

**AUDIT/FINANCE COMMITTEE
SEPTEMBER 18, 2018
MEETING MINUTES**

After determining that a quorum is present, the Audit/Finance Committee of the City of Denton, Texas, convened for a regular meeting on September 18, 2018, at 10:30 a.m., in the City Hall Conference Room, at City Hall, 215 E. McKinney Street, Denton, Texas

PRESENT: Mayor Chris Watts, Council Member John Ryan, and Council Member Paul Meltzer.

STAFF PRESENT: Bryan Langley, Deputy City Manager/COO; Mario Canizares, Assistant City Manager; Larry Collister, First Assistant City Attorney, Antonio Puente, Jr., Director of Finance; David Gaines, Assistant Finance Director, Kevin Ann Mullen, Treasury Manager; Harvey Jarvis Controller, Brian Hogan, Assistant Controller, Cody Wood, Assistant Controller, Umesh Dalal, City Auditor, William Mafi, Auditor, and Theresa Jaworski, Recording Secretary.

OTHERS PRESENT: John Manning and Kenton Lewis, with Patillo, Brown & Hill, Inc.

OPEN MEETING

Council Member and Committee Chair John Ryan brought the meeting to order at 10:30 a.m.

The following items were considered:

1. Hold a discussion and appoint a Chairperson for the Audit/Finance Committee.

Council Member Paul Meltzer made a motion to nominate John Ryan as the Chairperson for the Audit/Finance Committee. Mayor Chris Watts seconded the motion. Motion carried unanimously.

2. Consider approval of the Audit/Finance Committee Meeting Minutes of April 30, 2018.

Mayor Chis Watts motioned to approve the minutes followed by a second by Council Member Meltzer. Motion was approved unanimously.

3. Receive a report, hold a discussion, and give staff direction regarding the FY 2017-18 external financial audit to be conducted by Pattillo, Brown & Hill L.L.P.

Antonio Puente, Director of Finance, explained that the City Charter and State law require the City to have an annual external financial audit. Pattillo, Brown & Hill is the current external auditors for the City and this is the third year they have handled the external financial audit. Puente reminded the Committee that the external auditors report directly to the City Council and encouraged the Committee to ask any questions they may have about the audit. Puente followed by introducing John Manning with Pattillo, Brown, & Hill.

John Manning expressed his appreciation to the Committee for the opportunity to conduct the external audit for the City. With the interim work completed, he shared the objectives and purposes for the audit with the Committee, as well as their responsibilities in getting the process started for 2018. They will also address the opinions they offer, test of controls over areas they will look at, other control and compliance related procedures, internal control understanding and walk-throughs that are handled, and upcoming GASB standards. There will be a very brief explanation of the new financial reporting model and review 2018 calendar.

Manning introduced Kenton (Kent) Lewis, the supervisor over the City of Denton external audit, who will begin with the test of controls and then followed with outstanding GASB pronouncements.

Lewis shared with the Committee, the methods of working towards the end-goals, working through some of the risk assessments, planning procedures, and the GASB pronouncements. With this engagement, they will issue an opinion with four deliverables. There will be a reasonable assurance that the financial statements are materially correct, Government Audit Standards applicable for FY 2018, Federal and State Single Audits, and the SAS 114 Letter containing all required communications with governance.

Lewis continued with the Framework of Communications, breaking down the Planning, Performance and Completion. Lewis also pointed out the work coordination with the new City Auditor, on the methods for the test of controls and followed with the goal of risk assessments.

Manning went over the GASB pronouncements and the additional pronouncements over twenty years. There continues to be changes in the reporting model, processes on how we do the job, and things we look for at each audit engagement. This year, four new pronouncements will be effective as of June 30, for the 2018 audit, that will be applicable. Only one, the GASB Statement 75, will impact the City this year. GASB 75 reflects an overhaul in the standards for accounting and financial reporting for postemployment benefits other than pensions.

Manning explained that three years ago, the unfunded pension liability was added to the same site the assets were sent to at TMRS. The GASB folks came up with an actuarial applied liability over what they assess that is owed and that difference we're booking in the government-wide statements as a liability. This is for the post-employment benefit portion. They have figured out this is the health plan for retirees, what is estimated to cost and that liability is going to be put on the books this year as well. Very similar to the pension, when you issue a regular debt like a bond and build something, you have an asset and a liability to offset it. As you pay off the debt, the fixed asset depreciates so that they mirror each other. Essentially, these are just going to be liabilities with no offset.

That number will be a bigger number this year. Although that number has been in the report before GASB Statement 75, they changed a lot of provisions that only allow the use of one method in measuring this and how you measure the discount rate.

We wanted the City to know that's coming in. The City's doing all they can to have these figures available, so we don't anticipate a lot of problems with implementation of this standard, other than the impact to the financial statements. Starting January 1, 2018, you can no longer do an advance refunding where you can issue new debt at a lower rate, pay off old debt, place proceeds into a trust and pay the bonds off when they are callable. Now, with upcoming GASB Statement 84 fiduciary activities, the City currently has one agency fund so, this won't impact the City very much. Just a matter of moving that fund to a place where they deem it more appropriate. Nothing will change other than the reporting of that amount. 2021 will be a big one. The City had two types of leases, one operating and one capital. Capital lease is essentially taking ownership of that. Just like borrowing money from the bank, buying a fire truck, paying on it for five years and keeping it.

There were also leases with no indication that the City would keep the equipment, like copiers, recurring things that after four years, the vendor would just bring new copiers, and that involved just signing to continue that agreement. With GASB Statement 87, every lease would be treated similar to a capital lease. That would mean the asset would be put on and put the liability on, decrease the debt as those things get paid and amortize those as a regular capital asset. Unlike the OPEB liability, this one will offset with a capital asset instead of a straight hit of the equity at the bottom line.

Meltzer asked what the impact would be on the City.

Manning explained the leases on copiers, office equipment and things. There are footnotes for them but the impact is just in the income statement when the payments are made.

Meltzer asked if that changes anything else about the way the City is currently operating.

Manning advised the way payments are made and those arrangements in operations will be the same, it's just a matter of how they are kept on the books.

Meltzer asked if the changes affects bond rating to have bigger assets, bigger liability or just optics.

Manning confirmed, just optics. Mainly driven more by the corporate environment than government. There was criteria that needed to be in place for both and, to avoid confusion and simplify the process, and there was no longer the need to sign an agreement then determine whether it was operating with criteria to be established.

Puente suggested that in some states with bonding limitations and the amount of debt that could be issued by lending agencies, they moved to doing more lease arrangements as a way to finance some of these capital assets. We don't have that issue in Texas so the amount of leases that would be covered in this pronouncement, would be very few.

Bryan Langley, Deputy City Manager, added that these rules might be trying to address some off balance sheet financing that you've probably seen in other places.

Manning continued, even though you may not end up keeping this, you have a long term agreement signed by someone, committed to paying \$50,000 per year, therefore, you owe the

\$250,000. Their counter argument is that we could end the agreement and get the assets back. They were trying to end confusion, simplify, and have everything on the balance sheet.

Manning gave more specifics on GASB 75 and the Accounting and Financial Reporting for OPEB. There will be another big change that hasn't been quantified as to when, but they confirmed that it is coming. Now they are looking at the financial reporting model again and could make the report completely different. They are trying to decide between, a near-term short-term or long-term focus. As the information and updates are made available, they will be shared with you.

Manning shared the FY2018 Calendar and deadlines and expressed his appreciation to the Committee for the opportunity to present the information.

2. Receive a report, hold a discussion, and give staff direction regarding the Customer Service audit conducted by the City's Internal Auditor.

Umesh Dalal, City Auditor, advised the Committee that the first audit at the City of Denton was completed on the Customer Service Division, which reports to the Finance Department. This unit collects one-quarter of the resources that the City receives so the internal controls in this operation is very critical. That is why this unit ranked very high in risk assessment and the reason for looking at it.

Dalal shared several things that worked well in the division. Overall controls were adequate, but there was room for improvement. Customers are billed at appropriate rates, approved by the City Council. The duties of cashiers and collection personnel are properly separated, and the City has good fidelity insurance to cover for loss and misappropriation. The credit card industry has requirements that the City needs to follow. There are consequences for not following those requirements. At the worst scenario, the City could lose the privilege of accepting charge cards, which would be devastating to this operation. Customer Service was brought into compliance after some problems were identified.

Several findings were identified. Some associated with risks that were not tolerable and others that needed attention. The Finance Department's Customer Service division was very prompt to address all issues identified.

Dalal reviewed the issues discovered in the audit, the reasons for the concerns, and the recommendations to address the issues.

The Committee discussed the collection of past due accounts, the forwarding rule for customers who have left the City, and the collection agency's fees and procedures.

Meltzer asked how long the billing is forwarded to customers who have left the City.

Puente responded probably 90 day max.

Dalal recommended after 60 days of past due, the accounts should be given to the collection agency. The sooner they are given the account for collection, the sooner there is a response.

Watts stated that the City has data confirming from day 90 through the time until collection. If we applied this policy to the old set of data what, would be the result of that time and/or money spent for the City in collecting it as compared to this time spent for the agency to collect it?

Dalal answered that since the agency are collection experts, the expectation is that they would be more successful.

Watts added his understanding of the recommendation that accounts be sent to the collection agency sooner, but the data is not available supporting that recommendation. We have the data over the last 12 or 24 months showing how much we collected, how much we sent to the collection agency and we know how much the collection agency sent back. Before approval of this recommendation, there needs to be more data.

Dalal offered that the collection agency data ranked the account sent to the agency, was collected sooner but he would like to look at the data and to confirm that information.

Watts added there is not enough data to recommend to Council. He requested using the data the Auditor gathered from the first nine months of FY2018, showing a certain amount of delinquent debt and 70% of payments that was received between 30-60 days. I would like to see the total deposit collected, and the balance left. Here is some data that an analysis could be used showing that people are leaving and the final bill was unpaid. The whole point of the deposit was to retrieve enough to cover some or all of that bill.

Langley asked if Finance should bring the information back or Dalal.

Watts answered that it didn't matter, whoever could provide the data.

Ryan asked about the missing part on the collection efficiency. We are sending a certain percentage amount that goes past the 30 day mark to the collection agencies and that's an important number to know, as well.

Watts asked for clarification on sending debt to the collection agencies after 30 days.

Ryan added that if you add up what's on the data that's 100%. How much are we sending to the agency? Is that equal to what we are actually collecting? Is it ten percent?

Dalal confirmed that the data shows what the City has collected.

Meltzer asked also if there was an internal cost of service to collections that could be included in that data.

Dalal answered that information will be provided.

Dalal then addressed collection on large receivables. There are four accounts that total \$450,000 belonging to large corporations and these accounts are being pursued by the City Attorney's office. These accounts need follow-up, due to the amount that is owed.

Puente pointed out that these are non-utility related receivables with some related to pole attachments.

A discussion followed on clarification of the accounts owing large amounts.

Puente advised the Committee that staff is working with the Legal on addressing these accounts.

Dalal reported that the outcome of the audit was there were some control deficiencies observed but no horrible weaknesses. The good part is that the Finance Department took very prompt action. As soon as these issues were pointed out, they either fixed them or they are in the process of fixing them.

Watts asked if it was the drainage fee accrual that is past due. Is that drainage fee continuing to accrue or has someone taken it over?

Puente answered that it continues to accrue, they have not paid it.

Watts asked for clarification. Someone is receiving a bill they refuse to pay and we're putting a lien on the property and that's all we're doing? So, when it comes to a drainage fee without any utility fee whether it's water, sewer or electricity. If there is a delinquency on one of the components that is not paid separately, that's probably why. We need to figure out a way so that if someone is just not paying drainage and there is no enforcement, we need to enforce that or take the drainage fee off for everyone. It's not fair if everyone in Denton who owns real property is paying their drainage fee but people who just have a drainage fee, can just keep the account accruing. We need to find a way to address that.

Langley agreed and asked that the Committee allow staff to get with Legal and come back with some options.

Watts asked about information shared during the August 21 Committee meeting on the interest accrual on utility bills and a report. This was one that had been waived in the amount of \$26,000, the balance was for \$55,000 and that was supposed to be decided at the City Council Meeting on the 21 and apparently, we didn't have the authority to waive that.

Puente responded that staff will be bringing that back to Council on October 9.

Watts asked if this was addressed by Council on August 21.

Puente replied that the discussion with the Council was on whether to change the \$20 penalty or one percent fee and Council opted not to make any changes.

Watts asked if the interest component was not addressed at that meeting.

Puente answered no. They centered on the \$20 fee.

Langley added there has been some confusion in the ordinances and Larry has been helping us work through that. There are some special conditions riders that were in some of the rate ordinances but not all of them. They are necessary from time to time for operations such as errors in billing or issues. The best way to handle this, in talking with Legal, is to take out all these rate ordinances and bring you back one so you the Committee can address the billing adjustments.

Puente explained the issue arose when there was a municipal lien placed. There can't be any waiver of penalties or interest until the full balance is paid. That was the issue here, in that we had waived those penalties when there was already a lien. We have looked at this process and will not do that going forward.

Puente added that staff had been working with this account to come in and pay with the idea of waiving the fees, but since we can't do that, they have opted to hold off on their payments.

Watts requested that the formatting on the audit reports be set so that the headings remain at the top, so that the report is easier to read and follow.

Dalal asked the Committee if staff should take the audit to the full Council, after all the issues are cleared up.

Watts answered that it should not end with this Committee.

Langley suggested that the process is a little unclear. One way would be to have the discussion here and send the audit report to the City Council. As a public document, it would go on the web page with all your completed audits. Or have another work session item with the Council and go through it. That would be your prerogative on how you want to do it. It has been a while since the City has had an auditor and there isn't a process in place. That is a question for this Committee. How should this be handled going forward? Certainly the audit will go to Council, the question is, whether or not to have a work session item.

Meltzer added that there should be a step prior to that. It's a good thing that we have issues to be resolved and recommendations need to happen to get the benefit of them. As a matter of process, we recommend to Council on a yes or no venue. It's longer and more bureaucratic but is that correct? Then the question is to Committee or full Council? Why would we need a Work Session if it's already done?

Ryan explained the policy of the collections, that's more of a Council issue. Whether or not to lock the safe is to me, a management policy. I would recommend we send this out in an informal staff report in the Friday packets noting that the Audit/Finance has seen it and ask if they would like for this to come forward as a work session, then the full Council can decide if they would like to see it as well.

Dalal asked before I do that, should I bring back an analysis that was requested?

Ryan agreed that would be best to get that in there before taking it to full Council.

Watts agreed. This is was the only recommendation that was not answered.

Meltzer added if there is an appropriate part of City staff that evaluates security to the extent that we are using videotaping with all its limitations, it sounds like from your descriptions we are using 1980's style. The idea of motion-sensing and alerting is the wave of the present. Might want to take a look at that.

Puente responded that staff could do that.

3. Receive a report, hold a discussion and give staff direction regarding the 2018-19 Internal Audit Plan.

Dalal stated there are twelve projects in this audit plan. The last two of them are mandated items to be support of the Ethics Board and investigating complaints received from the fraud, waste and abuse hotline, which trickle in often.

Dalal reviewed each of the ten other audits planned for FY 2018-19: Economic Development, Accounts Payable, Procurement, Capital Project Administration and Compliance, Roadway Quality Management, Utility Cuts, Water Loss, and DME Energy Management Effectiveness.

Watts asked for clarification in plans for an audit on the DME Energy Management. You stated you will be looking at determining the adequacy and effectiveness of controls, then added whether we should have that office or not. There is a difference between seeing if the codes and laws are being followed and another to do a financial analysis that I think we've done on a couple of occasions. I don't think that's an audit function to determine, unless we don't think the numbers being presented to Council are questionable to make that determination of do we want to hire this out to a third party or do we want to keep this procedure process in-house.

Meltzer asked if a consultant was recently hired to look at this.

Watts confirmed they had but only asking based on your comment we are going to do this and then it's to determine if we want to have this here or do it somewhere else.

Dalal replied that one of the parts of this analysis will show how this office is in fact conducting its business. Internal controls is defined by Committee of Sponsoring Organizations or COSO, is a big standard. That standard defines internal control as looking at checks and balances, compliance with laws, regulations and policies, as well as effectiveness and efficiencies of operations. Basically, that is what I am using to gage that.

Meltzer asked, in the last meeting there were about 200 possible projects that were all merit worthy for risk assessment. I am curious to know what the next three would be if we took exception on any of those listed so that we can evaluate what the next priority would be.

Dalal asked if he could complete the remaining items and explained the Police Property Room and the critical part it plays in the on-going department's cases. The next audit be on Police Overtime. Not necessarily because there is anything wrong with it but to see if we are following the process established by the City to allow overtime and if it is distributed equally, to avoid morale problems.

Dalal followed with three additional projects to consider, should the Committee decides against approving any of the projects presented.

Watts stated that the Committee won't make a decision on this. It will go to Council. I'm not saying this is a recommendation from the Committee. This is a review by the Committee. When one of the members requests additional projects to be placed as an option, it should be for prioritization by the full Council.

Langley suggested a good practice would be for the Council to adopt the plan on annual basis. This would be informational for the Committee to get feedback for whatever document you bring forward to Council. Should this to be a work session with the Council or just provide an informal staff report, and put it on the agenda for approval?

Watts stated that the Committee would provide options for the whole Council to consider.

Langley confirmed that would be a work session.

The Committee discussed the options to best inform the full Council of the Audit Plan for their consideration.

Ryan suggested bringing a work session item with three to five additional options for the FY 2019 Audit Plan.

Langley offered to place that item on the agenda for next week.

Dalal agreed to present a work session item on September 25.

Ryan asked for further questions.

Watts asked to discuss a prior agenda item on the example of the utility bill of \$55,000 that had accrued interest. The comment was when the party discovered we couldn't waive the interest, they backed off from paying the bill.

Puente answered, that it was a different account.

Watts asked if there was another party that had a big delinquency with accrued interest with a lien. Is that bill continuing to accrue charges?

Puente confirmed. They were making payments when we were working with them. When informed that the fees could not be waived, they made two payments but it will continue to go delinquent.

Under Section 551.042 of the Texas Open Meeting Act, respond to inquiries from the Audit/Finance Committee or the public with specific factual information or recitation of policy, or accept a proposal to place the matter on the agenda for an upcoming meeting

AND

Under Section 551.0415 of the Texas Open Meetings Act, provide reports about items of community interest regarding which no action will be taken, to include: expressions of thanks congratulations or condolence; information regarding holiday schedules; an honorary or salutary recognition of a public official, public employee, or other citizen; a reminder about an upcoming event organized or sponsored by the governing body; information regarding a social, ceremonial, or community event organized or sponsored by an entity other than the governing body that was attended or is scheduled to be attended by a member of the governing body or an official or employee of the municipality; or an announcement involving an imminent threat to the public health and safety of people in the municipality that has arisen after the posting of the agenda.

Watts requested a list from staff of all the “drainage only” accounts that are in accrual, have liens filed against them, and continue to accrue charges. Also, he asked staff to provide a list of all the liens that the City has filed, the charges levied against them, and the legal options.

Ryan requested that the list also include the pole attachments.

Langley confirmed the list will be provided as requested.

Puente advised the Committee would traditionally meet in October with a number of items. Unless the Committee needs to meet earlier, staff will plan to bring these items to Committee in October.

Ryan advised October is fine.

Meeting adjourned at 11:29 a.m.

The September 18, 2018, Audit/Finance Committee Meeting Minutes were approved on November 6, 2018.



John Ryan, Audit/Finance Committee Chair



Theresa Jaworski, Recording Secretary