



Date: June 15, 2016

To: Bob Wingenroth, City Manager

From: Carol Holley, Internal Auditor *CH*

Subject: Stadium Concessions Revenue Contract (Internal Audit Report No. 2016-2)

As part of the FY2016 Annual Audit Plan, the Internal Auditor has completed the Stadium Concessions Revenue Contract audit. The audit report contains 15 opportunities to strengthen and enhance internal controls over the Stadium concession revenue contract. Staff concurred with 14 out of 15 (93%) recommendations and partially concurred with one. Action plans have been implemented to address all recommendations.

Internal Audit extends its appreciation to the Community & Recreation Services, Finance, Human Resources, and Information Technology Department staff that assisted throughout the audit.

Attachment

CC: Diane Arthur, Marketing & Communications Director
Mark Coronado, Community & Recreation Services Director
Lindsey Duncan, Finance Director
Mark Schott, Human Resources Director
Robert Wingo, City Attorney



SURPRISE

ARIZONA

Stadium Concessions Revenue Contract

Internal Audit Report No. 2016-2

February 22, 2016

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I. BACKGROUND



The Surprise Stadium (Stadium) is located at the Surprise Recreation Campus athletic facility. Designed by HOK Sport, the Stadium officially opened in December 2002 with over 10,000 facility seats. The Stadium features a 360-degree concourse with a constant field view, six suites, numerous party and group pavilions, club seating, as well as an oasis of lawn seating. The concession design

includes four permanently fixed concession stands with options for additional points of sale.

The Stadium serves as the spring training home for Major League Baseball's Texas Rangers and Kansas City Royals and home of the Arizona Fall League's Surprise Saguaros. The Stadium host little league, high school, and college sports tournaments. When not used for sporting events, the Stadium serves as a venue for special events (kid-friendly Movie Nights, Fourth of July fireworks celebration, and other activities).

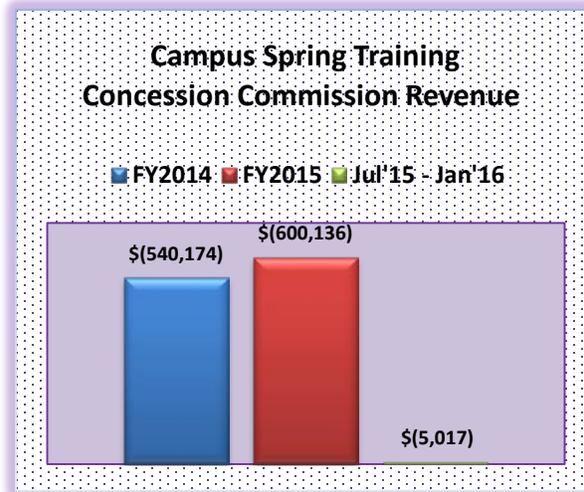
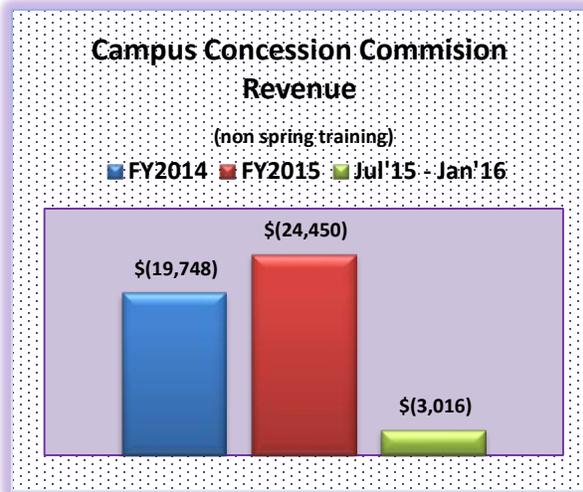
On March 13, 2013, the Community and Recreation Services Department (CRS), cooperatively with the Finance Department, issued a comprehensive Request for Proposal (RFP) for Stadium concessions. The City of Surprise (City) received four responses to the RFP. Through the evaluation criteria in the solicitation, one vendor was determined to have the requirements and overall best offer needed for the City to award the contract. City Council authorized the award of the contract on June 25, 2013.

The term of the contract commenced on July 1, 2013 and shall continue for a period of nine-year term with a two three-year option to extend for a total of fifteen years. The contract included the following:

- ✚ \$2 million dollar grant for capital upgrades
- ✚ \$775,000 investment on food and beverage merchandise equipment and enhancements
- ✚ \$10,000 annual sponsorship



Since July 1, 2013, the City has received over \$1.1 million in concession commission revenue, as summarized in the following charts:



II. OBJECTIVES AND SCOPE

As part of the City Manager approved FY2016 Annual Audit Plan, in January 2016 the Internal Auditor commenced with an audit of the Stadium Concessions Revenue Contract. The objective of the audit was to determine whether adequate internal controls were in place to accurately and timely, identify, report, collect, and safeguard Stadium concession commission revenues.

The scope of the audit was for the period July 1, 2013 to December 31, 2015. Procedures included:

- ✚ Interviews with City staff
- ✚ Review of internal policies and procedures
- ✚ Review of the Master Concessionaire Services contract
- ✚ Review of reports, spreadsheets, forms, and other documents supporting concessions revenue calculations
- ✚ Review and observation of the procedures for processing and safeguarding of concession payments
- ✚ Review of the certificate of insurance

III. CONCLUSION

The department has an understanding of the importance and need for strong effective internal controls over safeguarding City assets and have demonstrated this by moving forward with implementing changes throughout the process of the audit. The integrity of CRS staff has contributed to the current level of safeguards that are in place to protect City assets. The audit recommendations provide additional opportunities to enhance and strengthen current operational controls and to reduce the potential for fraud, waste or abuse of City assets.

Based upon the audit test results, interviews, and observations conducted by Internal Audit, sufficient evidence was not available to support an opinion as to whether or not all commission revenues due to the City were received. While the results of the audit did not identify any known evidence of fraud or misappropriation, opportunities to strengthen and enhance internal controls over managing the contract, decreasing the City's exposure to liability, and protecting cash receipts were identified.

Internal Audit appreciates the collaborative effort that management and staff provided throughout the course of the audit process.

IV. DETAILED OBSERVATIONS

Section 1 – Cash Handling

Opportunities exist to strengthen cash-handling controls to enhance security over cash and protect staff.

CRITERIA

The citywide Cash Handling Policies and Procedures provide City departments with a set of best practice guidelines for handling cash and cash equivalents to minimize the opportunity for mismanagement or theft of cash.

CONDITION

As of January 31, 2016, the City has received over \$1.1 million in concession commission revenue related to the contract. The CRS Sports Tourism and Events Division Manager receives and records the commission checks on the daily Mail Log and forwards all checks to the Administrative Technicians for posting in the CLASS system. The Customer Service Specialist (CSS) consolidates the payments with all remote CRS sites' daily deposits. Two support staff verify and place the consolidated deposit in the CRS safe until it is picked up by the armored service for delivery to the bank.

On February 3rd and 4th of 2016, the Internal Auditor observed the procedures for processing commission checks. The observation primarily focused on activities that might affect the safety of commission revenue payments and did not include a comprehensive review of CRS cash handling procedures. The following opportunities to enhance and strengthen controls over safeguarding commission payments were discussed with staff:

- ✚ Securing and limiting access to mail, funds, forms, and keys
- ✚ Adequately segregating duties
- ✚ Enhancing physical barriers and video surveillance in cash handling areas
- ✚ Implementing dual custody or mitigating processes that include a clear and unbroken chain of custody when handling cash
- ✚ Replacing the manual lock on the safe closet door with an electronic lock or initiating the use of a log to monitor access to the safe
- ✚ Providing annual cashing handling training to applicable staff

CAUSE

Adequate cash handling policies and procedures with applicable mitigating controls where resources are limited have not been implemented.

RISK

Cash variances or irregularities may go undetected and result in lost or misappropriated City assets.

RECOMMENDATIONS

CRS:

- A. Enhance controls over cash handling to safeguard cash and personnel by addressing the opportunities identified during the audit, to include but not limited to:
 - ✚ Complying with all citywide Cash Handling Policies and Procedures
 - ✚ Adequately segregating duties to prohibit one individual from having control over an asset and its related documentation
 - ✚ Implementing compensating controls over processes when limited by resources, such as reconciling daily cash registers at the end of the day in dual custody and management periodically reconciling daily deposits to bank statements and financial records
 - ✚ Providing the necessary cash handling training to staff handling cash
 - ✚ Adding adequate video surveillance cameras in areas where cash is handled and processed
 - ✚ Implementing procedures to secure forms, mail, keys, and cash at all times
 - ✚ Developing adequate procedures to report and monitor cash variances
- B. Assess the feasibility of adding an electronic key pad to control and monitor access to the safe closet or develop compensating controls, such as a manual log, to monitor access to the safe closet.

MANAGEMENT RESPONSES

- A. Concur. CRS will enhance controls over cash handling to safeguard cash and personnel. CRS respects the importance of the cash handling policy and will strive to comply with segregating duties to prohibit one individual from having control over an asset and its related documentation. Currently, due to current staffing levels /budget restraints, CRS may need a customer service specialist to cover absences at the front desk. CRS does not wish to assume the risk and will move forward during the budget process to provide documentation to support a request for additional staff or part time hours to maintain segregation of duties. Cash handling policy has been shared with all managers and supervisors in the department. Awaiting training to be rolled out by Finance Department to all staff handling cash. Estimated completion date unknown. The storage with unopened mail containing checks was moved inside the Division Manager's office. The key for the locked drawer containing deposit forms, deposit bags, the safe key and spare bag keys is now secured with the FSS and the CSA rather than a general location. The Daily Deposit form has been modified to include variances. All variances are tracked and managers are now notified.
- B. Concur. An electronic key pad was added to the safe closet on April 5, 2016.

The timely preparation of daily deposits will decrease the amount of cash stored onsite overnight.

CRITERIA

Section 20.e. of the citywide Cash Handling Policies and Procedures prepared by the Finance Department state that “deposits must be prepared and deposited daily”.

CONDITION

The City has contracted with an armored guard service to deliver daily deposits to the bank. The CSS receives processed commission payments and daily receipts from remote CRS locations and prepares one consolidated deposit on the following business day.

A review of the armored guard service log identified 31 consolidated CRS deposits totaling over \$58,300 for the month of December 2015. The business date of deposits and the armored service pick updates were compared to the deposit dates reflected on the City’s December 2015 and January 2016 bank statements. The analysis determined that it takes two to four business days from the date of receipt for deposits to reach the bank.

During the February 4, 2016 observation of the deposit preparation, the CSS had to delay the completion of the deposit preparation to contact two remote CRS locations for deposits and /or supporting paperwork.

CAUSE

Daily deadline times for receiving remote site deposits and preparing consolidated deposits have not been established and communicated to staff.

RISK

A delay in depositing funds increases the amount cash on hand and decreases the available cash in the bank to meet daily operating expenses.

RECOMMENDATION

CRS:

- A. Establish and communicate deadline times for completing daily deposits to make sure that deposits reach the bank in a timely manner. The policy should include:
- ✚ Identifying a deadline time for remote sites to deliver funds and supporting paperwork to the Customer Service Specialist
 - ✚ Requiring the Customer Service Specialist to complete the prior days deposit consolidation prior to the arrival of the armored guard service
 - ✚ Ensuring that a daily deposit is made when funds are received

MANAGEMENT RESPONSE

- A. Concur. CRS will establish and communicate deadline times for completing daily deposits to be dropped off to ensure that deposits can reach the bank in a timely manner. Deadline of 9 am Monday - Friday has been added to the CRS cash handling process. CRS contacted Finance to see if the armored service schedule could be modified to accommodate a later pick-up time as they may arrive as early as 9:30 am. Unfortunately, their schedule cannot be modified. CRS will continue to strive to complete the deposit before their arrival.

Section 2 – Commission Revenues

Audited sales reports are not used to confirm the accuracy of commissionable sales reported by the Vendor.

CRITERIA

The “Accounting, Reports, and Payments” section of the RFP stipulates that “itemized audited, performance and summary sales reports shall be provided at the end of each budget year”.

A best practice is to include a right-to-audit clause in commission based revenue contracts.

CONDITION

The Vendor provides CRS with monthly commission spreadsheets that summarize Stadium sales and commission revenue payable to the City. CRS staff reviews the spreadsheets for accuracy and completeness. Discrepancies are resolved with the Vendor. For the period of July 1, 2013 to December 31, 2015, the spreadsheets reflected a total of \$1.7 million in commission revenues that were due to the City. The monthly spreadsheets are not certified as audited to attest to the validity of Stadium sales and commission revenue. No supporting documentation is provided by the Vendor to validate the completeness and accuracy of the reported concession sales. The below table summarizes the commission revenue for the period:

Fiscal Year	Food/Beverages (Non-Spring Training)	Food/Beverages (Spring Training)	Suite/Catering	Retail	Sub-Contractors	Total
FY2014	\$14,754	\$ 495,558	\$ 6,635	\$297,329	\$32,311	\$ 846,587
FY2015	\$14,667	\$ 550,761	\$ 8,328	\$305,020	\$38,546	\$ 917,322
7/1/15 - 12/31/15	\$ 1,521	-	\$ 85	-	\$ 411	\$ 2,017
Total	\$30,942	\$1,046,319	\$15,048	\$602,349	\$71,268	\$1,765,926

The Vendor provides CRS with annual performance and summary sales reports that includes recommendations to improve service quality and increase sales. The annual performance reports are not referenced as “audited” to indicate compliance with the RFP “Accounting, Reports, and Payments” terms and conditions. The annual performance reports are not summarized in a manner that will allow CRS to use the reports as a source for verifying the accuracy of the monthly commission spreadsheets.

CAUSE

CRS staff rely upon the integrity and competency of the Vendor to provide accurate and complete revenue information.

Certified audited sales reports are not explicitly required in the RFP.

RISK

- ✚ Revenue-based commissions received may not be accurate or complete
- ✚ Potential loss of revenue
- ✚ Lack of accountability
- ✚ Inability to verify and validate the revenue paid to the City

RECOMMENDATIONS

CRS:

- A. Ensure that the Vendor provides annual sales reports that are certified by a public accountant.
- B. Reconcile monthly commission payments to the annual certified audited sales reports to ensure all commission revenue is received.

Finance:

- C. Considered including a provisional right-to-audit clause in revenue-based contracts. The provision should include, but not limited to:
 - ✚ Maintaining financial and related records for a specified number of years
 - ✚ Making sales records readily available to the City upon request
 - ✚ Requiring contractors to provide timely audited documentation that support revenue payments to the City.

MANAGEMENT RESPONSES

CRS:

- A. Concur. CRS will meet with the Vendor to discuss by October 31, 2016.
- B. Concur. Once the Vendor agrees to provide annual sales records that have been certified by a public accountant, CRS will reconcile to those to ensure City is receiving amount owed.

Finance:

- C. Concur. Though the standard terms and conditions contain a right-to-audit clause, the scope of work does not explicitly require the end of budget year itemized audit and performance and sales reports to be certified by a Certified Public Accountant. A more comprehensive audit clause with the provisions listed will be drafted for review by the City Attorney for incorporation into the Standard Terms and Conditions and revenue-based contracts language. The revised documents will be made available for City Staff and vendors on the Finance Department/Procurement Division internal and external websites by December 31, 2016. The Procurement Manager will provide training on the revised terms and conditions, and their inclusion into contracts, to applicable City staff by April 1, 2017.

Clarification on how to apply the annual Consumer Price Index to commission tiers is required to ensure the City's commission revenues are not diminished.

CRITERIA

Section 6, Commissions, of the contract requires all commission tiers to be adjusted annually by the Consumer Price Index (CPI).

CONDITION

The Master Concessionaire Service RFP establishes a two-tier methodology for calculating Spring Training Stadium concession revenues. The City is paid commission on concession sales based upon the approved tier level of concession sales multiplied by the applicable tier commission rate.

During the audit, a review of the commission rates used in the monthly commission spreadsheets determined that commission tiers are not adjusted annually. The Vendor is in the process of complying with the RFP by annually adjusting each dollar level tier of concession sales. No plans are in place to adjust the percentage tier rates. This approach will have the effect of diminishing the commission revenue received by the City.

CAUSE

The contract terms do not concisely define how to apply the annual CPI adjustment.

RISK

As the dollar tiers are annually adjusted by the CPI, the City will experience diminishing commission revenue.

RECOMMENDATIONS

CRS:

- A. Clarify with the Vendor the application of the annual CPI adjustment. A contract amendment should be executed to effectively document the resolution and to protect the City's interest.

Finance:

- B. Ensure that contract terms explicitly address how CPI adjustments are calculated.

MANAGEMENT RESPONSES

CRS:

- A. Concur. CRS will meet with the Vendor before October 31, 2016 to clarify the annual CPI adjustment. CRS will work with the Procurement Department to amend the language in the contract.

Finance:

- B. Concur. Section 6 of contract amendment 1 does not provide sufficient detail on how the commission tiers are CPI adjusted annually. Procurement will work with CRS and the Vendor to clarify how the annual CPI adjustment is applied. A contract amendment will be executed that incorporates the clarification. Though the timeline for this plan is impacted by the response time of the contractor, it is anticipated that the amendment be completed no later than August 31, 2016. Detailed CPI language will be incorporated into new contracts and solicitations as applicable.

City revenue generating contracts should include a penalty clause to deter vendors from making late payments.

CRITERIA

The “Accounting, Reports, and Payments” section of the approved Request for Proposal requires the issuance and receipt of a settlement check no later than ten days after the settlement month ends.

CONDITION

The Vendor provides CRS with monthly and annual commission spreadsheets itemizing commissionable sales and revenues. The CRS staff reviews, reconciles and compares the monthly spreadsheets to commission payments. A review of the spreadsheets and settlement checks received for the commission periods of July 1, 2013 to December 31, 2015 determined that checks for 23 out of 29 (79%) months were dated and received 2-19 days after the due date. Late payments are not assessed a late fee.

CAUSE

The RFP does not include the assessment of a late fee as an incentive for the timely payment of concession commissions.

RISK

-  Opportunity loss on potential to earn interest on late commission payments
-  Noncompliance with contract terms

RECOMMENDATIONS

CRS:

- A. Work with the Vendor to ensure that payments are received in a timely manner and in compliance with the contract.
- B. Work in conjunction with the Finance Department to ensure that all future CRS revenue RFPs include a penalty clause to deter vendors from making late payments.

MANAGEMENT RESPONSES

- A. Concur. CRS will meet with the Vendor before October 31, 2016 to review payment terms of the commission checks.
- B. Concur. CRS will work with the Procurement Department to add penalty clause to future revenue RFP's.

Section 3 – [REDACTED]

[REDACTED]

CRITERIA

[REDACTED]

[REDACTED]

CONDITION

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

CAUSE

[REDACTED]

RISK

[REDACTED]

RECOMMENDATIONS

[REDACTED]

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MANAGEMENT RESPONSES

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CRITERIA

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CONDITION

[REDACTED]

[REDACTED]

[REDACTED]

CAUSE

[REDACTED]

RISK

[REDACTED]

[REDACTED]

[REDACTED]

RECOMMENDATION

[REDACTED]

[REDACTED]

MANAGEMENT RESPONSE

[REDACTED]

Section 4 – Insurance Compliance

Increasing the insurance liability coverage to \$2 million will comply with the terms and conditions of the contract.

CRITERIA

Section 12 (Insurance Requirements) of the Master Concessionaire Services RFP established a \$2 million minimum general aggregated limit for the contract.

CONDITION

A certificate of insurance (COI) provides verification and proof of insurance types, limits of coverage, policy effective periods, name of insured, and other informative information about insurance obtained by third parties contracted with the City. The current COI for the contract expires on October 1, 2016. A review and comparison of the COI against the terms and conditions of the contract and applicable City policies identified the following:

	<i>Requirement</i>	<i>Observation</i>	<i>Opportunity</i>
A	Section 12.a.i. (Insurance Requirements) of the Master Concessionaire Services RFP requires a general aggregated liability coverage of \$2 million.	The general aggregate limit for the COI is "None".	The vendor should comply with the contract and limit the City's exposure to risk by increasing the insurance limit.
B	Section 12.a.i. (Insurance Requirement) of the Master Concessionaire Services RFP requires the following additional insured language added to the policy: <i>"The City of Surprise, its departments, agencies, boards, commissions, officers, officials, agents, and employees shall be named as additional insured with respect to liability arising out of the activities performed by or on behalf of the Contractor"</i> .	The COI does not reflect the required additional insured language.	CRS should work with the Risk Management Division and any additional departments to assess the necessity of the additional language and take any applicable actions to correct the issue.
C	Article IX, Section 2-356(e) of the City Code requires all successful bidders for contracted services to provide the City with an appropriate COI that limits the City's potential liability related to actions performed by a contractor on City property.	The current COI reflects a maximum liability coverage amount of \$1 million. This is insufficient and does not meet the \$2 million RFP requirement.	CRS should ensure the COI complies with the minimum City requirements. The Risk Management Division should review and approve any COI exceptions.
D	The Guidelines for Certificates of Insurance (Guideline) policy identifies what to include in the COI, designates the Risk Management Division as the recipient of the document, and requires the Risk Manager to review any exceptions that do not meet the minimum insurance coverage.	The Risk Management Division did not review and approve the COI. The Guideline is the citywide matrix utilized by the Procurement Division. It was last updated in 2008.	The Risk Management Division should review and approve the COI. The Risk Management Division should periodically review and update the Guideline.
E	The Risk Management Division has established 16000 N. Civic Center as the preferred address for all COI documents.	The address on the COI is 15850 N. Bullard Avenue.	CRS should have the COI address updated.

CAUSE

Updated citywide insurance policies and procedures are not in place to provide staff with the necessary training and guidance to aid and direct in obtaining the necessary City insurance requirements.

RISK

Inadequate insurance coverage exposes the City to liability, risk, and loss.

RECOMMENDATIONS

CRS:

- A. Reduce the City's potential exposure to liability by ensuring compliance with observations identified in the above table.

Human Resources:

- B. Review and update the citywide COI policies and procedures to include, but not limited to:
 - ✚ Accessing the adequacy of the current insurance matrix limits utilized by City departments to ensure sufficient coverage is provided
 - ✚ Ensuring coverage limits are based upon amount, services provided, and other applicable risk indicators, as necessary
 - ✚ Ensuring that all COI that do not meet the minimum requirements are forwarded to the Risk Management Division for review and approval
 - ✚ Inclusion of applicable and required insurance language to guarantee the City is adequately covered
 - ✚ Referencing the applicable City address
 - ✚ Providing periodic training on policies and procedures to ensure compliance

MANAGEMENT RESPONSES

CRS:

- A. Concur. CRS will meet with the Vendor by October 31, 2016 and discuss insurance coverage.

Human Resources:

- B. Partially Concur. The central contact for all Contracts/Agreements is the Procurement Section of the Finance Department, which has recently started training employees on related topics, "Procurement U". Ideally, the Procurement Manager should continue with training and provide refresher training at least every three years. The Risk Manager is currently working with the Procurement Manager to update EPM 8.2 Purchasing, which will include minimum thresholds required for insurance coverage. This policy will also direct employees to standard Procurement Department forms that include appropriate language regarding insurance and indemnification requirements, which have been approved by the City Attorney. The updated EPM will address the first five identified areas and the final suggestion will continue to be the responsibility of the Procurement Manager. Contingent on content provided by the Procurement Department, any new Employee Policy Manual Standards or amendment to existing Employee Policy Manual Standards will tentatively be completed by September 30, 2016.