

- **Establish the current balance of available AIPP funds and propose an update to City Code §20-123 (e) – *Arts in Public Places Capital Account*, to align with GASB 54 and the current accounting practice.**
- **Ensure that appropriate procedures for recording AIPP expenditures are developed and communicated to applicable City staff.**

MANAGEMENT RESPONSE: Agree

PROPOSED RESOLUTION: The balance will be updated by Accounting, taking into consideration past CIP expenditures, and will provide an updated balance to the Contract Administrator by May 1, 2012. Balance updates will be provided to the Contract Administrator on a monthly basis thereafter. Accounting will work with the Contract Administrator and the City Attorney's Office to update City Code 20-123 (e) to align with GASB 54.

RESPONSIBLE PARTY: City Treasurer, City Attorney's Office and Contract Administrator

COMPLETED BY: MAY 1, 2012

The Contract Administrator, in conjunction with Finance & Accounting staff, should:

- **Ensure that the balances and activity of designated art-related funds are communicated to SCC management. Also, the City's record of activity and fund balances should be regularly reconciled with the SCC's.**

MANAGEMENT RESPONSE Agree

PROPOSED RESOLUTION: Accounting has initiated discussions with Capital Project Management and the Contract Administrator to communicate the appropriate accounting procedures for AIPP expenditures. In addition, Accounting and Budget have initiated changes in the budget development process and accounting structure to properly identify, isolate, and report AIPP expenditures within capital projects. The Contract Administrator will communicate the AIPP, Community Arts and Downtown Cultural Arts Trust balances with the SCC at each month's regularly scheduled meeting.

RESPONSIBLE PARTY: City Treasurer and Contract Administrator

COMPLETED BY: Complete

- **Determine if the General Fund should reimburse \$300,000 to the Community Arts Trust Fund for its FY 2009/10 funding of the annual Financial Participation Agreement. If the monies are not to be reimbursed, specific City Council authorization should be sought for this use of the fund.**

MANAGEMENT RESPONSE: Disagree

PROPOSED RESOLUTION: The use of the Community Arts Trust to fund a portion of the 2009/10 SCC annual Financial Participation Agreement was a strategic management decision during a period of significant economic downturn resulting in severe impacts to the general fund. The Downtown Group Community Arts Trust Policy and Procedures state:

Procedures #3: In addition, Downtown Group staff may, in their judgment, decide to fund projects or programs of which they become aware throughout the fiscal year to enhance the arts and culture of Scottsdale. Such funding decisions shall be adequately documented as to how the project or program meets this policy criteria.

The use of the Community Arts Trust fund was in alignment with these procedures and alleviated the need for additional cuts to the general fund.

RESPONSIBLE PARTY: Contract Administrator and City Treasurer

COMPLETED BY: N/A

City Auditor's Comment:

Annual funding of the SCC Financial Participation Agreement is a general obligation of the City, historically paid with General Fund monies. Use of this special revenue Trust fund was not disclosed to the City Council in the FY 2009/10 budget Council Report nor in the FY 2009/10 FPA Council Report. Further, the staff-developed procedures referenced above also require other steps that were not followed, including meeting annually with the Cultural Council to discuss the possible use of these monies for the Community Art Grants program.

- **Comply with or revise the existing Economic Vitality policy requiring annual meetings with the SCC to discuss use of the City's Community Arts Trust Fund.**

MANAGEMENT RESPONSE: Agree

PROPOSED RESOLUTION: The Contract Administrator will ensure annual communication with the SCC management on the use of the City's Community Arts Trust Fund.

RESPONSIBLE PARTY: Contract Administrator

COMPLETED BY: Complete

B. The Contract Administrator should:

- **Work with SCC management to develop an efficient method to process, review and approve expenditures from the AIPP fund.**
- **Request training from Finance & Accounting to ensure appropriate processing of transactions, including clarification of the applicable account numbers and titles and the various earmarked funds and City-held designated funds.**

MANAGEMENT RESPONSE: Agree

PROPOSED RESOLUTION: The Contract Administrator will work with SCC management to develop new procedures for processing, reviewing and approving AIPP expenditures. Accounting is committed to training and assistance in appropriate processing of transactions. In addition, Accounting has participated in support efforts to revise the accounting structure for Economic Vitality (cost centers and accounts) to isolate and report contractual expenditures in an accurate and timely manner.

RESPONSIBLE PARTY: Contract Administrator, Accounting and SCC Management

COMPLETED BY: MAY 1, 2012

C. Community Services management should work with the City Treasurer to evaluate the related indirect overhead costs associated with the services in accordance with Council-adopted financial policies.

MANAGEMENT RESPONSE: Agree

PROPOSED RESOLUTION: Community Services staff will identify all related indirect overhead expenses associated with the direct costs of special event repair or required replacement resulting from third party events managed and scheduled by the Scottsdale Cultural Council held on the Scottsdale Mall and these total expenses will be invoiced to that event promoter for reimbursement.

RESPONSIBLE PARTY: City Treasurer and Community Services Executive Director

COMPLETED BY: To be implemented by JULY 1, 2012

3. Consistent contract oversight is needed.

Recommendations:

The Economic Vitality Director should:

- **Review the scope of the Contract Administrator's oversight and administrative duties and assign sufficient resources to ensure key elements of the Agreement are met. Specifically, the Contract Administrator should be required to maintain a file of contract-related procedures, update the *CIP Payment Procedures* to include calculation, processing and reporting of the 1% for the Art in Public Places and Art in Private Development programs.**
- **Ensure the Contract Administrator is monitoring the status of key contract requirements, such as with the existing *Master Agreement Matrix*. The Contract Administrator should record dates when information was requested and received along with any related SCC communications.**

MANAGEMENT RESPONSE: Agree

PROPOSED RESOLUTION: The Scottsdale Cultural Council contract is in compliance and will continue to be well monitored through efficiencies and process improvements identified in the Management Action Plan. The Economic Vitality Director and Contract Administrator will continue to evaluate the scope of the oversight and administrative duties and make resource allocation adjustments where and when necessary. The Contract Administrator maintains electronic files of contract related procedures, as well as a Master Agreement Matrix that was not consistently updated prior to April 2011 when the existing contract administrator was designated. The Contract Administrator has consistent meetings and

communication with SCC Management where contract issues are discussed and monitored.

RESPONSIBLE PARTY: Economic Vitality Director and Contract Administrator

COMPLETED BY: Complete

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Councilman Robert Littlefield
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