OBJECTIVE

This audit was conducted to determine whether effective internal controls are in place to minimize or mitigate any potential risks associated with the City's relationships with nonprofit support organizations (NPSOs).

SCOPE & METHODOLOGY

To accomplish our objective, we:

- Reviewed and evaluated written agreements between the City and NPSOs.
- Interviewed City personnel and other stakeholders regarding roles and responsibilities.
- Reviewed selected job descriptions, management policies, and personnel rules.
- Reviewed grant-related documents and requirements.
- Analyzed financial reports, transactions, and documents for FY 2017 and FY 2018.
- Conducted other procedures as necessary to achieve the audit objective.

BACKGROUND

The Mesa Arts Center (MAC), the Arizona Museum of Natural History (AzMNH), and the i.d.e.a. Museum are City-owned venues overseen by the City's Arts and Culture department. Each venue is funded through a combination of General Fund dollars, earned revenues (admissions, rentals, etc.), and contributions received from a venue-specific 501(c)3 nonprofit support organization (NPSO). These organizations include the Mesa Arts Center Foundation (MACF), the Arizona Museum of Natural History Foundation (AzMNHF), and the i.d.e.a. Museum Foundation (formerly the i.d.e.a. Museum Board of Directors, Inc.). The City has entered into formal agreements with these NPSOs, to establish the relationships, and to delineate roles, responsibilities, and resources.

There are significant differences between the three Arts and Culture related NPSO agreements, as each venue, NPSO, and relationship has its own unique character and history. However, they were audited as a group because the risks associated with the relationships, and the internal controls required to mitigate them, are common to all three relationships. Also, the Arts & Culture department was already in the process of updating all three agreements, and they welcomed the opportunity to gain additional insight into how internal controls could be strengthened for the benefit of all stakeholders.
The Parks, Recreation, and Community Facilities (PRCF) Department also benefits from the support of an NPSO: the Foundation for Mesa Parks and Recreation. However, that relationship has not been formalized in a written agreement. Our understanding is that an agreement is currently being drafted.

CONCLUSION

In our opinion, there are opportunities for the City to improve the system of internal controls in place to help govern its relationships with NPSOs. Our observations and recommendations are presented below under three categories: written agreements, staff activities, and grants. Rather than providing a detailed discussion of risks and controls, the information presented in this report is intended to provide context and explain the basis for the recommendations. We have discussed the recommendations, as well as the underlying risk/control analysis, with management, and their response to each recommendation is included below.

OBSERVATIONS & RECOMMENDATIONS

Section 1: Written Agreements

Observations:

According to the American Alliance of Museums (AAM), Core Standards: Leadership and Organizational Structure, the following is expected of all accredited museums:

“There is a clear and formal division of responsibilities between the governing authority and any group that supports the museum, whether separately incorporated or operating within the museum or its parent organization.”

This and other expectations outlined in the AAM standards, along with contract-related guidance found in City Management Policies, and best practices developed by the City's contracts administrator, provided us with specific criteria by which to evaluate the City's agreements and relationships with the Arts and Culture NPSOs. Based on these criteria, the following are some of the elements we looked for in the agreements:

- Clearly defined roles and responsibilities for each party.
- Guidance for resource-sharing arrangements, i.e. specific resources to be provided; limitations, if any; expectations for oversight and governance; recordkeeping & reporting requirements; etc.
- Communication protocols.
- Financial protocols and expectations.
- A timeline for formal reviews, including legal reviews.
- A provision for verifying compliance (Right to Audit clause).

We found that all three of the City's Arts and Culture NPSO agreements include, to varying degrees, many of the elements required by the AAM Standards and City policies. We also found some opportunities for improvement. Below are our recommendations for controls that should be incorporated into the updated agreements (if not already included). The first recommendation applies to all NPSOs, including the PRCF NPSO. Applicability of the other recommendations should be considered within the context of each specific NPSO relationship.

**Recommendations and Management's Responses:**

1-1. The City's relationships with NPSOs should be formally documented in written agreements, which should include clearly defined, specific roles and responsibilities of both parties.

   **Management Response:** Action Plan 1-1: Process is underway for all three of the A&C Department's NPSO MOU agreements, and we all concur that they will include clearly defined, specific roles and responsibilities for both parties.

1-2. If the City is to provide staff time to the NPSO, i.e. for administrative or other duties, this should be clearly stated in the agreement, with specific parameters for what is included. It should also be clearly stated that all work performed by City employees is assigned and supervised by City staff. (More recommendations on this topic are included in the Staff Activities section of this report.)

   **Management Response:** Action Plan 1-2: We concur that a fairly detailed overview of any staff duties to be completed on behalf of the NPSO (within reason for a description of annualized duties) for each NPSO should be included in the MOU agreements, and will clearly state that all work performed by City employees is assigned and supervised by City staff.

1-3. All significant terminology should be clearly defined, especially terms that are used to allocate revenues, expenses, or key responsibilities. For example, if membership revenues are allocated to the NPSO, the terms “membership” and “membership revenues” should be clearly defined.

   **Management Response:** Action Plan 1-3: Concur, and will include in MOU documents definitions of any unusual terminology or terminology specific to budget allocations or staff/organizational responsibilities.

1-4. Promotional offers which may impact revenues, if initiated by the NPSO, should be pre-approved in writing by the Department Director or designee. An example of this might be a membership promotion that includes free companion passes or discounts.

   **Management Response:** Action Plan 1-4: Concur, and this pre-approval requirement will be included in all MOU documents.
1-5. The City’s Standard Terms and Conditions, which are included in most of the City’s contractual agreements, should be included in the NPSO agreements, if deemed applicable by the City Attorney’s office.

**Management Response:** Action Plan 1-5: Concur, and will include the City’s Standard Terms and Conditions as deemed applicable by the City Attorney’s office.

1-6. Agreements should specify the manner and frequency of reporting and reimbursements.

**Management Response:** Action Plan 1-6: Concur, and plan to follow recommendation of the City Auditor for quarterly reporting and reimbursements at a minimum, with monthly accounting whenever feasible

1-7. Expenditures to be funded by the NPSO should be pre-authorized and processed on a reimbursement basis only. The reimbursement requirement would not apply to grants or sponsorships in which funding is provided to the City in advance of the expenditures.

**Management Response:** Action Plan 1-7: Concur, and pre-authorization and payment through reimbursement only will be included in the new MOU agreements.

1-8. City employees should not be permitted to serve as officers of NPSOs or voting members on NPSO boards.

**Management Response:** Action Plan 1-8: Concur and is now the approved practice at all three NPSO. Will be incorporated into all three MOU agreements.

**Estimated completion date for all Section 1 Action Plans:** All agreements must go through review and approvals by City Manager’s office, and all three are in different stages of readiness for that review. We anticipate completion of all MOU approvals by FYE 2019.

### Section 2: Staff Activities

**Observations:**

The City provides various resources, including staff time, to help the NPSOs achieve their goals. In some cases, this means that City employees are required to use systems and processes that are separate from those of the City. While this has been an accepted practice for many years, it is not without its challenges; and it may expose individual employees, the City, and the NPSOs to a variety of risks. In contrast, City systems and processes can provide excellent internal controls to reduce these risks. In fact, there are many benefits to having staff use City systems, processes, policies, rules, and procedures for all assigned duties and activities, regardless of which entity they are serving. If implemented, this simple change could improve consistency, accuracy, timeliness, efficiency, accountability, transparency, and reporting capability, while reducing risks for all stakeholders.
However, there are certain tasks that City staff should not perform for NPSOs. These include bookkeeping, financial reporting, and management, particularly if the employee also performs those duties for the City. Even if both entities share the same mission and goals, it is all but impossible to avoid the inherent appearance of a conflict of interest that arises when one individual fulfills both sides of an agreement between two parties.

The following recommendations are intended to help the City minimize the potential risks associated with various staff activities:

**Recommendations and Management’s Responses:**

2-1. City staff working on behalf of an NPSO, or engaging in activities which are funded by an NPSO, should be required to comply with all City policies, procedures, and Personnel Rules.

*Management Response: Action Plan 2-1: Concur. This has been the standard in most cases, and in those situations where it has not been the practice or fully understood, changes have been made or are in process to ensure all City staff activities comply with City policies, procedures and Personnel Rules, and that the NPSO boards understand this requirement and its implementation.*

*Estimated Completion Date: For all by or before FYE 2019.*

2-2. City staff time spent on behalf of NPSOs should be tracked and used to inform resource-sharing decisions.

*Management Response: Action Plan 2-2: We will be including general descriptions and percentages of time spent by City staff for each NPSO in the new MOU agreements, which should all be signed by FYE 2019. We propose instituting tracking at the outset of the new fiscal year, since we are seeking an annualized picture of activity. However, in the case of staff members who are entirely devoted to fundraising activity, most of which is performed in partnership with the NPSO and in relation to its 501(c)(3), we will simply count a flat percentage of their time (likely 80% or higher) as being in support of the work of the NPSO.*

*Estimated Completion Date: To begin tracking on July 1, 2019 and ongoing after that.*

2-3. Cash/check/cc handling by City employees should fully comply with all applicable City policies. This includes recording transactions in City systems, and depositing funds into City accounts.

*Management Response: Action Plan 2-3: Concur. In most cases, this is the current practice, with one exception. At the i.d.e.a. Museum Store, where sales have been accomplished through the NPSO’s Quickbooks account, new procedures to improve compliance have been identified, and a system change is being explored. Depending on the solution selected, there may be an additional 6-12 months required for completing a*
system change, based on costs or processes required. We are exploring multiple options now and expect to have the process well underway, if not completed, by FYE 2019.

Estimated Completion Date: Seeking at minimum a workable solution by FYE 2019, but in the instance of a complete system change, no later than FYE 2020.

2-4. Any funds received on behalf of the NPSOs should be passed through to the NPSO via City disbursements on an agreed upon schedule.

Management Response: Action Plan 2-4: Concur, and plan to follow recommendation of the City Auditor for quarterly reporting and reimbursements at a minimum, with monthly accounting whenever feasible.

Estimated Completion Date: Plan to be on quarterly reimbursement schedule by January 2019, and codify schedule in completed MOU by FYE 2019.

2-5. Reimbursement requests submitted to NPSOs should be processed on an agreed-upon schedule (if not monthly, at least quarterly), and should be accompanied by appropriate supporting documentation.

Management Response: Action Plan 2-5: Concur, and plan to follow recommendation of the City Auditor for quarterly reporting and reimbursements at a minimum, accompanied by appropriate supporting documentation, with monthly accounting whenever feasible.

Estimated Completion Date: FYE 2019.

2-6. If a check payable to an NPSO is received by City staff, it should immediately be restrictively endorsed, placed in a secure location, and deposited promptly. The NPSO should be notified of all incoming checks as soon as possible.

Management Response: Action Plan 2-6: Concur, and practice is in place at the NPSO for each A&C organization.

Estimated Completion Date: Completed.

2-7. All expenditures, regardless of purpose or funding source, should be processed through City systems and in accordance with City policies and procedures. No payments should be transacted directly between an individual employee and an NPSO.

Management Response: Action Plan 2-7: Concur. This is in place at all organizations, and the requirement will be included in all revised MOU documents. Communications are underway to ensure all staff understand the required processes.

Estimated Completion Date: Completed.

2-8. City employees should not be issued NPSO credit cards. City procurement cards should be used when a credit card purchase is necessary.
Management Response: Action Plan 2-8: Concur. This is current practice at MAC and AZMNH. i.d.e.a. Museum has made most of these changes and is in a transition process that will be completed within the coming one to two months.

Estimated Completion Date: Phasing out by January 30, 2019 at the latest, and sooner if possible.

Section 3: Grants

Observations:

NPSOs receive many grants for specific programs, projects, or other activities at the supported venues. City employees track the financial and operational information associated with these grant-funded activities, to ensure compliance and fulfillment of the terms of the grant. Much of this administrative work is accomplished with spreadsheets and other manual processes; and multiple employees are involved. Given the volume and complexity of the information and activities involved, and the manual processes in use, it is important to have strong internal controls, to mitigate the risk of errors and ensure accuracy and completeness.

The following are some of the recommended ways in which best practices and internal control standards can be applied to the administration of NPSO grants. If any of these controls are not already in place, we recommend that they be implemented:

Recommendations and Management’s Responses:

3-1.Grant-related information and documentation should be maintained in a central repository, with appropriate controls designed to ensure the information can be retrieved by those who need it. While there are several ways to accomplish this, a SharePoint site might work well, as it would allow for document tracking, role-based access controls, and protection against accidental loss of data.

Management Response: Action Plan 3-1: Concur; the repository exists for all three organizations. Practices are in place, and grant information and documents are maintained and accessible to all involved parties.

Estimated Completion Date: Completed.

3-2.City staff should review grant documents carefully to determine whether the grant has been awarded to the City or the NPSO. Those awarded to the City should remain with the City, and should be entered into the City’s Grant Lifecycle Management system. Those awarded to the NPSO should be received by (or immediately forwarded to) the NPSO; and the NPSO Bookkeeper (or equivalent) should be provided with copies of the award documents, for tracking and disbursement purposes.

Management Response: Action Plan 3-2: Concur; practice is in place at all three organizations.
3-3. The Arts and Culture department should develop policies and procedures for grants administration, including protocols to ensure documentation, reporting, and reimbursement requests consistently meet grantor and City requirements. For example, employees responsible for grant-funded activities should be provided with written guidance on how to accurately track/record/report eligible expenses; and grant requirements should be provided in writing to those responsible for meeting them.

**Management Response:** Action Plan 3-3: Concur. Arts and Culture Director, in cooperation with MAC Assistant Directors and museum Directors, and development staff, will create a Grants Administration Policy and Procedures document for the department. To ensure collaborative process and staff understanding and buy-in, and given many other deadline pressures this fiscal year, we will need some time to execute. However, process will be well underway by fiscal year-end and we'll plan to complete the process by Calendar year-end 2019. However, in the interim, all grants, as is the case historically, are tracked and reported in compliance with grantor requirements, and we will ensure that both financial tracking and reporting requirements are shared in writing with the staff responsible.

*Estimated Completion Date: Calendar year-end 2019.*