

INTERNAL AUDIT REPORT

2016-05

Harry J. McDonald Memorial Center

Parks and Recreation Department

September 29, 2016

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Municipality of Anchorage

Ethan Berkowitz, Mayor

Internal Audit Department

September 29, 2016

Honorable Mayor and Members of the Assembly:

I am pleased to present for your review **Internal Audit Report 2016-05, Harry J. McDonald Memorial Center, Parks and Recreation Department**. A brief summary of the report is presented below.

In accordance with the 2016 Audit Plan, we have completed an audit of the Harry J. McDonald Memorial Center, Parks and Recreation Department. The objective of this audit was to determine if Fire Lake Arena Management, Inc. (Contractor) was in compliance with the contract requirements. Specifically, we determined if the Contractor submitted its budget and expenditures for approval; if the Contractor was in compliance with the contract's insurance and bond requirement; if the Contractor provided reports and documents required by the contract; if the Contractor paid reserve account payments to the reserve account required by the contract; if the Contractor was in compliance with the contract's requirement for controlling properties; and if the Contractor was in compliance with other pertinent contract requirements.

Our audit revealed that the Contractor had not complied with some of the contract's requirements. Specifically, the Contractor did not remit to the Municipality the 2013 and 2015 net profits, did not always timely submit monthly reserve account payments, and had not performed an annual inventory, tagged property with Municipal asset tags, nor submitted a current inventory listing to the Municipality. In addition, the Contractor did not obtain prior written approval from the Municipality for some expenditures that were not contained in the approved budget, paid professional services in excess of \$10,000 without prior written approval from the Municipality, and did not always comply with the contract's subcontracting requirements. Finally, the Contractor did not submit to the Municipality an annual operating budget for approval by July 1 of the preceding calendar year, incorrectly recorded a barter transaction in their financial system, and the Contractor's current comprehensive/general liability, excess liability, and commercial automobile liability policy did not contain a waiver of subrogation against the Municipality.

There were nine findings in connection with this audit. Management was responsive to the findings and recommendations.

Michael Chadwick, CICA
Acting Director, Internal Audit



Municipality of Anchorage

Ethan Berkowitz, Mayor

Internal Audit Department

September 29, 2016

Internal Audit Report 2016-05
Harry J. McDonald Memorial Center
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Introduction. The Harry J. McDonald Memorial Center (Center) is a facility that has an Olympic-size ice rink, a multi-use turf field, a two-lane walking/jogging track, and two community meeting rooms. The Center is owned by the Municipality of Anchorage (Municipality) and managed by Fire Lake Arena Management, Inc. (Contractor), a non-profit company formed in 1983 solely to manage the Center since 1984. According to the contract between the Municipality and the Contractor, effective January 2011, the Contractor assumed responsibility for all aspects of the Center's operations, scheduling, marketing, promotion, ticket sales and revenue collection, costs accounting, and maintenance. The Contractor remits to the Municipality the Center's net profit and six percent of gross revenues. The Municipality deposits these funds into a capital reserve fund maintained by the Municipality. As of August 2016, the reserve account balance was \$794,173. The contract is administered by the Eagle River/Chugiak Parks and Recreation Division of the Parks and Recreation Department (Department).

Objective and Scope. The objective of this audit was to determine if the Contractor was in compliance with the contract requirements. Specifically, we determined if the Contractor submitted its budget and expenditures for approval; if the Contractor was in compliance with the contract's insurance and bond requirement; if the Contractor provided reports and documents required by the contract; if the Contractor paid reserve account payments to the reserve account required by the contract; if the Contractor was in compliance with the contract's requirement for controlling properties; and if the Contractor was in compliance with other pertinent contract requirements.

The audit was conducted in accordance with generally accepted government auditing standards, except for the requirement of an external quality control review, and accordingly, included tests of

accounting records and such other auditing procedures as we considered necessary in the circumstances. The audit was performed during the period of May through June 2016. The audit was requested by the Administration.

Overall Evaluation. The Contractor had not complied with some of the contract's requirements. Specifically, the Contractor did not remit to the Municipality the 2013 and 2015 net profits, did not always timely submit monthly reserve account payments, and had not performed an annual inventory, tagged property with Municipal asset tags, nor submitted a current inventory listing to the Municipality. In addition, the Contractor did not obtain prior written approval from the Municipality for some expenditures that were not contained in the approved budget, paid professional services in excess of \$10,000 without prior written approval from the Municipality, and did not always comply with the contract's subcontracting requirements. Finally, the Contractor did not submit to the Municipality an annual operating budget for approval by July 1 of the preceding calendar year, incorrectly recorded a barter transaction in their financial system, and the Contractor's current comprehensive/general liability, excess liability, and commercial automobile liability policy did not contain a waiver of subrogation against the Municipality.

FINDINGS AND RECOMMENDATIONS

1. **Net Profit Not Remitted in 2013 and 2015.**

- a. **Finding.** The Contractor did not remit to the Municipality the 2013 and 2015 net profits. Specifically, our analysis of the Contractor's audited annual financial reports showed a total net profit of \$59,185 from 2011 through 2015. In 2013, the Contractor's audited annual financial report stopped including the net profit "Due to Municipality of Anchorage." According to the Contractor, they decided to keep the net profit for the Center's operation since the Municipality stopped providing an operating subsidy in 2013. However, the part of the contract regarding payments to the reserve account and the operating subsidy from the Municipality has remained unchanged since the contract was signed in 2011.

The contract states that the Contractor may negotiate an incentive fee based on net operating income if the Center produces an audited year end net profit. However, since an incentive was not negotiated in 2013 and 2015, the adjusted net profit of \$30,022 should have been remitted to the Municipality as shown in the below table. According to the Department Director, these funds have historically been placed in the reserve account.

| Net Profit 2011 – 2015 | | | | | | | |
|-----------------------------------|-------------------------------------|---|--|---|--|-----------------------------------|---|
| | <u>Net Profit</u> ^{Note 1} | | <u>Net Profit Remitted to Municipality</u> | = | <u>Net Profit Owed to Municipality</u> | <u>Net Loss</u> ^{Note 2} | <u>Municipality Subsidy</u> ^{Note 3} |
| 2011 | \$ 0 | - | \$0 | = | \$ 0 | (\$20,837) | \$ 50,000 |
| 2012 | \$ 0 | - | \$0 | = | \$ 0 | (\$30,907) | \$ 50,000 |
| 2013 | \$ 8,907 | - | \$0 | = | \$ 8,907 | \$ 0 | \$ 0 |
| 2014 | \$ 0 | - | \$0 | = | \$ 0 | (\$131,809) | \$ 75,000 |
| 2015 | <u>\$50,278</u> | - | <u>\$0</u> | = | <u>\$ 50,278</u> | <u>\$ 0</u> | <u>\$ 0</u> |
| Totals: | \$59,185 | - | \$0 | = | \$ 59,185 | (\$183,553) | \$175,000 |
| | | | | | Less repayment of 2011 subsidy ^{Note 4} : | (\$ 29,163) | |
| | | | | | Amount Owed to the Municipality: | \$ 30,022 | |

Source: Auditor analysis of the Contractor's annual audited financial reports.

Note 1: Net profit does not include the operating subsidy from the Municipality.

Note 2: In 2014 the Center's ice rink was renovated.

Note 3: The 2012 subsidy less the net loss appears to have been carried over to subsequent years. It was not returned to the Municipality. According to the Department Director, the 2011, 2012, and 2014 subsidies were not subject to repayment.

Note 4: In 2013, the Contractor paid \$13,211 to the Municipality as part of a reconciliation of payments owed from 2007 through 2011. This amount included a payment of \$29,163 for the 2011 repayment of the Municipal subsidy less the net loss. According to the Department Director, this subsidy was not subject to repayment.

In addition, from 2010 to 2015 the Contractor's account receivables balance increased 287 percent, from \$30,848 to \$119,316. As a result, the Contractor may not have the necessary cash on hand to pay the net profit due to the Municipality.

- b. **Recommendation.** The Contract Administrator should ensure that the Contractor remits to the Municipality the audited year-end net profit.
- c. **Management Comments.** Management stated, "Concur. Contract Administrator shall contact FLAMI and Center Manager for collection and deposit to reserve account the unpaid amount of \$30,022."
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

2. **Monthly Reserve Account Payments Not Always Paid Timely.**

- a. **Finding.** The Contractor did not always timely submit monthly reserve account payments. Appendix A, Section 11, *Reserve Account* of the contract states "Contractor shall deposit Six Percent (6%) of Gross Revenues collected during any calendar month in the Reserve Account within twenty (20) days after the end of the prior month unless directed otherwise, in writing, by the Administrator." For example, the February 2013 reserve account payment was due March 20, 2013; however, the Contractor submitted the payment on November 8, 2013, 233 days late. The Contractor also did not timely submit reserve account payments for October, November, and December 2015, until March 12, 2016, and reserve account payments for January and February 2016, were not submitted until April 11, 2016.
- b. **Recommendation.** The Contract Administrator should ensure that the Contractor complies with the contract's reserve account deposit requirements.

- c. **Management Comments.** Management stated, “Concur. Contract Administrator shall be diligent in ensuring contractor meets reporting and payment schedules for collection and deposit.”
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

3. **Annual Inventory Not Performed.**

- a. **Finding.** The Contractor had not performed an annual inventory, tagged property with Municipal asset tags, nor submitted a current inventory listing to the Municipality. For example, some recently purchased items, such as three new desktop computers with monitors and a large tool cabinet, were not tagged with the Municipality’s asset tags and were not included in the PeopleSoft fixed asset listing. Appendix A, Section 15, *Control of Property*, of the contract states “Contractor shall control and account for all property belonging to Anchorage and shall maintain a current inventory of Facility property. Contractor shall perform a yearly physical inventory and submit to Anchorage by August 15 of all Municipal-owned property. Contractor shall implement the tagging and inventory procedures established by the Municipality for the tracking of controlled property.”
- b. **Recommendation.** The Contract Administrator should ensure that the Contractor complies with the contract’s inventory and tagging requirements and maintains a current inventory listing.
- c. **Management Comments.** Management stated, “Concur. Contract Administrator shall coordinate a comprehensive asset inventory to update all records to ensure compliance and accuracy no later than 12/31/16.”

- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

4. **Some Expenditures Not Approved.**

- a. **Finding.** The Contractor did not obtain prior written approval from the Municipality for some expenditures that were not contained in the approved operations budget. For example, in 2015:

- The Contractor incurred \$12,266 for overtime expenses although the approved overtime budget was \$0.
- The Contractor incurred \$5,832 for accrued vacation expenses although the approved accrued vacation expenses budget was \$0.
- The Contractor spent \$4,001 for computer supplies although the approved computer supplies budget was only \$600.

The contract requires prior written approval from the Contract Administrator for any expenditure not contained in the approved operations budget.

- b. **Recommendation.** The Contract Administrator should ensure that the Contractor obtains written approval from the Contract Administrator for any expenditure not contained in the approved operations budget.
- c. **Management Comments.** Management stated, “Concur. Contract Administrator shall impose tighter oversight to ensure contractor meets requirements for budget deviation submittals and approvals.”
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

5. **Professional Service Contracts Not Approved.**

- a. **Finding.** The Contractor paid professional services in excess of \$10,000 without prior written approval from the Municipality. The contract requires the Contractor to obtain prior written approval of the Contract Administrator for professional services and auditing firm subcontracts costing more than \$10,000. Specifically, from 2011 to 2013, the Contractor paid \$28,451 to one vendor who provided auditing and accounting services. From 2014 to 2015, the Contractor paid \$17,500 to another vendor who provided auditing and accounting services. According to the Contractor, there were no written contracts for these services.
- b. **Recommendation.** The Contract Administrator should ensure that the Contractor comply with the contract for professional services costing more than \$10,000.
- c. **Management Comments.** Management stated, “Concur. Contract Administrator shall ensure Contractor complies and that all accounting and audit service contracts are approved and on file prior to execution.”
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

6. **Subcontractor Requirements Not Always Followed.**

- a. **Finding.** The Contractor did not always comply with the contract’s subcontracting requirements. Specifically, we found the following;
 - *Subcontractor Hired without the Municipality’s Written Approval* - The Contractor did not submit a copy of the contract to the Municipality for prior approval when a subcontractor was hired for the Center’s in house advertising sales. In 2015, the subcontractor was paid \$12,175. Section 9,

Subcontracts and Assignments, of the contract states “. . . the Administrator shall be notified and provided copies and shall approve in writing any subcontract exceeding Ten Thousand Dollars (\$10,000) prior to the entry of any such agreement.”

In another case, the Contractor entered into an agreement to hire a subcontractor for its concession services. The Contractor did not submit a copy of the contract to the Municipality for prior approval. Appendix C, 7, *Concessions*, of the contract states “If a sub-contractor is utilized, it will be with prior permission of the Municipality.”

- *Subcontracts Did Not Contain Non-discrimination Language* - Contracts with subcontractors did not contain the non-discrimination language required in the contract between the Contractor and the Municipality. Section 9 of the contract requires this language.
- *No Annual Report* - The Contractor did not provide the Municipality by January a written annual report detailing all subcontracts and their related expenses and revenues from the previous year. Section 9, *Subcontracts and Assignments*, of the contract states “Contractor shall provide to Anchorage annually by January 31 a written report detailing all subcontracts and their related expenses and revenues from the previous year.”

- b. **Recommendation.** The Contract Administrator should ensure that the Contractor complies with the contract’s subcontracting requirement.
- c. **Management Comments.** Management stated, “Concur. Contract Administrator shall ensure Contractor is compliant with all subcontracting requirements.”

- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

7. **Annual Budget Submitted Late.**

- a. **Finding.** The Contractor did not submit to the Municipality an annual operating budget for approval by July 1 of the preceding calendar year. Appendix A, Section 1, *Operations Budgets*, of the contract states “Operation budgets will be submitted in writing yearly for approval by the Municipality no later than July 1 of the preceding calendar year. Submitted budgets shall be negotiated so that approval is made by October 15 of the year submitted.” Specifically, the 2015 operating budget was not submitted for approval until January 21, 2015, and the Contractor submitted the 2016 operating budget on April 12, 2016, as part of the Center’s January, February, and March 2016 monthly financial reports to the Municipality.
- b. **Recommendation.** The Contract Administrator should ensure that the Contractor submits its operation budget for approval by the Municipality no later than July 1 of the preceding calendar year as required by the contract.
- c. **Management Comments.** Management stated, “Concur. Contract Administrator shall ensure Contractor meets contract requirements for operating budget submittal, reviews, and approval.”
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

8. **Barter Transaction Incorrectly Recorded.**

- a. **Finding.** The Contractor incorrectly recorded a barter transaction in their financial system. Specifically, in 2013 and 2014, a vendor provided the Contractor advertising

time worth \$10,000. In return the vendor received banner advertising in the Center. The Contractor created a \$10,000 invoice in their financial system. However, the Contractor never created an offsetting bill from the vendor for the \$10,000. As a result, the Contractor's net profit was overstated by \$10,000.

- b. **Recommendation.** The Contract Administrator should ensure that the Contractor accurately records barter transactions in their financial system.
- c. **Management Comments.** Management stated, "Concur. Contract Administrator shall ensure Contractor follows accounting principles for recording any/all non-typical financial transactions."
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

9. **Insurance Requirement Not Met.**

- a. **Finding.** The Contractor's current comprehensive/general liability, excess liability, and commercial automobile liability policy did not contain a waiver of subrogation against the Municipality. Section 8.D, *Insurance*, of the contract states "Anchorage must be listed as an additional insured on all policies (except Professional Liability and Worker's Compensation) and such policies shall contain a waiver of subrogation against Anchorage." Lack of adequate insurance coverage could increase the risk of potential liability issues for the Municipality.
- b. **Recommendation.** The Contract Administrator should ensure that the Contractor is in compliance with the contract's subrogation insurance requirements.
- c. **Management Comments.** Management stated, "Concur. Contract Administrator shall ensure all contract insurance requirements are met and on file."

- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

Discussion With Responsible Officials. The results of this audit were discussed with appropriate Municipal officials on August 12, 2016.

Audit Staff:
Scott Lee