

**APPROVED MINUTES
APPROVED 1/23/2017**



**CITY OF SCOTTSDALE
AUDIT COMMITTEE**

Monday, November 14, 2016

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

REGULAR MEETING

PRESENT: Suzanne Klapp, Chair
Virginia Korte, Councilmember
Kathy Littlefield, Vice Mayor (arrived at 3:34 p.m.)

STAFF: Sharron Walker, City Auditor
Kyla Anderson, City Auditor's Office
Cathleen Davis, City Auditor's Office
Brian Biesemeyer, Acting City Manager
Karen Churchard, Tourism & Events Director
Joyce Gilbride, City Treasurer's Office
Anna Henthorn, City Treasurer's Office
Jeff Nichols, City Treasurer
Brent Stockwell, Assistant City Manager

GUESTS: Jill Shaw, Heinfeld, Meech & Co.
Genia Kehayes, Experience Scottsdale
Rachel Pearson, Experience Scottsdale
Brittney Williams, Heinfeld, Meech & Co.

CALL TO ORDER

Chair Klapp called the meeting to order at 3:30 p.m. A formal roll call confirmed the presence of Chair Klapp and Councilmember Korte. Councilwoman Littlefield arrived at 3:34 p.m.

1. Approval of Minutes, Regular Meeting, October 24, 2016

COUNCIL MEMBER KORTE MOVED TO APPROVE THE MINUTES OF THE OCTOBER 24, 2016 REGULAR MEETING. CHAIR KLAPP SECONDED THE MOTION, WHICH CARRIED BY A VOTE OF TWO (2) TO ZERO (0). VICE MAYOR LITTLEFIELD WAS NOT YET PRESENT.

2. Discussion and Possible Direction to Staff Regarding Audit No. 1701, FY 2015/16 Financial and Compliance Audit

Jill Shaw, Heinfeld, Meech & Co. stated that opinions were issued on the Comprehensive Annual Financial Report (CAFR) and the financial reports for the component units – the MPC, SPA and five separate CFDs. Along with the reports is a letter called Communication to Governance. The audit standards govern specific items required to be addressed with audit committees and bodies of governance. Highlights of the letter include:

- The audit was performed in accordance with generally accepted auditing standards as well as government auditing standards.
- There were no new significant accounting policies.
- There was one new Governmental Accounting Standards Board (GASB) Standard that was reported on in regards to fair value measurements. This was like the for-profit sector, valuing investments in accordance with certain levels.
- A change from the prior year was a restatement to net position balances. It was in reference to land and streets donated to the City between 1985 and 2005. During this time, these assets were brought onto the City's books, but were reported as infrastructure. and therefore depreciated. Through research by the Treasurer's Office, it was determined that a large portion of this value was for the land beneath the streets and should be moved to a non-depreciable category. This was being done correctly for the last ten years though so it was not noted as a weakness in internal controls.

Chair Klapp asked whether there was a requirement to go back and recapture that depreciation. Ms. Shaw stated it was actually the opposite, removing the depreciation, which resulted in a large increase to the net position. As part of the process dedicated to whether depreciation of streets was accurate the historical calculations were reviewed, with a senior accounting staff member visiting the street department to obtain information regarding addition of street overlays and other relevant records from 2005 and earlier. From 1985 to the early 2000's, the City was not required to depreciate most assets according to governmental accounting standards.

Ms. Shaw explained there are some estimates in the financial statements, which is typical. A partial list includes: depreciable assets, allowance for uncollectable accounts, pension liability, pollution remediation liability. The assumptions and methods in developing estimates have not changed from previous years.

No difficulties were encountered in performing the audit. No audit adjustments had to be made to the audit records. One past adjustment in the City's records related to retainage that was below materiality thresholds and was not recorded. There were no disagreements with management. Management provided a representation letter at the end of the audit, as per standard procedures.

As part of the audit process, there is requirement to review the expenditures of the Highway User Revenue Fund (HURF) and monies dedicated for transportation purposes. The audit revealed that these expenditures are in accordance with statutes governing purchases related to streets.

A single audit was required, as the City spends more than \$750,000 in federal funds. This year, they specifically looked at the Community Development Block Grant Program (CDBG) and Section 8 Federal Programs. There were no reportable findings.

As a result of audit procedures, a few minor items in internal control were noted in the Management Letter. Auditors specifically looked at voided transactions as it relates to cash revenues. A void would be a method with which someone could potentially skim cash by voiding a transaction and having it not appear in the financial records. There were noted instances where there was no supervisor approval documented on the void or the supervisor approval was not in a timely manner.

A retainage payable adjustment finding was specific to the Airport fund. The accounting staff will check specifically with the Airport that retainage is recorded going forward.

The footnote disclosure for operating lease payments coming to the City related to SkySong reflected an understatement of approximately \$1.7 million in future payments for the life of the agreement.

COUNCILMEMBER KORTE MOVED TO ACCEPT AUDIT NO. 1701 FY 2015/16 FINANCIAL AND COMPLIANCE AUDIT REPORT AND SUBMIT THE REPORT TO THE COUNCIL WITH A RECOMMENDATION FOR APPROVAL. VICE MAYOR 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. 1705, Destination Marketing Contract

Kyla Anderson, Senior Auditor, stated that the audit was performed to evaluate compliance with terms and effectiveness of controls established in the City's Destination Marketing Contract. The City has contracted with Experience Scottsdale since 2001 and the current five-year contract is set to expire in June, 2017. In FY 15/16, the contract cost approximately \$9.4 million and was funded with 50 percent of the City's bed tax revenues.

Performance measurables and results could be more relevant. Experience Scottsdale is required to annually prepare performance criteria. Review of the performance measures found that:

- Performance goals are set as guaranteed minimums, rather than establishing performance expectations. Some measures are not reporting on Scottsdale benefit and a few data errors were made.
- Scottsdale hotels and other tourism related businesses are not prioritized.

Financial oversight of the Destination Marketing contract can be improved. Specific findings included:

- The reported private reserves are likely partially funded with City revenue and some reported marketing is funded with State tax dollars.
- The City pays the full cost of Experience Scottsdale's Fiesta Bowl contract.
- The contract does not specify allowable uses of bed tax funds.
- The City's McCormick-Stillman Railroad Park was charged for advertising.

Contract administration can be improved. The contract administrator is responsible for monitoring contract compliance. The following findings were made:

- Performance measure documentation has not been required.
- Experience Scottsdale's purchasing process was not reviewed and approved.

The Tourism and Events Department agreed with the findings and responded that they will consider the recommendations for the next Destination Marketing contract for FY 17/18.

Councilmember Korte stated that she would like to hear from Karen Churchard and from the Convention and Visitors Bureau on this audit. Councilmember Korte stated that the purpose of the audit was to look into compliance in terms of effectiveness and control of the Tourism Department and the contract. The audit went beyond this, into the operations of the Convention and Visitors Bureau. She asked about conversation between Experience Scottsdale and the auditors and whether there was an opportunity to discuss the operational points that were made.

Sharron Walker, City Auditor, stated that the auditors looked at the compliance and the terms of the contract. The contract establishes the requirement for the performance measures to be agreed to, for the Destination Marketing Guide, and for the budget reports of the revenues and expenses. In looking at performance benchmarks which said Scottsdale properties, the data included all the members, of which 180 properties were outside the City of Scottsdale. In other words, they were not distinguishing the Scottsdale activities from total activities. The auditors were looking at what the contract states and what the performance measures are reported to be, in comparison to what was found in the records. The recommendations are directed at whether there should be controls in the contract that define more specifically what is an allowable use of the monies.

Councilmember Korte questioned the practicality of this within the SCVB (Experience Scottsdale) in terms of their ability to track. She asked whether there was discussion

with SCVB before this became a public document, specifically in regards to feasibility with their operations and potential increase in administrative costs. Ms. Churchard stated that a few of the findings are feasible, including overall performance measures. There were some good points made on making sure we are measuring what we want to be measured. The finding about not reviewing their procurement process was our error in not doing that. In terms of accounting for how dollars are managed between what was Scottsdale versus the Office of Tourism, this would be a very cumbersome endeavor. The Office of Tourism can be easily addressed with a notation. It is a good thing that the Office of Tourism provides more money to promote Scottsdale destinations. The Office of Tourism pays for a specific project, with the exception of general and administrative costs. Overall, some of the things we agree with but we don't want them to become too cumbersome.

Ms. Walker stated that the intent is not to add significant administrative effort. For example, while doing the audit, we noted there are three or four different ways that administrative expenses are reported. The audited financial statements have a category called support services which includes salaries and wages. The budget that is presented to the City has all personnel costs in one line item and the other functions are reported separately. In the fourth quarter report that was given to the City, the amounts and percentages are slightly different. So the audit is not saying add more. The simplest approach would be to go with the audited financial statements. Having personnel as a separate line item in the budget document does not provide an accurate reflection of administration and general expenses.

Genia Kehayes, Experience Scottsdale, commented that this is not done on a monthly basis. The only accounting staff consists of herself and a part-time accountant; they do not have the capacity to do this work on a regular basis. Ms. Walker stated that having this part of the annual reporting would be one way to go. They are not looking to add a layer of extra work. It is a matter of reaching an understanding on how information that is reported should be classified. Ms. Kehayes added that the City receives a copy of the audit by September 30th of every year. Vice Mayor Littlefield urged consistency in the measurement standards used.

Chair Klapp commented that the way she read the audit, certain recommendations were made and management agreed to adopt those recommendations. The only issue seemed to be that there might be changes discussed the next time the contract is up for renewal. Rachel Pearson, Experience Scottsdale, stated that they are open to discussions with the City regarding needed changes. Some of the concern is that the recommendations seemed to be asking for a change in the business model and the way internal accounting is performed. These potentially go beyond measures that would be included in the contract. Ms. Walker commented that the recommendations are for the contract administrator to consider making changes to clarify the contract. They were recommendations, not directives. The audit recommends that the contract specify what is allowable and includes specific requests as to reporting.

Councilmember Korte stated that while the audit's purpose was to analyze how the contract administrator works, it is not clear that the audit report is directed to the contract administrator. The audit seems to address Experience Scottsdale. An example includes, "Requiring the organization to prioritize Scottsdale businesses in its promotions and responses to inquiries." This raises the question of whether an entire change in business model is required. Ms. Walker stated that all of these

recommendations start out with language similar to, "The contractor administrator should consider," et cetera. Councilmember Korte commented that if robust conversations had taken place with Experience Scottsdale regarding these operational points, they might not even be included in the audit, as there would be a greater understanding of the overall model.

Councilmember Korte directed a question to Experience Scottsdale as to whether they were given the opportunity to discuss the findings and be included in the process. Ms. Pearson stated that Experience Scottsdale was not aware that these were the kinds of recommendations that were going to come out as a result of the audit and they were not given notice until it became a public document. The tone of the document feels accusatory in certain places, seeming to indicate that Experience Scottsdale has falsely provided information to the City, as opposed to a recommendation that they change the way they report. For example, they are accused of not properly accounting for private sector funds in the private sector reserve, as opposed to a recommendation that they consider not only a private sector reserve but also a City reserve.

Councilmember Korte referred to performance measure results and asked why they are so different from audit numbers versus reported. Ms. Pearson stated that the City has not requested a report based on only what is being done for the City of Scottsdale proper. Historically, they have provided performance measures that are based upon the organization's overall performance on behalf of the destination, regardless of funding source and the member who is receiving the benefit.

Vice Mayor Littlefield stated that there needs to be consistency between the report and the contract.

Chair Klapp stated that she read the management action plan as being typical of the way contracts are audited. They were not directed specifically to Experience Scottsdale. It was directed to the contract administrator. There might be terms that could be added to the contract that provide better understanding of the audit results.

Ms. Churchard stated her concern with the recommendation to prioritize Scottsdale businesses in light of the gift clause.

Brent Stockwell, Assistant City Manager, stated what is meant in the form (Management Action Plan) is they agreed that these are areas that the contract administrator should look at and present to City Council. They accepted what was provided and now have the opportunity to work closely with Experience Scottsdale and to present that to City Council with the new agreement.

Councilmember Korte commented that she still believes this is a reflection more on Experience Scottsdale than the contract administrator. If there had been more conversation with Experience Scottsdale regarding some of the recommendations, some of the findings would be reflected differently.

COUNCILMEMBER KORTE MOVED TO TABLE APPROVAL OF AUDIT NO. 1705 UNTIL AFTER THERE IS FURTHER DISCUSSION BETWEEN THE AUDITORS, THE CONTRACT ADMINISTRATOR AND EXPERIENCE SCOTTSDALE.

Vice Mayor Littlefield stated that the audit needs to be readdressed in terms of what is actually wanted from the audit. She has highlighted that the destination marketing contract can be improved in areas such as performance measures. She is looking for what are we measuring and how are we making any kind of determination, not a specific activity within Experience Scottsdale.

VICE MAYOR LITTLEFIELD SECONDED THE MOTION, WHICH CARRIED BY A VOTE OF TWO (2) TO ONE (1). CHAIR KLAPP DISSENTED.

Vice Mayor Littlefield noted that it may come back the same, but at least it will have been reviewed.

Chair Klapp asked if this will come back in December. Ms. Walker explained she is not planning a December meeting, so it will likely be on the Committee's January meeting agenda.

Brian Biesemeyer, Acting City Manager, commented that the intent of this is to assist in negotiations with Experience Scottsdale and to facilitate an open discussion on areas of potential contract improvement.

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

Ms. Walker stated that the upcoming schedule is on track and there are no particular comments at this time.

5. Presentation and Possible Direction to Staff Regarding Agenda Items for Next Audit Committee Meeting

There is no plan for a December meeting. The January meeting will take place on January 23, 2017. Upcoming items include E-Verify, Airport Advisory Commission Sunset Review and quarterly updates.

Public Comment

No members of the public wished to address the Committee.

Adjournment

The meeting adjourned at approximately 4:17 p.m.

SUBMITTED BY:

eScribers, LLC