

CITY OF MILFORD
FINANCE & AUDIT COMMITTEE MINUTES
September 25, 2023

The Finance and Audit Committee of the Milford City Council met on Monday, September 25, 2023 in the Joseph Ronnie Rogers Council Chambers at Milford City Hall, 201 South Walnut Street, Milford, Delaware.

PRESIDING: Chairman Jason James Sr.

IN ATTENDANCE: Committee Members:
Councilpersons Daniel Marabello, Nirmala Samaroo, and Andrew Fulton

STAFF: City Manager Mark Whitfield and City Clerk Terri Hudson

Public Comment Period Prior to Official Meeting

No one was signed up to speak and the floor was closed to public comments.

Call to Order

Chairman James called the Committee Meeting to order at 5:11 p.m., then deferred to Finance Director Lou Vitola.

Councilmember Fulton arrived after the meeting started.

Audit Update

Director Vitola stated that between onboarding new Accountant Kevin Gaboriault, the new system going live on July 3rd, and some heavy project load throughout the City, it has been difficult to schedule the auditors on the FY22 audit. Our new Accountant is working on the new GASB pronouncement and is almost done with the lease pronouncement. Other schedules being finalized include absence and pension reports, as well as the two GASB pronouncements. Once done, that is when the final draft of the statements will be in hand and he will be able to touch base with the audit team, reconfirm the schedule and move toward completion of FY22. At that point, Council will see the first draft at an upcoming Council meeting, as an item for information or something that can be discussed on the floor, depending on the City Manager and Council.

He will then communicate the schedule once it is complete and the final draft ready to share to prevent losing too much time on FY23. In retrospect, the lateness of the 21 has pushed FY22 back.

There is nothing exciting or different in the audit and no surprise to Council. The lease pronouncement has a zero net impact on the balance sheet and has a zero net impact on the balance sheet because there are the coagulation results in a deferred inflow and a deferred outflow and are offsetting.

That is true for situations where the city is the lesser and the lessee, and will have two types of deferred liabilities, two types of deferred assets, deferred inflows and outflows that will offset each other. It is just a process of complying with the pronouncements and preparing the schedules and the support required with the source documentation backup.

Other than that, it is the 22's presented in July following the end of the year.

The enterprise funds will not be materially different than what was seen in the audit.

As a result, there is nothing negative and the fact that there's no news doesn't mean that is bad news. It is just delayed.

When asked the completion date, Director Vitola said it needs to be done by the first Council Meeting in December which coincides with last year. Then the 23's need to be months later with March 31st as the goal which puts it back on schedule.

Regarding the lease pronouncement, Chairman James asked if there will be any changes in those amounts impacting those operating statements and just balance sheet classifications; Director Vitolas explained it will hit the P&L but with very small numbers. Anything that hits the utilities will be indirect and only copiers and postage machines in public works and customer services allocated to a portion of the general fund and a portion of the enterprise funds. Nothing more.

Internal Control Discussion

Director Vitola provided background at a higher level though some details will be provided. Internal controls are those individual processes, policies, or procedures that any organization handling assets should undertake to safeguard the assets. The City is a large organization with a \$60 million budget and \$60 million liquid on the balance sheet.

He explained we are not just safeguarding assets but are trying to future proof the processes. Not every component of, say the meter to cash process, which includes revenue is directly related to safeguarding cash. But it's related to a control environment that promotes accurate reporting ensures that we don't have any unrecognized revenue or lost revenue which indirectly could result in falling short of our economic potential and goals.

The fact we are a city and not a fortune 500 company in the private sector that operates for profit does not mean that internal controls are any less important for us. In some ways smaller dollar amounts are harder. He said we are talking about fewer people. One of key tenants to strong internal controls is the notion of segregation of duties, and it's harder to parse out all the different parts of certain processes with a limited amount of people.

You can find in the newspaper cities, counties, towns, states, even federal agencies that that have been victim to failures and losses of assets because of something that could be presented or prevented with a simple internal control. Great example is the bank rec bank reconciliation. At the center of internal controls, it remains critically important now as it ever was though he does not want to go into any specific incidents with the city.

He was exploring banking activity which led to us being able to thwart a potential fraud attempt. Had that not been done, or if we were months behind, something like that could harm the city permanently.

Fortunately, we don't have to rely only on people count for segregation to duty and robust internal controls at the end of the day. We rely on IT controls and third-party vendors and certain settings we can instruct vendors to put in place. There is an established set of assigners on bank accounts, and staff can only transact in pairs.

Even though only certain staff can make payments or setting up vendors in payment portals, making wire payments or ACH payments, or receiving cash and checks and electronically depositing them, no one person can do anything without another person's approval. There are also limits in place that could be executed in Ach or wire payments in one day Even if using the pre-approved template approved by two people, and are within the limit, one person still cannot issue a payment without another person also approving it. Those two people must be supervisors at the approval level.

The City charter and code looks at the highest level of the organization and the controls are very broad, and law driven. It includes the budget requirements, debt policies, and the independent annual audit that work together to promote fiduciary responsibility in a way that can't be subverted by just one individual or be done behind closed doors. When something needs council approval, it reaches the highest level of the city, and meets the required transparency Council desires.

Some things are made available on the City website and provided to the media which prevents some type of attempted fraud or diversion.

He emphasized the charter can't be changed without the state legislature including controls over the overall solvency and financial health of the city comes down to its voters of the City who make decisions on debt issues.

There are internal controls that remain under Council's purview including the investment management policy, fund reserves policy and the monthly financial reporting requirements. Though not law, they make the expenditure control process transparent to citizens to promote future fiduciary responsibility.

Director Vitola then provided an in-depth description of the annual auditing process for the Committee Members.

Councilmember Marabello commended Director Vitola on the strong internal control under the current management noting that in in the past he knows there were problems, and asked the policy on bank reconciliations, the time frame and who handles them.

Director Vitola shared that for segregation of duty reasons, there are too many people that touch too many different parts of transactional abilities. Because the City is so small, he hired a third party to do the bank reconciliations and that outside person comes on site to pull in all the detail and the bank statements and conduct the other review. They can take months to be finalized. He qualifies that with 98% or more with the cleared payments, the cleared receipts, and the items in transit. Those happen on a weekly basis going forward. As we track it, it could take months to reconcile and understand that last 2% until the reconciliation is final and some adjudication to every penny. But we reach and execute the reconciliation and reach a point of reasonableness by the end of that following month.

The Director clarified he is only ballparking the 2% and is not a material number relative to the total. It could be a batch of credit cards paid for on the 30th of the month, some of which interface with the bank on the 31st, others which interface with the bank on the 1st, and a mix of each of those portions were rejected. It then becomes a research nightmare and hard to find \$147 here and \$352 there. That is what holds up from the 100% but no core risks that emerge like a series of check numbers from 2000 to 2500 that we have no idea about.

We get the vast majority in a short amount of time, and then must hustle the balances.

The perpetual inventory of items was mentioned, though Director Vitola verified that a physical inventory is performed annually during the audit. However, the warehouse clerks do cycle counts though he is unsure often that is needed, but in most cases if there is a discrepancy on a certain item or fast-moving items such as the street head replacements. But for the most part it's an annual count for diesel fuel, gasoline, and warehouse items.

Most of the time it involved something that was utilized outside of the warehouse for a project that didn't get caught and expensed. Once we account for active projects where items are deployed, we are usually very close in inventory within 6 figures and is usually the amount over a \$1 million in inventory value and then there is the water piece.

He said the biggest problem is an emergency after hours and having it coded on its way out.

Councilmember Fulton confirmed with Director Vitola the inventory control is annual and the projects list all items used and cross checked against the inventory for deduction purposes. Director Vitola said if a discrepancy is found, it is an item that was not coded but is corrected and matched appropriately.

Director Vitola also explained that the six-figure discrepancy means within six figures, and less than \$100,000 and \$27,000 or \$54,000 out of \$1.6 million. That is the balance of inventory at the given time at the end of the year and usually within 5% tolerance. As a function of annual expenditures, it is smaller as a percentage.

Director Vitola is ballparking though he is willing to look closer at prior year adjustments to talk about actual numbers. He has looked at the inventory for the last three years and he is comfortable with the small variances and reviews by the team.

When asked if that is written off, or items found, Director Vitola said there was a reversal adjustment. Other than that, it has not approached six figures, but he is talking about his first couple years and the previous fiscal years.

He then talked about varying issues and mainly items that were never received by the City and how they were handled inventory wise, stating there was a reversal necessary the following year when it involves a large item. That is the only time it has approached six figures, and it was probably FY20, the first year he was hired.

Councilmember Fulton asked about a negative balance of items ordered but not received; Director Vitola said he is talking about different issues and Councilmember Fulton apologized.

Also mentioned was cybersecurity measures taken by our IT Department.

Chairman James asked that more internal control information be provided specifically about the accounts payable subledger and if it is purged periodically. In addition, he would like for Director Vitola to go into more detail about the accounts receivable and how that is managed, in addition to former city employees and making sure there is no activity occurring in those situations.

He also noted that our HR Director is the only employee who can add or delete employees in the system, as well as adjust salaries. The payroll administrator is only able to execute payroll and the City Accountant Sandra Peck solely handles any type of payment to employees that are non-payroll items.

Monthly Financial Reporting

Director Vitola said there are a couple things going on. One is the challenges with the software version. Finance is implemented and converted in Tyler but there are a lot of complementary processes not in place. Payroll is one, as well as utility billing and cash receipts.

Each day there are hundreds and sometimes thousands of transactions that happen and should be imported into the finance system every day. That is one problem he is dealing with related to the report and there are additional training needed for items needed in a month-end manager model within the system that influences balance sheets. Without balance sheet accounts, the trial balance is unable to be used in the cash reports.

Director is still having to do those manually and other areas that depend on the execution of these processes that get imported. He continues to work through those issues and at some point, it will be easier to produce the report quickly. Right now, it is a slower process, but he is cross training the second accountant that was hired who will handle those reports. The second item is the cash balance sheet and there is a need to be freed up internally to accept the timing of the training needed for the month-end reports and the trial balances (TB).

The only change since the last meeting is that Tyler responded with the workaround on the full TB generation module in the reporting section. Another area allows a TB to be generated at any time which will help Director Vitola with the cash balances he is experiencing with the monthly report.

The FY24 incorporates the one-page balance sheet, and the ARPA report is only needed quarterly now.

Long term on the two P&L reports is the pairing operational data. Right now, it is restricted by space on the page, and the report will need to grow with operational statistics to keep Council more informed of the variances needed to budget from year to year.

Additional analysis will be done by the newest accountant in utilities, though he is asking if the Committee wants to see that with a deeper dive.

Chairman James would like to see the key performance indicators included which will allow Council to make more informed decisions.

Director Vitola shared the goal is cost recovery, low rates, and the recovery of rates. They don't want changes in volume to make or break and he does not see the purpose of reporting that.

He reviewed the various reports and asked if any additional information is needed; Chairman James emphasized a high-level balance sheet is needed, which the Director agreed to include as part of the FY24 goal.

Investment Management Update

Director Vitola explained that the initial baseline investment that was moved to the PFM custodians to manager is:

\$30 million baseline

- \$4.06 million structured investment matching 2016 G/O maturities
 - Gross & NPV avoided debt service exceed initial redemption plan
- \$25.9 million invested from 270 days to 5 years based on reserve policies
 - \$10.4mm up to 1.5 years

- \$ 5.4mm up to 2 years
- \$ 7.6mm up to 3 years
- \$ 2.5mm up to 5 years
- All maturities are yielding at least 5%

The \$4.06 million is related to what was initially going to be the redemption of the electric bonds in FY2022. But by January 1, 2023, which is the maturity date for the FY23 payment and the string through 2037, that totals \$4.06 million, there was an over collection of more than \$3 million identified in the 2019 rate study and Council decided to pair that with \$1.06 million in reserves to arrive at \$4.06 million to match the balance of the electric portion of the 2016 general obligation bonds due between 1/1/23 and 1/1/37. That was made attractive by the lowered interest rate of approximately 2.25% of those outstanding bonds. Some were at 2%, some between 2 to 2.25% and the longest dated ones were at 2.25%.

In March 2022, the yield curve was close to zero and investments were earning mere basis points through February 2022. After that, the yield curve increased and in mid-2022 to late 2022 and clipped at 2.5% average which was the trigger to make the redemption of those bonds uneconomical. At that point, he stopped working with the RFAs and Bond Council on a plan to redeem that slice of the QSBS represented by the electric bonds, and waited to see what the market would do.

Through 2022 it continued to increase which was our timeline to redeem, and rates continued increasing into 2023.

Instead of redeeming the bonds, they instead parked the \$4.06 million in investments that would exceed the 2.25% which provides the best of both worlds.

The electric operating cash is not needed to retire the bonds from 2024 on. Even though we didn't redeem them, the cash was not needed, and that cash was instead invested higher than 2.25% and instead of buying around \$6.2 million worth of avoided debt service. The net present value of those cash flows back to today is six times higher than the net present value of redeeming those bonds. The reinvestment then wins by a lot.

That \$4.06 million earmarked in reserves will not go away. Had we redeemed the bonds, it would have gone away and shown as a completed transaction. We can continue not using electric funds for them, which is critical, because that's what was assumed in the last two rate studies was that would not have to use electric funds for that. Even though this is something different.

That chapter is finally over and though the investment policy restricts ten-year maturities, the last few \$100,000 on the maturities over 10 years, and the 2035, 2036, and 2037 will either have to be invested in a one, two, and three-year ladder so they mature, or they can then be invested in ten-year instruments and reinvested at the end of the ten years.

He is waiting on the people who can do the math to let him know the way to go, though he took a shot at it and is unable to find a win or loss.

The other \$26 million was invested pursuant to the policy and all maturities are yielding at least 5%. Regardless of the maturities are yielding over 5% and the yield curve inverted. The early maturities starting at 270 days are at 5.2 and 5.3%, and the one year and two-year are a little higher at 5.3 to 5.35% and the three to five years are at 5%.

He said more formal reporting will be available moving forward and the PFM will be at the meeting this time next year. Chairman James said that can be discussed later.

There being no further business, the Committee Meeting was adjourned by Chairman James at 6:02 p.m.

Respectfully submitted,

Terri K. Hudson, MMC
City Clerk/Recorder