



CITY AUDITOR'S OFFICE

# Scottsdale Arts Contract

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January 11, 2018

AUDIT REPORT NO. 1807

**CITY COUNCIL**

Mayor W.J. "Jim" Lane  
Suzanne Klapp  
Vice Mayor Virginia Korte  
Kathy Littlefield  
Linda Milhaven  
Guy Phillips  
David N. Smith





January 11, 2018

Honorable Mayor and Members of the City Council:

Enclosed is the audit report for the *Scottsdale Arts Contract*, which was included on the Council-approved FY 2017/18 Audit Plan to evaluate contract compliance, effectiveness and administration.

Scottsdale Arts underspent approximately \$202,000 of purpose-restricted City funding, and art maintenance funds have not increased in proportion to new art acquired. Additionally, Scottsdale Arts is not progressing in its efforts to become more independent of City funding. Finally, Contract Administrator oversight of program management and public transparency can be improved.

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

Sincerely,

A handwritten signature in blue ink that reads "Sharron Walker".

Sharron E. Walker, CPA, CFE, CLEA  
City Auditor

Audit Team:

Cathleen Davis, CFE, CIA - Senior Auditor  
Brad Hubert, CIA - Senior Auditor



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# AUDIT HIGHLIGHTS

## Scottsdale Arts Contract

January 11, 2018

Audit Report No. 1807

### WHY WE DID THIS AUDIT

An audit of the *Scottsdale Arts Contract* was included on the City Council-approved fiscal year (FY) 2017/18 Audit Plan. The audit objective was to evaluate contract compliance, effectiveness and administration.

### BACKGROUND

In 1988, the City entered into a Management Services Agreement (MSA) designating Scottsdale Arts (legally titled the Scottsdale Cultural Council) as the principal organization managing arts and cultural activities for the City.

Under the MSA, Scottsdale Arts manages, programs and operates certain City-owned facilities and art programs including:

- Scottsdale Center for the Performing Arts
- Scottsdale Museum of Contemporary Art
- Scottsdale Public Art
  - Art in Public Places Program
  - Cultural Improvements Program
  - Community Arts Grant Program

Each year, an annual Financial Participation Agreement (FPA) establishes the financial terms to pay for the MSA. City funding for Scottsdale Arts through the FPA has ranged from \$4.1 million in FY 2012/13 to \$4.5 million in FY 2016/17.

The Tourism & Events Director serves as the City's Contract Administrator.

### City Auditor's Office

City Auditor 480 312-7867  
Integrity Line 480 312-8348  
[www.ScottsdaleAZ.gov](http://www.ScottsdaleAZ.gov)

### WHAT WE FOUND

Scottsdale Arts underspent approximately \$202,000 of purpose-restricted City funding, and art maintenance funds have not increased in proportion to new art.

- The Contract Administrator has not ensured Scottsdale Arts appropriately spent the purpose-restricted funds, and some amounts were underspent.
- City funding to Scottsdale Arts has increased by almost 10% over the past ten years, but purpose-restricted funds decreased by 7.4%. In particular, art conservation and restoration funds decreased by 7%.

**Scottsdale Arts is not progressing in its efforts to become more independent of City funding.**

- While the MSA encourages Scottsdale Arts to maximize non-City revenues, its ratio of City funds to non-City funds has ranged as high as 47% during the past five years.
- Scottsdale Arts does not raise funds as efficiently and its administrative costs were about 3 percentage points higher than similar organizations.
- The Contract Administrator has not enforced the MSA requirement for Scottsdale Arts to provide critical evaluations of its performance measures.

**Contract Administrator oversight of program management and public transparency can be improved.**

- Scottsdale Arts has received additional funding through the City's Community Arts Trust fund and transparency over the fund granting process could be improved.
- The Contract Administrator does not have a list of public art installed by the City or by private developers to verify that Scottsdale Arts is fulfilling its annual inspection and maintenance responsibilities.

### WHAT WE RECOMMEND

We recommend the Contract Administrator:

- Review use of purpose-restricted funds at least annually and ensure the required art conservation and restoration analysis is submitted and the restricted funding is appropriate.
- Require Scottsdale Arts to submit a financial development plan and critically evaluate its performance measures. Also, periodically monitor the organization's financial and performance progress.
- Develop a public process for granting Community Arts Trust funding and maintain an inventory of public art.

### MANAGEMENT RESPONSE

The Department agreed with the audit recommendations.





## BACKGROUND

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In 1987, Scottsdale Arts (legally titled the Scottsdale Cultural Council) was created as a non-profit corporation to provide advisory and management services for the City's art and cultural facilities. In 1988, the City entered into a Management Services Agreement (MSA) designating Scottsdale Arts as the principal organization managing arts and cultural activities for the City. The current MSA covers July 1, 2008, through June 30, 2018, with an optional 10-year extension. Each year, an annual Financial Participation Agreement establishes the financial terms to pay for the MSA. The City's Tourism & Events Director serves as the Contract Administrator for these agreements.

### City Arts and Cultural Facilities and Programs

Under the Management Services Agreement, Scottsdale Arts manages, programs and operates certain City-owned facilities and art programs, including:

*Scottsdale Center for the Performing Arts (SCPA)* - Opened in 1975, the Center located at Drinkwater Boulevard and Second Street includes:

- The Virginia G. Piper Theater - an 853-seat proscenium theater that hosts theater, music, dance, film and other performances;
- Stage 2 - smaller space consisting of a raised stage and projection screen with theater-style seating for 137;
- The Dayton Fowler Grafman Atrium - at 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 and the ArtReach Space - smaller galleries located within the SCPA and used to showcase artwork by local K-12 students.

In June 1987, the Scottsdale Cultural Council formed as a private non-profit entity, distinct from the City, to provide advisory and management services for the City's arts and cultural programs and facilities.

*Scottsdale Museum of Contemporary Art (SMoCA)* - Located next to the SCPA, the Museum was established 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)* - Beginning in 1989, the City adopted a one-percent for art ordinance and established the SPA program. With artwork spread throughout the City's 184-square miles, SPA features a diverse range of community events, exhibitions and temporary and permanent public art. The SPA staff manages the following:

- *Art in Public Places (AIPP)* Program - 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), bridges and plazas." 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.

- *Cultural Improvements Program (CIP)* - developers in certain areas, including the Downtown District, are required to place artwork onsite that costs 1% of the building improvement or valuation, or pay that amount into the City's Downtown Cultural Trust Fund.<sup>1</sup> The trust fund is used exclusively to purchase art to be placed in the Downtown District.
- *Community Arts Grant Program* - provides funding for Scottsdale-based arts and cultural organizations as well as to valley arts organizations for projects that take place in Scottsdale. The MSA requires Scottsdale Arts to 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 such as board development, strategic planning, and marketing.

*Scottsdale Civic Center Mall* - surrounding City Hall, the Mall is home to the annual Scottsdale Arts Festival, the Scottsdale Culinary Festival and other events. The Mall's Amphitheater, a grass-covered hill for outdoor concerts and performances, accommodates up to 1,800 people.

Scottsdale Arts also runs the *Gallery @ The Library* and *Gallery @ Appaloosa Library*. Located at the Civic Center Library and the Appaloosa Library, these galleries are used to display artwork from local artists and exhibits geared toward youth and families.

The MSA requires Scottsdale Arts to promote the City's arts and cultural interests at the local, regional, state and federal levels. More specifically, the agreement requires Scottsdale Arts to develop and implement a strategic plan every five years, provide annual progress reports to the City, work to maintain SMOCA's accreditation from the American Association of Museums and provide an annual inventory of the City art collection.

### Scottsdale Arts

As shown in Figure 1 on page 5, Scottsdale Arts is governed by a Board of Trustees and a President/Chief Executive Officer manages the organization's operations. Scottsdale Arts is comprised of 7 operating divisions, each managed by a Division Director, with approximately 120 full-time equivalent employees. Although not shown in the figure, the Center for the Performing Arts, SMOCA, and Scottsdale Public Arts operating divisions also have advisory boards whose purpose is to represent the community's interests.

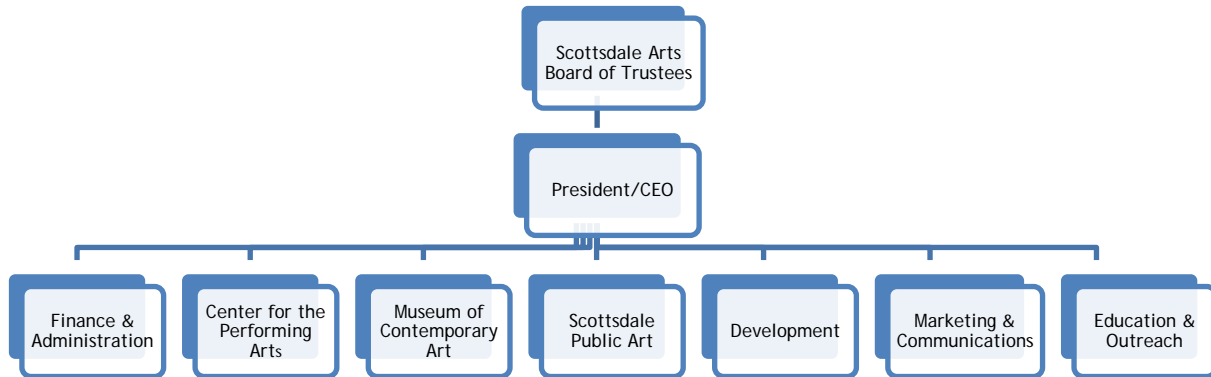
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<sup>1</sup> The Cultural Improvement Program was previously called the Art in Private Development program.

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Figure 1. Scottsdale Arts Organizational Structure



SOURCE: Organization chart provided by Scottsdale Arts.

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In October 2017, the President/Chief Executive Officer of Scottsdale Arts resigned. The Board of Trustees selected an Interim CEO and an Interim Chief of Operations to lead the organization while searching for a permanent CEO.

### City Funding

The management services fee, which is paid through the Financial Participation Agreement, generally increases by 3% annually, from \$4.1 million in FY 2012/13 to \$4.5 million in FY 2016/17. Of this amount, \$780,000 to \$863,000 was restricted each year to pay for public art program management, public art maintenance, equipment maintenance and community art grants.

Scottsdale Arts also works closely with the City’s Tourism & Events department to coordinate events and activities and with Capital Projects Management to select and install the public art funded as part of Capital Improvement Projects. In addition to the management service fee, the City may provide funding for additional arts grants, facility or equipment improvements and special events, such as Canal Convergence. The total amount of funding ranged from \$4.7 million to \$5.2 million per year as shown in Table 1 on page 6.

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**Table 1. City Funding for Scottsdale Arts, FY 2012/13 to FY 2016/17**

	FY 2012/13	FY 2013/14	FY 2014/15	FY 2015/16	FY 2016/17
<b>Financial Participation Agreement, including restricted:</b>	<b>\$4,130,298</b>	<b>\$4,254,207</b>	<b>\$4,254,207</b>	<b>\$4,381,832</b>	<b>\$4,513,288</b>
Art in Public Places Program and Cultural Improvement Program Management and Administration <sup>1</sup>	\$657,203	\$623,397	\$556,200	\$572,474	\$572,474
Community Art Grants Program Management, Administration and Grant Awards	\$59,000	\$59,000	\$159,000	\$80,000	\$60,000
City Artwork Conservation & Restoration	\$130,000	\$128,880	\$130,000	\$130,000	\$130,000
Specialty Equipment and Specialty Fixtures Maintenance and Repair	\$17,100	\$17,610	\$17,610	\$17,610	\$17,610
Total Purpose-Restricted Funds	\$863,303	\$828,887	\$862,810	\$800,084	\$780,084
<b>Additional Funds Provided</b>					
Art in Public Places	\$575,921	\$914,712	\$818,948	\$296,204	\$349,182
Special Events & Grants <sup>2</sup>	\$5,500	\$7,895	\$0	\$100,000	\$45,000
Community Arts Trust	\$0	\$0	\$0	\$0	\$56,860
Other Funds Provided <sup>3</sup>	\$1,919	\$3,133	\$3,297	\$2,218	\$3,551
<b>Total Additional Funds Provided</b>	<b>\$583,340</b>	<b>\$925,740</b>	<b>\$822,245</b>	<b>\$398,422</b>	<b>\$454,593</b>
<b>Total Funding Provided to Scottsdale Arts</b>	<b>\$4,713,638</b>	<b>\$5,179,947</b>	<b>\$5,076,452</b>	<b>\$4,780,254</b>	<b>\$4,967,881</b>
<b>Facility Improvements through Tourism &amp; Events</b>					
Facility Improvements	\$0	\$0	\$0	\$116,594	\$590,833

<sup>1</sup> The Cultural Improvement Program was previously called the Art in Private Development program.

<sup>2</sup> Special Events and Grants category includes funds for events such as Canal Convergence, La Gran Fiesta, and the Spring Training Festival.

<sup>3</sup> Other funds provided include labor and food costs for City events and trainings held at Scottsdale Arts facilities and the annual liquor license renewal fee.

SOURCE: Auditor analysis of SmartStream financial reports.

## OBJECTIVES, SCOPE, AND METHODOLOGY

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An audit of the *Scottsdale Arts Contract* was included on the City Council-approved fiscal year (FY) 2017/18 Audit Plan. The audit objective was to evaluate contract compliance, effectiveness and administration.

To gain an understanding of the Scottsdale Cultural Council (Scottsdale Arts) agreement, we reviewed the Management Services Agreement (MSA), contract no. 2008-048-COS, effective July 1, 2008, and the associated annual Financial Participation Agreements. We also reviewed related City Council Reports.

We reviewed a related audit report previously issued by this office, Audit No. 1204 *Cultural Council Contract Compliance*. We also reviewed 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, § 5.3083, *Cultural Improvements Program*, and Administrative Regulation (AR) 215 *Contract Administration* to gain an understanding of authoritative policies.

To gain an understanding of the City's contract administration of the Scottsdale Arts MSA, we interviewed Tourism & Events Department personnel who administer these agreements, including the Tourism & Events Director and the Tourism Development Coordinator. In addition, we interviewed City personnel from the Accounting and Risk Management departments as well as the Director of Finance and Administration from Scottsdale Arts.

To gain an understanding of Scottsdale Arts operations, we reviewed its strategic plan, annual reports, IRS 990 forms, audited financial statements and other publicly available information on the organization's website.

To assess compliance with the terms of the City's agreement with Scottsdale Arts and evaluate whether the City has adequate controls to ensure effective administration of the agreement, we:

- Reviewed self-support requirements in other City agreements with third-party organizations and reviewed funding models for similar cultural and arts organizations.
- Compared City contributions to Scottsdale Arts-generated revenue and benchmarked ratios to similar cultural and arts organizations.
- Evaluated performance measures reported to the City for relevance and specificity and calculated select financial and performance ratios for trend analysis and benchmarking to similar cultural and arts organizations.
- Reviewed payments from the City's Community Arts Trust to Scottsdale Arts and other organizations.
- Assessed the sufficiency of City contributions to Scottsdale Arts restricted for Public Art conservation and restoration.
- Assessed controls over the maintenance of private art installed as part of the City's Cultural Improvement Program.

- Analyzed Scottsdale Arts expenditures related to the Art in Public Places program, the Community Arts Grant program, City artwork conservation and restoration and specialty equipment and fixtures maintenance and repair.
- Reviewed key contract documents to determine if contract files were reasonably maintained and if the Contract Administrator had an active role in identifying and resolving issues with the agreement's terms and conditions. We also confirmed that the City's Contract Administrator Academy training was completed.
- Reviewed certificates of liability insurance and evidence of property insurance provided by Scottsdale Arts.

Our audit found that Scottsdale Arts underspent approximately \$202,000 of purpose-restricted City funding, and art maintenance funds had not increased in proportion to new art acquired. Additionally, Scottsdale Arts is not progressing in its efforts to become more independent of City funding. Finally, Contract Administrator oversight of program management and public transparency can be improved.

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 2017 to December 2017.

## FINDINGS AND ANALYSIS

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### 1. Scottsdale Arts underspent approximately \$202,000 of purpose-restricted City funding, and art maintenance funds have not increased in proportion to new art.

Over the past 3 fiscal years, the Contract Administrator has not required Scottsdale Arts to report on its spending of the City's purpose-restricted funding. Further, although more public art has been added, the purpose-restricted funds specified in the Management Services Agreement (MSA) for art maintenance have decreased.

- A. The Contract Administrator has not ensured Scottsdale Arts appropriately spent the purpose-restricted funds. Therefore, the City has no assurance the funds restricted for the purposes listed in Table 2, on page 10, were actually expended as required by the Financial Participation Agreements (FPA).

The City pays Scottsdale Arts for the MSA duties through annual FPAs that specify the amounts to be paid each year. In the MSA, and therefore the FPA, requirements are established restricting some funding to specific purposes. These include: specialty equipment and fixtures maintenance and repair, City artwork conservation and restoration, the Community Art Grants program, and Art in Public Places and Cultural Improvement programs' management and administration.

As shown in Table 2, over the past 3 fiscal years, Scottsdale Arts has spent approximately \$202,000 less than specified for the restricted purposes. Because the restricted categories do not offset each other, this amount only summarizes underspending.

The "audit-determined" amounts in the table excluded expenses that were clearly not within each specified purpose. For example, we excluded Public Art administrative salaries that were allocated as art conservation and restoration expenses. In Public Art management and administration, we excluded the art purchases as the City separately funds those expenses.

In addition, some purpose-restricted expenditures may not be appropriate. For instance, Scottsdale Arts recorded expenses such as food, office supplies, roof repairs, software, training and travel as art conservation and restoration expenses and iTunes gift cards as equipment and fixtures maintenance and repair expenses. However, the audit-determined amounts do not exclude these questionable expenses.

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**Table 2. Analysis of Purpose-Restricted Funds Use, FY 2014/15 to FY 2016/17**

	FY 2014/15	FY 2015/16	FY 2016/17
<b><i>Art in Public Places and Cultural Improvement Programs Management and Administration - FPA</i></b>	\$556,200	\$572,474	\$572,474
Scottsdale Arts' Expenses	\$540,000	\$569,533	\$653,957
Audit-determined Expenses <sup>1</sup>	\$556,200	\$572,474	\$572,474
Estimated over/(under) spending <sup>2</sup>	\$0	\$0	\$0
<b><i>Community Art Grants Program Management, Administration and Grant Awards <sup>3</sup> - FPA</i></b>	\$159,000	\$80,000	\$60,000
Scottsdale Arts' Expenses	\$80,000	\$80,000	\$60,000
Audit-determined Expenses	\$80,000	\$80,000	\$60,000
Estimated over/(under) spending	(\$79,000)	\$0	\$0
<b><i>City Artwork Conservation and Restoration - FPA</i></b>	\$130,000	\$130,000	\$130,000
Scottsdale Arts' Expenses	\$130,000	\$128,687	\$124,281
Audit-determined Expenses	\$72,799	\$97,297	\$96,635
Estimated over/(under) spending	(\$57,201)	(\$32,703)	(\$33,365)
<b><i>Specialty Equipment and Specialty Fixtures Maintenance and Repair - FPA</i></b>	\$17,610	\$17,610	\$17,610
Scottsdale Arts' Expenses	\$13,141	\$26,567	\$18,179
Audit-determined Expenses	\$13,141	\$26,567	\$18,179
Estimated over/(under) spending <sup>4</sup>	(\$4,469)	\$8,957	\$569
<b>Annual Total Underspent Categories Only</b>	<b>(\$140,670)</b>	<b>(\$32,703)</b>	<b>(\$33,365)</b>
<b>3-Year Total Underspent Categories Only <sup>4</sup></b>			<b>(\$202,269)</b>

FPA - Financial Participation Agreement annual restricted amounts.

<sup>1</sup> Once the required spending was met, no further audit analysis was performed.

<sup>2</sup> Estimated over/(under) spending is based on FPA-restricted compared to audit-determined amounts.

<sup>3</sup> Scottsdale Arts' long-standing practice has been to spend this amount on grant awards, not for management or administration expenses. In FY 2014/15, the City approved an additional \$100,000 for grants, but it was not fully spent.

<sup>4</sup> Because the underspent \$4,469 was spent in the following year, it is excluded from the 3-Year Total.

SOURCE: Auditor analysis of the Financial Participation Agreements, Scottsdale Arts' annual reports and Scottsdale Arts' financial records for FY 2014/15 to FY 2016/17.



Until recently, Scottsdale Arts did not separately track the balance of purpose-restricted funding compared to the related expenditures. Also, in preparing its annual financial statements, the organization netted all purpose-restricted funding and expenses together to calculate a carryforward amount. This method results in understating the amounts not spent for the specifically restricted purposes. For example, Scottsdale Arts reflected only \$5,723 as deferred purpose-restricted City funding in its FY 2016/17 financial records. As summarized in Table 2, the FY 2016/17 estimated underspending totaled more than \$33,000.

- B. As shown in Table 3, City funding to Scottsdale Arts through the FPA increased from \$4.2 million to \$4.6 million, or almost 10%, over the past ten years. During this same period, the purpose-restricted funds decreased from approximately \$1 million to about \$780,000, a 7.4% reduction.

**Table 3. Management Services Fee: FY 2008/09 Compared to FY 2017/18**

	FY 2008/09	FY 2017/18	% Change
<b>Financial Participation Agreement <sup>1</sup></b>	<b>\$4,235,606</b>	<b>\$4,648,687</b>	<b>9.8%</b>
Art in Public Places and Cultural Improvement Program Management and Administration	\$815,102	\$572,474	(29.8%)
Community Arts Grant Program Management, Administration and Grant Awards	\$ 58,509	\$ 60,000	2.5%
City Artwork Conservation and Restoration	\$140,000	\$130,000	(7.1%)
Specialty Equipment and Specialty Fixtures Maintenance and Repair	\$ 12,000	\$ 17,610	46.8%
<b>Total Purpose-Restricted Funds</b>	<b>\$1,025,611</b>	<b>\$780,084</b>	
<b>Restricted Funds Percentage</b>	<b>24.2%</b>	<b>16.8%</b>	<b>(7.4%)</b>

<sup>1</sup> Amount for FY 2008/09 excludes \$1.2 million one-time additional funding paid for the operational impacts related to the Scottsdale Center for the Performing Arts renovation.

SOURCE: Auditor analysis of the Financial Participation Agreements for FY 2008/09 and FY 2017/18.

This purpose-restricted funding reduction can particularly have negative consequences for the maintenance and restoration of City-owned public art and inspections of privately-owned public art installed as part of the Cultural Improvement Program.

Even though the City has been adding new public art, the dedicated maintenance funding has decreased. During the past five years, the City added at least 15 large pieces at a cost of more than \$3 million. But the amount earmarked for public art conservation and restoration has remained around \$130,000 annually since FY 2009/10. The Contract Administrator indicated the amounts for purpose-restricted categories are based on the amounts Scottsdale Arts requests.

As further indication of the City's view of the importance of maintaining public art, the MSA requires Scottsdale Arts to submit a ten-year City Artwork Conservation and Restoration analysis. This analysis, together with budget estimates for conservation and restoration, is due to the City by December 31 each year. However, the Contract Administrator has not required this analysis, which would help the City evaluate whether the annual conservation and restoration funding is sufficient.

### Recommendations:

The Contract Administrator should:

- A. Review Scottsdale Arts' use of all purpose-restricted funds at least annually to ensure compliance with the Management Services and Financial Participation Agreements.
- B. Ensure Scottsdale Arts prepares and provides the annual ten-year City Artwork Conservation and Restoration analysis, together with budget estimates for conservation and restoration by December 31 each year. Further, work to ensure that the funding restricted to conservation and restoration is appropriate.

### 2. Scottsdale Arts is not progressing in its efforts to become more independent of City funding.

The Management Services Agreement (MSA) encourages Scottsdale Arts to maximize revenues from other (non-City) sources. However, its ratio of City funding to non-City funding has ranged as high as 47% during the past five years. In addition, Scottsdale Arts does not raise funds efficiently when compared to similar organizations and does not critically evaluate its performance measures.

- A. While the City has paid Scottsdale Arts approximately \$4.7 million to \$5.1 million per year over the past five years, the MSA with the organization also requires Scottsdale Arts to maximize its revenues from other, non-City sources.
  - The MSA does not require Scottsdale Arts to raise specific amounts of non-City funds as are required in some other City contracts. For example, the City's agreement with the Scottsdale Museum of the West specifies that the City will match private fundraising up to \$400,000 per year.
  - As shown in Table 4 on page 13, during the past 5 fiscal years, Scottsdale Arts' revenue from non-City sources has ranged from approximately \$5.7 to \$6.6 million annually. As a result, City funding represented from 41% to 47% of the organization's total funding. Other non-City funding was at its lowest, approximately \$5.7 million, during FY 2014/15 and FY 2015/16.

**Contributed Revenue**  
Monies and in-kind donations, generally resulting from fundraising or grant writing efforts.

**Earned Revenue**  
Monies earned through ticket sales, museum admissions, Arts Festival revenue, memberships, food and beverage sales, and other revenues.

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**Table 4. Scottsdale Arts City Funding and Other Revenue, FY 2012/13 to FY 2016/17**

(amounts in thousands)	FY 2012/13	FY 2013/14	FY 2014/15	FY 2015/16	FY 2016/17
City Funding <sup>1</sup>	\$4,741	\$5,138	\$5,061	\$4,653	\$4,884
Other Revenue <sup>2</sup>	\$6,686	\$6,795	\$5,665	\$5,765	\$6,616
<b>Total Revenue</b>	<b>\$11,427</b>	<b>\$11,993</b>	<b>\$10,716</b>	<b>\$10,418</b>	<b>\$11,500</b>
City Support Percentage	41%	43%	47%	45%	42%

<sup>1</sup> The “City Funding” amounts in this table are slightly lower than funding totals in Table 1 due to financial reporting classifications. For example, City payments for City events and trainings held at the SCPA are classified as “Other Revenues” for financial statement purposes.

<sup>2</sup> FY 2016/17 Other Revenue excludes \$298,414 withdrawn from endowment funds for use.

SOURCE: Auditor analysis of Scottsdale Arts’ Audited Financial Statements for FYs 2012/13 to 2016/17.

- Related to maximizing other revenues, the MSA requires Scottsdale Arts to prepare and implement a financial development plan, including goals for earned and contributed revenue, as a component of its strategic plan. However, the Scottsdale Arts strategic plan does not include specific, measurable and time-bound goals, required by the MSA, for earned and contributed revenues or a target percentage for non-City funding. Instead, the strategic plan incorporates a general goal to increase contributed revenue by broadening the donor base, increasing the number of gifts over \$25,000, establishing a planned-giving program to create an endowment fund and developing new opportunities for program sponsorships.
- B. Contributing to its lack of financial progress, Scottsdale Arts does not raise funds efficiently in comparison to similar organizations nationally and locally.

Scottsdale Arts spends \$0.45 to \$0.62 annually to raise each contributed dollar that it does not receive from the City. This is three to four times more than the national and Arizona average of \$0.14 per contributed dollar for comparable organizations.<sup>2</sup>

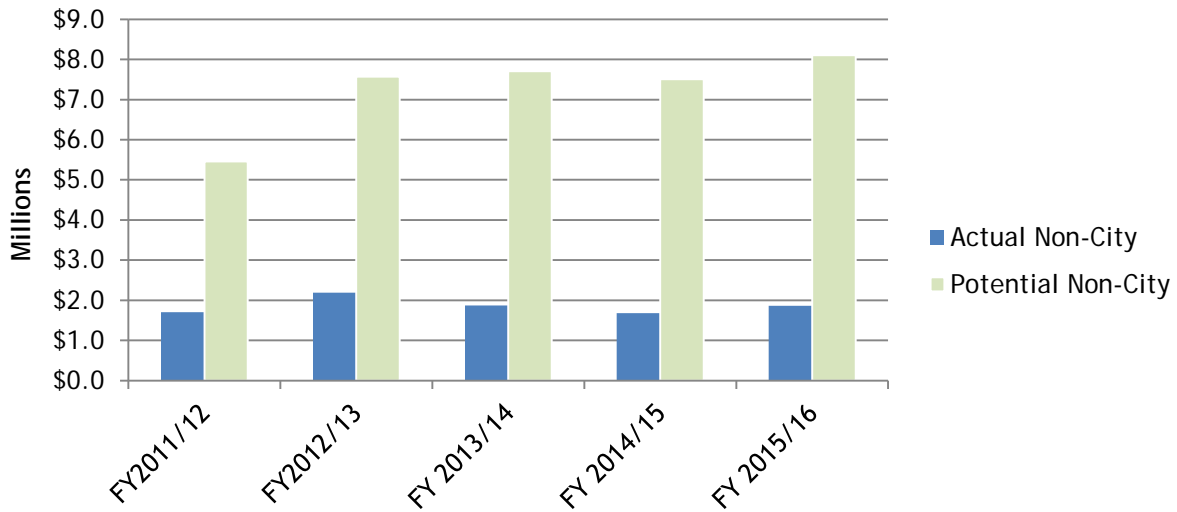
As shown in Figure 2 on page 14, if Scottsdale Arts had achieved the national average in fundraising efficiency, it would have raised between \$5.4 million to \$8.1 million annually from FY 2011/12 to FY 2015/16.

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<sup>2</sup> We obtained national, regional and Arizona averages for comparable organization performance measures from [www.CharityNavigator.org](http://www.CharityNavigator.org). We defined the comparable organizations as Arts, Culture and Humanities non-profits with expenses between \$3.5 and \$13.5 million per year.

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Figure 2. Actual versus Potential Fundraising Efficiency Results



SOURCE: Auditor calculation using information from Scottsdale Arts IRS Form 990 and CharityNavigator.org Sector Analyzer reports for Arts, Culture and Humanities organizations.

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Further, Scottsdale Arts is somewhat unique due to the high percentage of funding it receives from the City without related fundraising or grant writing costs. Based on review of its IRS Form 990s, Scottsdale Arts receives nearly 75% of its contributed revenues from the City while similar arts organizations in Arizona only average 3% of total contributions from government funding.

As summarized in Figure 3 on page 15, other cities in the Valley that operate similar programs either provided arts and culture programming directly through City departments or allowed outside groups to use government-owned arts facilities with little to no public funding.

*(continued on next page)*

Figure 3. Comparable Valley Arts and Culture Facilities

Heard Museum	<ul style="list-style-type: none"><li>•Private organization and privately owned facility</li><li>•Government Funding: None</li></ul>
Herberger Theater Center	<ul style="list-style-type: none"><li>•Private organization operates city-owned facility</li><li>•Government Funding: The City of Phoenix owns the facility and provides maintenance</li></ul>
Mesa Arts Center, Arizona Museum of Natural History and i.d.e.a. Museum	<ul style="list-style-type: none"><li>•City of Mesa department</li><li>•\$14.9 million department budget</li></ul>
Phoenix Art Museum	<ul style="list-style-type: none"><li>•Private organization operates city-owned facility</li><li>•Government Funding: The City of Phoenix owns the facility, provides maintenance and building upkeep, and leases the facility for \$1 per year</li></ul>
Phoenix Theatre	<ul style="list-style-type: none"><li>•Private organization operates city-owned facility</li><li>•Government Funding: The City of Phoenix owns the facility, provides utilities up to a fixed allowance, and leases the facility for \$1 per year</li></ul>
Tempe Center for the Arts, Tempe History Museum and Tempe Public Art	<ul style="list-style-type: none"><li>•City of Tempe department</li><li>•\$7 million department budget</li></ul>

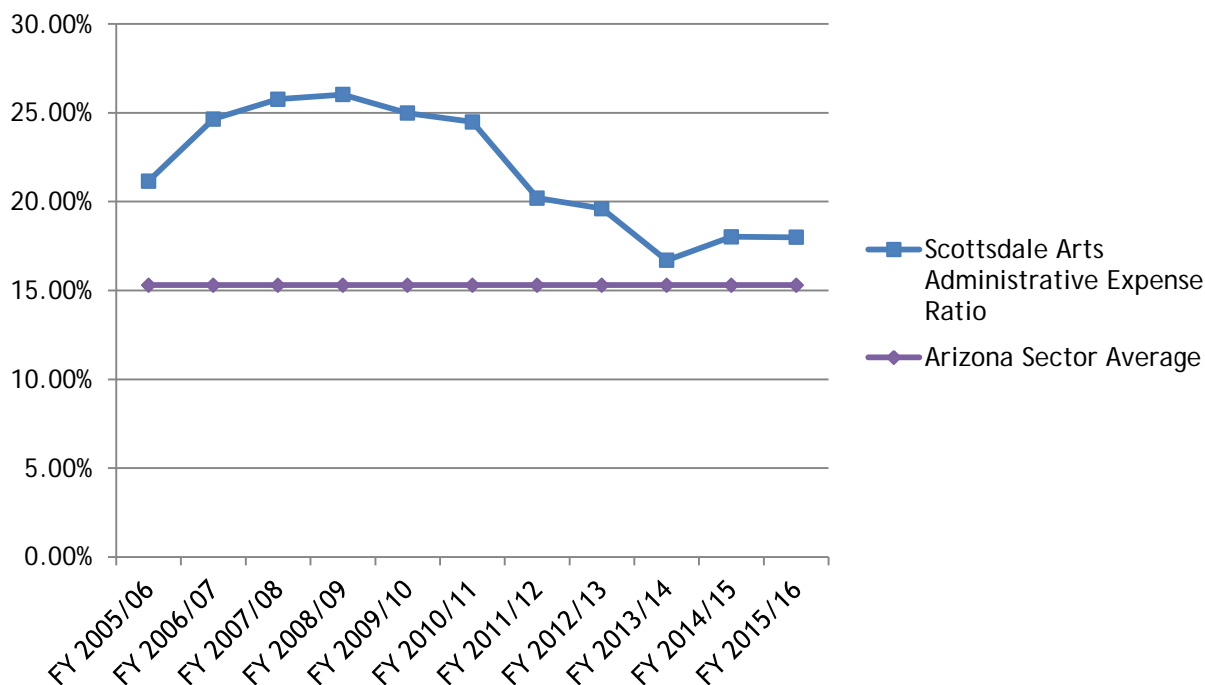
SOURCE: Auditor review of IRS Form 990s, city budgets and city agreements for each facility.

One potential result of the lack of external fundraising is that Scottsdale Arts has a low working capital ratio in comparison to comparable arts organizations. Charity Navigator calculates its working capital ratio to reflect how long an organization could sustain its operations without generating new revenue.<sup>3</sup> Scottsdale Arts maintains an average of about 2 months of working capital while comparable arts groups in Arizona average 1.4 years and regional and national arts groups average approximately 3 years. A shortage of working capital means that Scottsdale Arts may be limited in its ability to expand existing programs or undertake new efforts.

<sup>3</sup> Working Capital Ratio is defined by [www.CharityNavigator.org](http://www.CharityNavigator.org) as working capital divided by average total expenses. Working capital includes unrestricted and temporarily restricted net assets and excludes permanently restricted net assets.

C. As shown in Figure 4, Scottsdale Arts spent 17.9% of its total expenses on administrative costs in FY 2015/16. While this administrative percentage has decreased over the past decade, it is still about 3 percentage points higher than the 14.5% that comparable organizations in the Southwest region average and the 15.3% average for the Arizona sector of comparable organizations.

Figure 4. Scottsdale Arts' Administrative Expenses versus Arizona Sector Average



SOURCE: Auditor calculation using data from Scottsdale Arts IRS Form 990 and CharityNavigator.org Sector Analyzer Reports for Arts, Culture and Humanities organizations.

One factor of the higher administrative costs is the Scottsdale Arts CEO's higher compensation. In FY 2015/16, his pay was 74% higher than the regional average and 55% higher than the Arizona average for CEO compensation at comparable organizations. This CEO resigned in October 2017, and Scottsdale Arts is currently recruiting for the position.

D. Although the MSA requires Scottsdale Arts to critically evaluate its performance measures each year, the Contract Administrator does not enforce this requirement.

Section 5.2 of the MSA requires the organization to provide the Contract Administrator with an annual comprehensive written operational plan and report. It also requires the organization's annual report to critically evaluate the organization's performance measures; satisfaction of its primary duties under the agreement; and achievements regarding program quality, educational outreach, civic engagement and financial accountability.

The Scottsdale Arts' annual reports provided to the public and the budget narratives provided to the City include a variety of relevant measures, such as the examples in Figure 5. But they do not provide the required critical evaluation of the organization's results and how the organization satisfied its primary MSA duties.

Figure 5. Select Performance Measures for Scottsdale Arts, FY 2015/16



SOURCE: Auditor review of Scottsdale Arts' FY 2015/16 Annual Report.

E. Scottsdale Arts has not established resident company relationships with local performing arts organizations as many similar arts and culture organizations have done. For example:

- the Herberger Theater Center in Phoenix lists the Arizona Theater Company, the Center Dance Ensemble and the iTheatre Collaborative as resident companies;
- the Tempe Center for the Arts has resident company relationships with groups including the Scottsdale Musical Theatre Company and Stray Cat Theatre; and
- the Mesa Arts Center lists formal relationships with groups including the East Valley Children's Theatre, the Southwest Shakespeare Company, and the Symphony of the Southwest.

Establishing partnerships with local performing arts groups can provide Scottsdale Arts with guaranteed programming for the City facilities it operates. As well, the resident performing groups may bring additional audiences to the City's facilities.

## Recommendations:

The Contract Administrator should:

- A. Require Scottsdale Arts to submit a financial development plan that includes specific goals for earned and non-City contributed revenues and periodically monitor the organization's plan performance.
- B. Consider making the Management Service Agreement more specific in requiring Scottsdale Arts to make progress toward financial independence. Alternatives could include stipulations that the amount of funds provided by the City will be dependent on the amount raised from non-City sources or specific performance measure goals.
- C. Review administrative cost percentages on a periodic basis to ensure Scottsdale Arts is maximizing use of City funds to provide the desired programs and services.
- D. Require Scottsdale Arts to critically evaluate its performance measures and financial information each year.
- E. Encourage Scottsdale Arts to establish artistic partnerships with local performing arts groups and consider establishing requirements for such partnerships in new agreements.

### 3. Contract Administrator oversight of program management and public transparency can be improved.

Scottsdale Arts has received additional funding through the City's Community Arts Trust fund and transparency over the fund granting process could be improved. Additionally, complete lists of art acquired through the Art in Public Places program and the Cultural Improvement Program are not maintained.

- A. The Contract Administrator directly authorizes additional funds to Scottsdale Arts for community art programs from a separate City arts trust fund. This reduces Scottsdale Arts' incentive to fund such programs from its ongoing City funding, and a public process to invite grant applications would be more transparent.
  1. The Contract Administrator directs use of the City's Community Arts Trust fund, which had about \$649,000 at June 30, 2017.

During the last two fiscal years, Scottsdale Arts informed the Contract Administrator which community arts organizations it recommended for City grants, and the Contract Administrator authorized the recommended amounts to be paid directly to Scottsdale Arts. In the last two fiscal years, these grants have totaled almost \$140,000 in added funding.

Community Arts Trust Awards	Amount	
	FY 2016/17	FY 2017/18
International Film Festival	\$ 0	\$ 37,500
Scottsdale Arts' Community Art Grants	\$ 31,860	\$ 25,000
Scottsdale Philharmonic	\$ 0	\$ 20,000
Los Trompos	\$ 25,000	\$ 0
Totals	\$56,860	\$82,500



The awards to the Scottsdale Arts' Community Art Grants program were for the organization to provide additional funding for the Desert Foothills Theater, the Detour Company Theater, the Frank Lloyd Wright Foundation, the Scottsdale Artist's School, the Scottsdale Ballet Foundation, the Scottsdale Philharmonic and STARS.

Funneling the additional monies through Scottsdale Arts rather than paying the grants directly to the specific community arts organizations, as the City did a few years ago, removes any incentive for Scottsdale Arts to dedicate more of the funds it already receives to community arts organization grants. Also, Scottsdale Arts did not include these additional Community Arts Trust Awards in its FY 2016/17 Annual Report, and the Contract Administrator does not verify that these amounts were then paid to the specified organizations.

2. Developing a public process for community arts organizations to apply for the City's Community Arts Trust grants would improve transparency and oversight.

About two years ago, the Acting City Manager approved a formal procedure authorizing the Tourism & Events Director to provide grants from the Community Arts Trust. However, adding a public process to annually invite and review grant requests and present the recommended awards to City Council for approval would improve transparency. Such a process is used when the City awards human services grant funding to nonprofit agencies. In FY 2017/18, the City provided grants ranging from \$9,000 to \$37,500 after the City's Human Services Commission conducted a public process to solicit and evaluate proposals. The Commission then recommended 8 grants, which City staff presented to City Council for approval.

- B. The MSA includes the Cultural Improvement Program (previously called the Art in Private Development program) among Scottsdale Arts responsibilities. Scottsdale Revised Code §7.1 spells out the program requirements, which includes an annual inspection of public art installed by private developers.

The Contract Administrator does not have a list of public art installed by the City and by private developers to verify that Scottsdale Arts is fulfilling its annual inspection responsibility. The City's Planning and Development Services department reviews the Cultural Improvement Program art invoices, and the City's Capital Project Management group approves invoices for public art that is installed as part of its capital projects.<sup>4</sup>

Tracking public art installed by the City and by private developers would help the Contract Administrator confirm whether Scottsdale Arts' annual inventory and maintenance evaluation includes all public art pieces.

- C. The MSA requires that Scottsdale Arts' policies and procedures align with City policy to the "greatest extent possible." While City administrative regulations require at least 10 calendar days' notice for public meetings, Scottsdale Arts has only provided a few days' notice, ranging from 1 to 5 days for its most recent board meetings. Additionally, notice of future meeting dates are not available on Scottsdale Arts' website and the next planned meeting date is generally not listed on marked meeting

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<sup>4</sup> The Planning and Development Services department, as part of its permitting processes, ensures private developers install public art or pay into the Cultural Improvement Program accounts as required.

agendas. The Contract Administrator does not monitor Scottsdale Arts' practices for its meeting notices and agendas.

### Recommendations:

The Contract Administrator should:

- A. Develop a public process for non-profit arts organizations to request awards through the Community Arts Trust using similar City award processes for guidance.
- B. Maintain an inventory of art installed as part of the Art in Public Places and Cultural Improvement Programs in order to verify that Scottsdale Arts is performing its required inspections annually.
- C. Encourage Scottsdale Arts to provide its calendar of board meeting dates on its website and to continue working to provide advance meeting agendas as close to the Council's 10-day notice policy as possible.

## MANAGEMENT ACTION PLAN

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1. **Scottsdale Arts underspent approximately \$202,000 of purpose-restricted City funding, and art maintenance funds have not increased in proportion to new art.**

### Recommendations:

The Contract Administrator should:

- A. Review Scottsdale Arts' use of all purpose-restricted funds at least annually to ensure compliance with the Management Services and Financial Participation Agreements.
- B. Ensure Scottsdale Arts prepares and provides the annual ten-year City Artwork Conservation and Restoration analysis, together with budget estimates for conservation and restoration by December 31 each year. Further, work to ensure that the funding restricted to conservation and restoration is appropriate.

MANAGEMENT RESPONSE: Agree

### PROPOSED RESOLUTION:

- A. The Contract Administrator will work with the City Treasurer's Office to review use of all purpose-restricted funds at least annually to ensure compliance with the Management Services and Financial Participation Agreements.
- B. The Contract Administrator received the annual ten-year City Artwork Conservation and Restoration analysis, with budget estimates for conservation and restoration on December 28, 2017. Moving forward, the Contract Administrator will ensure this information is received by December 31 each year, and used to help ensure that the funding level restricted to conservation and restoration is appropriate.

RESPONSIBLE PARTY: Contract Administrator Karen Churchard, Tourism & Events Director

COMPLETED BY: 06/30/2018

2. **Scottsdale Arts is not progressing in its efforts to become more independent of City funding.**

### Recommendations:

The Contract Administrator should:

- A. Require Scottsdale Arts to submit a financial development plan that includes specific goals for earned and non-City contributed revenues and periodically monitor the organization's plan performance.
- B. Consider making the MSA more specific in requiring Scottsdale Arts to make progress toward financial independence. Alternatives could include stipulations that the amount of funds provided by the City will be dependent on the amount raised from non-City sources or specific performance measure goals.
- C. Review administrative cost percentages on a periodic basis to ensure Scottsdale Arts is maximizing use of City funds to provide the desired programs and services.

- D. Require Scottsdale Arts to critically evaluate its performance measures and financial information each year.
- E. Encourage Scottsdale Arts to establish artistic partnerships with local performing arts groups and consider establishing requirements for such partnerships in new agreements.

MANAGEMENT RESPONSE: Agree

PROPOSED RESOLUTION:

- A. The Contract Administrator will discuss with Scottsdale Arts adding a requirement in the new MSA that a financial development plan that includes specific goals for earned and non-City contributed revenues be required annually by May 30.
- B. The Contract Administrator will discuss with Scottsdale Arts options for making the new MSA more specific in requiring Scottsdale Arts to make progress toward financial independence, including the alternatives identified in this report.
- C. The Contract Administrator will discuss with Scottsdale Arts adding a review of administrative cost percentages on a periodic basis to ensure Scottsdale Arts is maximizing use of City funds to provide the desired programs and services within the new MSA.
- D. The Contract Administrator will discuss with Scottsdale Arts methods for improving the critical evaluation of its performance measurements and financial information each year.
- E. The Contract Administrator will continue to encourage Scottsdale Arts to establish artistic partnerships with local performing arts groups, and will discuss adding a requirement in the new MSA that specific goals be established.

RESPONSIBLE PARTY: Contract Administrator Karen Churchard, Tourism & Events Director

COMPLETED BY: 06/30/2018

### 3. Contract Administrator oversight of program management and public transparency can be improved.

#### Recommendations:

The Contract Administrator should:

- A. Develop a public process for non-profit arts organizations to request awards though the Community Arts Trust using similar City award processes for guidance.
- B. Maintain an inventory of art installed as part of the Cultural Improvement Program in order to verify that Scottsdale Arts is performing its required inspections annually.
- C. Encourage Scottsdale Arts to provide its calendar of board meeting dates on its website and to continue working to provide advance meeting agendas as close to the Council's 10-day notice policy as possible.

MANAGEMENT RESPONSE: Agree, with changes to recommendation

PROPOSED RESOLUTION:

- A. Scottsdale Arts is required under the MSA to provide the City with arts and cultural advisory, planning and managerial services for the City. In addition, Scottsdale Arts has an established process for community arts grants. Finally, the Tourism & Events Department does not have the resources to develop a new process for non-profit arts organizations to request awards through the Community Arts Trust. As a result, staff is reluctant to create a new process to duplicate efforts already provided by Scottsdale Arts. However, to improve transparency and oversight, the Contract Administrator will either include supplemental funding of Community Arts Trust funds as part of the annual Financial Participation Agreement approved by the City Council, or bring forward for City Council approval any additional funding provided to community arts agencies through Scottsdale Arts. The administrative directive regarding use of Community Arts Trust funds will be revised accordingly.
- B. The city has received from Scottsdale Arts an inventory of art installed as part of the Cultural Improvement Program. This inventory has been included as a City GIS layer, and a process will be developed to ensure this inventory is updated on an annual basis. This will help the Contract Administrator confirm whether Scottsdale Arts' annual inventory and maintenance evaluation includes all public art pieces.
- C. The Contract Administrator will request that Scottsdale Arts include their annual calendar of board meeting dates on its website and provide advance meeting agendas as close to the Council's 10-day notice policy as possible.

RESPONSIBLE PARTY: Contract Administrator Karen Churchard, Tourism & Events Director

COMPLETED BY: 06/30/2018

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**City Auditor's Office**

7447 E. Indian School Rd., Suite 205  
Scottsdale, Arizona 85251

OFFICE (480) 312-7756  
INTEGRITY LINE (480) 312-8348

[www.ScottsdaleAZ.gov/auditor](http://www.ScottsdaleAZ.gov/auditor)



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