



CITY AUDITOR'S OFFICE

Scottsdale's Museum of the West Contract

March 3, 2020

AUDIT REPORT NO. 2006

CITY COUNCIL

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March 3, 2020

Honorable Mayor and Members of the City Council:

Enclosed is the audit report for *Scottsdale's Museum of the West Contract*, which was included on the Council-approved FY 2019/20 Audit Plan. This audit was conducted to evaluate compliance with terms and effectiveness of contract administration for the City's Museum of the West contract.

While generally effective, contract administration can be improved. Specifically, the City continued to make utility payments for the museum's administration building, totaling about \$77,000 for 5-1/2 years. Also, responsibility for certain maintenance items can be clarified, and reporting requirements can be met more completely and timely.

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

Sincerely,

A handwritten signature in black ink that reads "Sharron Walker". The signature is written in a cursive, flowing style.

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

Audit Team:

Kyla Anderson, CIA, CLEA – Sr. Auditor
Brad Hubert, CIA, CGAP – Sr. Auditor

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AUDIT HIGHLIGHTS

Scottsdale's Museum of the West Contract

March 3, 2020

Audit Report No. 2006

WHY WE DID THIS AUDIT

An audit of *Scottsdale's Museum of the West Contract* was included on the fiscal year (FY) 2019/20 Audit Plan. The audit objective was to evaluate compliance with contract terms and effectiveness of contract administration for the Scottsdale Museum of the West contract.

BACKGROUND

Western Spirit: Scottsdale's Museum of the West opened on January 15, 2015. The City owns the museum property, and contracts with a museum manager/operator, the nonprofit Scottsdale Museum of the West, Inc. (SMoW Inc.)

The City and SMoW Inc. have amended the management agreement five times, most recently in October 2017.

The museum operator is responsible for all furniture, fixtures and equipment inside the facilities as well as all utilities except exterior water. The City is responsible for maintaining the buildings, including the roof, electrical and HVAC systems, and the building exterior and grounds.

For calendar years 2015 through 2018, SMoW Inc. reported \$9.8 million in revenues, of which \$3.3 million, or 34%, was provided by the City.

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WHAT WE FOUND

While generally effective, contract administration can be improved.

Specifically, we found:

- Some utility and maintenance requirements were not handled in compliance with contract terms. From June 2014 through December 2019, the City paid approximately \$77,000 for the administration building electric utilities, which is the museum operator's responsibility. In addition, some maintenance requirements could be further clarified.
- Required reports were not complete or submitted timely. The annual plan did not include some required information, and annual performance reports were not provided. Also, audited financials and quarterly donation reports were not received timely.

WHAT WE RECOMMEND

We recommend the Contract Administrator:

- Request reimbursement from SMoW Inc. for the City's payments for the administration building utilities; review maintenance work orders periodically to determine whether the items are within the City's responsibility; and develop written clarification for other items, such as hot water heater repairs and replacements and humidity control system components.
- Work with SMoW Inc. to ensure that all required reports are complete and submitted to the City on a timely basis.

MANAGEMENT RESPONSE

The department agreed with the audit recommendations and plans to complete implementation by September 2020.

BACKGROUND

Western Spirit: Scottsdale's Museum of the West opened on January 15, 2015. In 2004, the City Council approved a \$7.5 million capital improvement project to assist in developing a cultural facility in downtown Scottsdale, with interest focused on the Loloma Transit Station site near Main Street and Marshall Way. By 2006, the City and the Scottsdale Cultural Council, now referred to as Scottsdale Arts, agreed to jointly fund a feasibility study for a western art museum at the site.¹ A year later, Scottsdale Museum of the West Inc. (SMoW Inc.), a private nonprofit formed to support creation of the western art museum. In July 2008, the City entered into a development agreement with SMoW Inc. to design and construct the museum building. This agreement was terminated in January 2012.

Subsequently, in May 2012, the City issued a new Request for Qualifications for a museum manager, to which SMoW Inc. was the only respondent. In February 2013, the City entered a design-build contract with a construction company to build the museum and a management agreement with SMoW Inc. to operate it. As of January 31, 2020, the City and SMoW Inc. have amended the management agreement five times, most recently in October 2017.



SOURCE: City of Scottsdale Tourism and Events department.

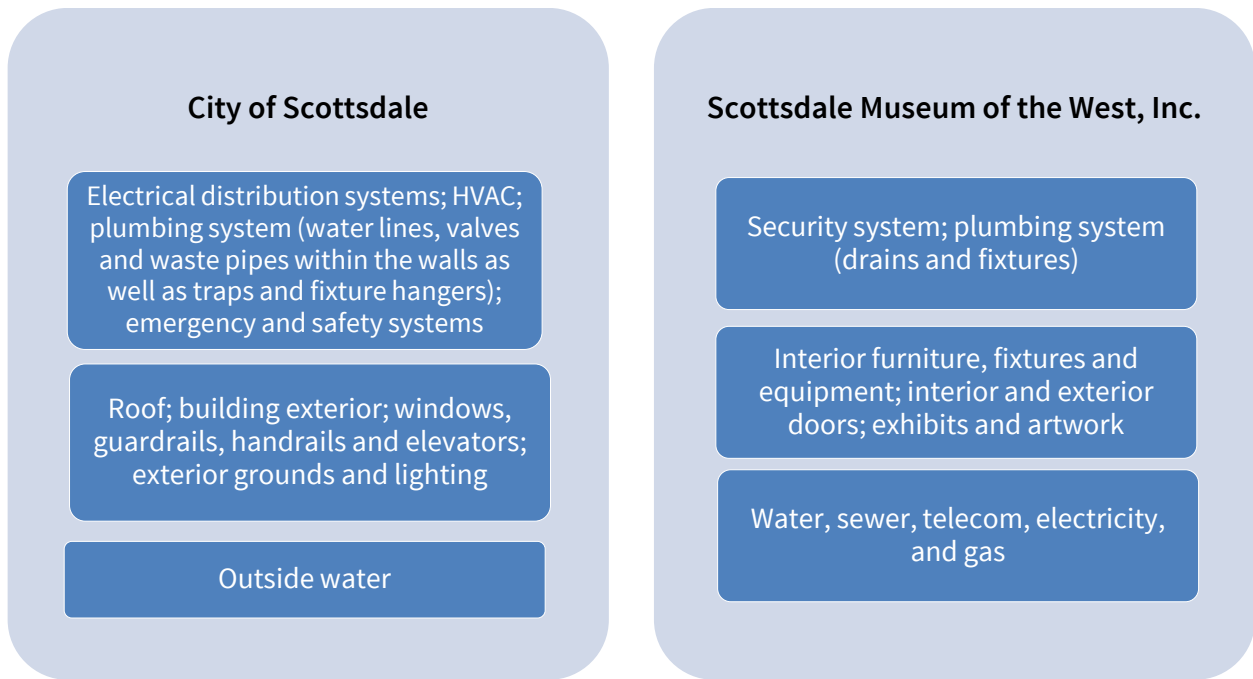
The museum's collection of artwork and artifacts consists of pieces donated to or acquired by SMoW Inc. Some pieces are also temporarily loaned to the museum for special exhibits. The management agreement requires the museum to provide an annual inventory of the owned and the short-term borrowed collections. Should SMoW Inc. cease to operate the museum, the collection ownership reverts to the City and the City would be responsible for returning any borrowed pieces to their owners.

Besides the museum building, SMoW Inc. also uses the City's former Loloma Transit Station building for administrative offices and is responsible for the museum's exterior plaza. Because these facilities are City-owned, the management agreement specifies responsibilities such as maintenance, repair and utilities.

As summarized in Figure 1 on page 4, the museum operator is responsible for all furniture, fixtures and equipment inside the two buildings as well as all utilities except exterior water. The City is responsible for maintaining the buildings, including the roof, electrical and HVAC systems, and the building exterior and grounds.

¹ Since 2016, the Scottsdale Cultural Council operates as Scottsdale Arts.

Figure 1. Contracted Maintenance and Utility Responsibilities



SOURCE: Auditor analysis of 2013-025-COS-A4.

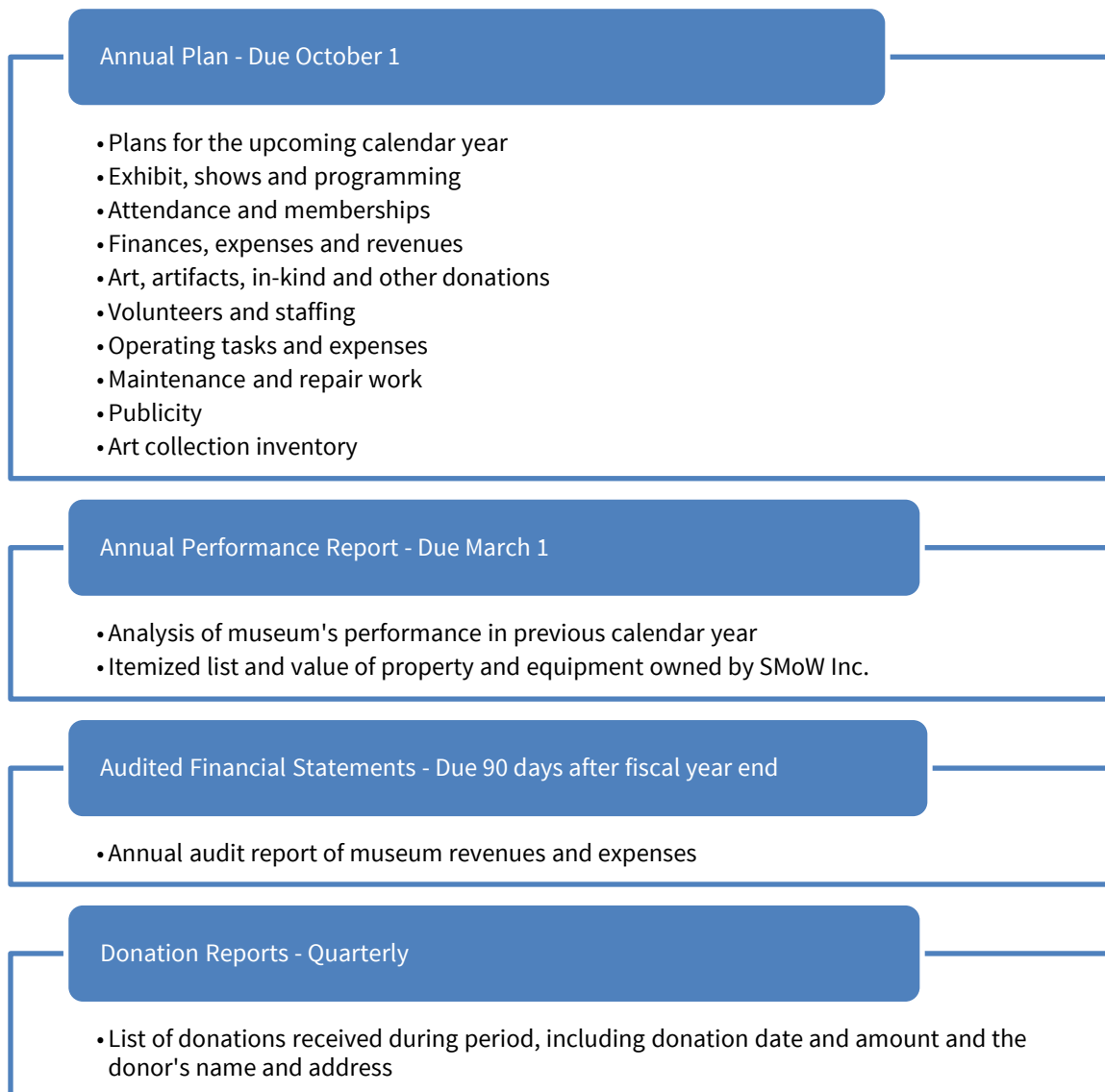
In addition to constructing the facility, the City committed to paying up to \$400,000 for design work for the exhibit space. As well, the City agreed to make five annual payments of not more than \$400,000 each to match donations raised by SMoW Inc. over each twelve-month period.

A February 2016 contract amendment provided an additional \$380,628 for a new museum exhibit, while an October 2017 amendment provided \$500,000 to fund educational programs.

Further, the Tourism Development Commission recommended additional donation-matching payments of up to \$400,000 in FY 2018/19 and in FY 2019/20, both of which were approved by the City Council. In FY 2018/19, the City Council also approved reimbursing SMoW Inc. \$200,000 from the City's Tourism Development Fund for its marketing and media buys.

As summarized in Figure 2 on page 5, the management agreement requires SMoW Inc. to submit certain periodic reports to the City, including an annual art inventory.

Figure 2. The Museum’s Annual Reporting Requirements



SOURCE: Auditor analysis of Contract 2013-025-COS-A4.

For calendar years 2015 through 2018, SMoW Inc. reported \$9.8 million in revenues, of which \$3.3 million, or 34%, was provided by the City.

OBJECTIVES, SCOPE, AND METHODOLOGY

An audit of *Scottsdale's Museum of the West Contract* was included on the City Council-approved fiscal year 2019/20 Audit Plan. The audit objective was to evaluate compliance with contract terms and effectiveness of contract administration for the Scottsdale's Museum of the West contract. The audit focused on reviewing the contract during fiscal years 2017/18, 2018/19 and 2019/20 through January 2020.

To obtain an understanding of the Scottsdale's Museum of the West contractual requirements, we reviewed the Museum Management Agreement (Contract No. 2013-025-COS) and its five associated amendments:

- 2013-025-COS-A1, June 17, 2014, updated utility responsibilities
- 2013-025-COS-A2, December 2, 2014, updated matching donation requirements
- 2013-025-COS-A3, February 23, 2016, accepted new Hopi pottery collection and added new exhibition gallery
- 2013-025-COS-A4, January 24, 2017, restated agreement and changed letter of credit to a security deposit
- 2013-025-COS-A5, October 17, 2017, added requirement for museum to provide educational programs

To further our understanding, we also interviewed the Contract Administrator, Real Estate Manager and Real Estate Management Specialist and reviewed staff's Council reports and other public information reported about the planning, construction and opening of the museum.

To evaluate compliance with contract terms and effectiveness of contract administration, we:

- Reviewed all City payments to Scottsdale Museum of the West between August 2013 and July 2019 for compliance with contract requirements.
- Compared all City maintenance work orders for the Scottsdale Museum of the West facility between July 2017 and January 2020 and utility payments between June 2014 and January 2020 with the contract provisions.
- Assessed the effectiveness of contract administration, including whether contract-required reports were being provided to the City, and reviewed all items in the contract administration file to assess completeness. As well, we reviewed the SMoW Inc.'s IRS Form 990s and statement of incorporation.

Our audit found that while generally effective, contract administration can be improved. Some utility payments and maintenance requirements were not handled in compliance with contract requirements, and required reports provided to the City are not always complete or timely.

We conducted this performance audit in accordance with generally accepted government auditing standards. 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 December 2019 to February 2020.

FINDINGS AND ANALYSIS

1. While generally effective, contract administration can be improved.

The Contract Administrator meets regularly with the Scottsdale Museum of the West, Inc.'s (SMoW Inc.) museum director to stay aware of the museum's progress. However, a few contract administration areas can be improved.

A. Some utility and maintenance requirements were not handled in compliance with contract terms. In addition, some maintenance requirements could be further clarified.

1. The City paid an electric utility that, by contract, is SMoW Inc.'s responsibility.

Since June 2014, SMoW Inc. has been contractually required to provide and pay for electricity at the museum facilities, including the museum building, the adjacent administration building and the outdoor plaza. Prior to this time, the contract required the City to pay for more utilities, including electric service. However, the first contract amendment limited the City's responsibilities to just outdoor water service. City staff paying the City's utility bills were apparently not aware that SMoW Inc. was using the administration building and should have put the electric account into its own name.

As a result, based on utility records, the City has paid more than \$77,000 in electric bills for the museum administration building (the former Loloma Transit Station building) from June 2014 through December 2019.

2. The City has been providing maintenance services for some items that fall within the SMoW Inc.'s contractual responsibility and for other items where responsibility is unclear. For example, the City is required to maintain only the "water lines, valves and waste pipes within the walls as well as traps and fixture hangers." However, City maintenance staff have responded to calls for service on drains, fixtures and hot water heaters. Less clear, the contract cites both parties as being responsible for the humidity control systems. As humidity control is critical for museum operation, the division of responsibilities, and therefore potential liability, should be detailed.

To date, the City's non-contracted maintenance costs have been minimal (approximately \$1,500), but as the building ages, maintenance and repair costs will increase.

B. Required reports were not complete or provided timely.

As part of the management agreement contract, SMoW Inc. is required to submit certain information to the City, including an annual plan, annual performance review, and annual audited financial statements. Also, for the matching payments, certain donation information was required quarterly. However, the annual plans did not contain some required information, the annual performance reports were not submitted, and the audit and donation reports were not submitted timely.

1. In its annual plan, SMoW Inc. has not included the required list of artwork, artifacts and in-kind donations received during the year and a complete inventory of the owned and borrowed artwork collections. Instead, SMoW Inc. provides a list of the pieces included in

the prior year exhibits. This list may not include pieces recently donated to the museum or other pieces that were not displayed during the year.

The contract requires the annual plan to include a complete list of items in the museum's collection, including both owned and borrowed pieces, with a description of each item and the date the museum received or disposed of it. SMoW Inc. is also required to notify the City before disposing of any owned item, and the collection becomes City property if SMoW Inc. ceases operating the museum.

Without a complete and accurate inventory, if the City would have to take over museum operations, the Contract Administrator would not be able to determine if the owned collection is complete and be able to return all borrowed items to their owners.

2. The Contract Administrator and SMoW Inc. have considered the required annual performance reports to be covered by submittal of its annual plan. However, the performance report serves to analyze actual performance against the annual plan goals. As well, the performance report is also required to include an itemized list of fixtures, furniture, equipment and other items owned by SMoW Inc., along with their values.

The performance report details would help both SMoW Inc. and the Contract Administrator evaluate the museum's performance and recognize the programs and promotions that are working or need improvement. The required furniture, fixtures and equipment list can serve to answer any future questions regarding property ownership.

3. Donation records and audit reports were not submitted timely.

As part of the management agreement, the City agreed to pay SMoW Inc. up to \$400,000 to match the donations it received during each 12-month period from June 2013 through May 2018. Subsequently, in the two following fiscal years, the City Council approved continuing this donation-matching payment as part of the City's Tourism Development Fund budget. Although the original agreement only required an annual donations report, the second Amendment, dated December 2, 2014, changed this to a quarterly reporting requirement. Despite this, SMoW Inc. provided donation reports only twice per year, and the Contract Administrator did not enforce the quarterly reporting requirement.

Another requirement of the management agreement is that SMoW Inc. submit financial audit reports to the City within 90 days of the fiscal year end. SMoW Inc. includes its audited financial statements for the prior year with its annual plan, which is submitted by October 1. However, the museum's fiscal year ends on December 31, so the audited financial statements should be provided to the City by March 31. Timely receipt of the audited financial statements would allow the Contract Administrator to be aware of any material financial concerns the museum may face.

(Continued on next page)

Recommendations:

The Contract Administrator should:

- A. Request reimbursement from SMOW Inc. for the City's payments for the administration building utilities and discontinue the City's payments for this building's utilities. In addition, review maintenance work orders periodically to determine whether the items are within the City's responsibility. Further, develop written clarification for other items, such as hot water heater repairs and humidity control system components.
- B. The Contract Administrator should work with SMOW Inc. to ensure that all required reports are complete and submitted to the City on a timely basis.

MANAGEMENT ACTION PLAN

1. While generally effective, contract administration can be improved.

Recommendations:

The Contract Administrator should:

- A. Request reimbursement from SMoW Inc. for the City's payments for the administration building utilities and discontinue the City's payments for this building's utilities. In addition, review maintenance work orders periodically to determine whether the items are within the City's responsibility. Further, develop written clarification for other items, such as hot water heater repairs and humidity control system components.
- B. The Contract Administrator should work with SMoW Inc. to ensure that all required reports are complete and submitted to the City on a timely basis.

MANAGEMENT RESPONSE: Agree

PROPOSED RESOLUTION:

- A. The Contract Administrator will discuss with the City Manager, City Attorney and City Treasurer reimbursement for the City's payments for the administration building and proceed based on their direction. The CA will work with Public Works to transfer responsibility for future payments for the building's utilities, develop a plan to review maintenance work orders periodically, and bring forward a contract amendment to clarify maintenance responsibilities further.
- B. The Contract Administrator will work with SMoW Inc. to ensure all required reports are complete and submitted to the City on a timely basis.

RESPONSIBLE PARTY: Contract Administrator, Karen Churchard

COMPLETED BY: 9/30/2020

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