

**AUDIT/FINANCE COMMITTEE
MARCH 5, 2019
MEETING MINUTES**

After determining that a quorum was present, the Audit/Finance Committee of the City of Denton, Texas, met for a regular meeting on March 5, at 10:30 a.m., in the City Hall Conference Room, at City Hall, 215 E. McKinney Street, Denton, Texas

PRESENT: Mayor Chris Watts and Council Member Paul Meltzer.

ABSENT: Council Member John Ryan.

STAFF PRESENT: Bryan Langley, Deputy City Manager/COO, Antonio Puente, Jr., Chief Financial Officer; David Gaines, Assistant Finance Director, Harvey Jarvis, Controller, Brian Hogan, Assistant Controller, Cody Wood, Assistant Controller, Cassandra Ogden, Director of Procurement and Compliance, Jamie Lindsey, Compliance Officer, Umesh Dalal, City Auditor, William Mafi, Auditor, Madison Rorshach, Auditor, Nancy Towle, Treasury Manager, Randee Klingele, Sr. Treasury Analyst, Hailey Payne, Treasury Analyst, and Theresa Jaworski, Recording Secretary.

OTHERS PRESENT: J. K. Manning and Kenton Willis with Pattillo, Brown and Hill.

OPEN MEETING:

In the absence of Council Member John Ryan, Mayor Chris Watts brought the meeting to order at 10:33 a.m.

1. ITEMS FOR CONSIDERATION

A. Consider approval of Audit/Finance Committee Meeting Minutes of November 6, 2018.

Council Member Paul Meltzer made a motion to approve the November 6, 2018, meeting minutes. Mayor Chris Watts seconded the motion. Motion passed unanimously.

B. Management Report – Annual Debt Report as of September 30, 2018.

Tony Puente, Chief Financial Officer, explained the Annual Debt Report that is prepared annually to provide citizens and the general public with a comprehensive and easy to understand summary of the City's debt profile. Additionally, this report includes required information in accordance with Texas Local Government Code 140.008 (House Bill 1378). The report provides a high level introduction to the types and uses of debt issued by the City as well as the most recent bond ratings. Staff has differentiated between tax-supported and revenue-supported debt in order to give the public a better understanding of which debt is paid for by property taxes versus rate revenues. The report details the principal and interest for each major service area of the City and provides two visual representations by dollar amount and percentages.

Meltzer asked if the report is used by consumers.

Puente offered to check for hits on the City's website.

Bryan Langley, Deputy City Manager added that there had been some questions on this in the past. In previous conversations with the Audit/Finance Committee, it was decided to make the information available in one place. The information is available in the CAFR but the current report is more visual and consumable.

Meltzer suggested that for next year's report, it would be helpful to treat the DME part of the report separately from parts that affect the debt ratios of the general fund to give a different impression of the covered ratio.

Puente explained that is part of what the state law required. In the column titled HB 1378, on the City column, the revenue supported debt is backed out and that would include the DME debt, adding that the report would be posted on the City website the Friday following the meeting.

C. Management Report – Certificate of Distinction for City Investment Policy.

Puente reported that every two years, staff submits the City's Investment Policy to the Government Treasurer's Organization of Texas (GTOT). This is managed through a contract providing administrative services with GTOT and the Center for Public Management at the University of North Texas. The City submitted the policies and the requested documentation and was awarded the Certificate of Distinction for Investment Policy, meeting all the Standards of Best Practice and Public Funds Investment Act (PFIA).

D. Receive a report, hold a discussion and give staff direction regarding the FY 2017-18 Comprehensive Annual Financial Report and annual audit.

Puente introduced John Manning and Kenton Willis with Pattillo, Brown & Hill, L.L.C., and acknowledged City staff who also worked on the document.

Kenton Willis with Pattillo, Brown and Hill, shared with the Committee the planning and process of the FY 2018 audit.

John Manning with Pattillo, Brown and Hill, followed with the results of the audit and conclusions. The financial statements are the responsibility of the City, the outside auditors are responsible for offering an opinion on the financial statements, based on the audit test work performed. We were able to offer an unmodified opinion on the overall CAFR. This means there was no need to modify the opinion for anything that was lacking, for unreliable controls or the lack of upkeep on capital assets. An unmodified opinion was also offered on compliance and no internal deficiencies. This year, because of the new electric items going on, disclosures for some of the purchase agreements for the wind power were necessary, we had to test those to ensure they were not being purchased as a derivative instrument. The City prepared the disclosures, they were reviewed and found to be in good shape.

Manning continued. This year, the unfunded actuarial group liability for the retiree health plan and the fireman's retirement and relief plan had to be included. Both items were approved properly by the City and all eight or nine additional pages of disclosures have been added as well. This was the last big accounting change for a few years. On the grant accounting, City staff was keeping up with it perfectly but with the help of the grant accounting summary format we offered, staff was able to tie the receivables, and get the expenditures and revenues tied into the general ledger. This resulted in getting the Schedule of Expenditures of Federal Awards (SEFA) and Schedule of Federal and State Awards (SEFSA) very quickly. As far as upcoming standards, there are two types of leases: operating, meaning you don't ever own the equipment and capital, that means you own its form of debt.

With the new standard that is sort of marrying what they are doing in the public sector, there are no two types of leases, either you have a lease that's capital or you don't. The City is already looking at the lease agreements and evaluating the impact. The good thing about this standard for example, is when considering a lease agreement for copiers, you will also be able to capitalize the equipment. A debt will be added but there is also an added capital asset and it's not just a direct hit. The City does a very good job with record keeping and report presentation.

Meltzer asked, with the City's P-card pressure tested and the internal audit item that is coming up, were the findings in that audit an influence in the external auditor's findings?

Manning explained that findings from the internal audit on P-cards was not available as the external audit was completed in January. Typically, any audits released by the City Auditor's office is built into the external auditor's risk assessment. The difference is in the way the City Auditor's office is able to take an area and dissect it, look at a lot more transactions and detail that could result in major findings. When there are major findings that we are made aware of, those findings are built that into the next risk assessment. Most of the time, the internal audit reports with findings include suggestions to correct or improve so that there is no longer an issue.

Chris Watts made a motion to move the FY 2017-18 Comprehensive Annual Financial Report and Annual Audit Report forward for the City Council's consideration. Paul Meltzer followed with a second on the motion. Motion carried unanimously.

E. Receive a report, hold a discussion and give staff direction regarding the City's external financial audit services and contract.

Puente informed the Committee that the current three-year, initial contract with Pattillo, Hill, and Brown L.L.P., is expiring and there are no automatic renewals. He followed with a history of the last few contracts going back to 2008 with Weaver and Tidwell and options the City may exercise for external financial audit services beginning with the Fiscal Year ending September 2019. In 2016, an RFP was submitted and the contract awarded to Pattillo, Hill, and Brown, L.L.C. From staff's perspective, the firm has done a good job with no reason to prevent awarding a new contract or the City can issue an RFP for these services, if that is the Committee's preference.

Puente also stated that this contract, by either automatic contract renewal or by RFP, would be managed by the Internal Auditor. The Finance department would continue to be involved in the evaluation process, and work with the auditors.

Metzler asked, if the external auditors should have picked up the issues found by the P-card audit, making us vulnerable and questioning the renewing of the contract.

Puente responded that the external auditors selected specific transactions, looking at them individually to ensure policies and procedures were followed. In the random selection, they did not look at the ones the City Auditor focused on, but looking at the big universe of transactions. In providing this report to the external auditors, they will certainly take that into account and do more testing.

Metzler wondered if there should be a different approach, due to the state statutes.

Langley explained that the external auditors are looking at a level of materiality. For an organization Denton's size with a budget of \$1.2 billion and all the things going on, they can't look at every transaction in six to eight weeks. They scope their audit and try to look at the biggest weaknesses and areas of concern. No external auditor would go into this level of detail, in my opinion. They are primarily looking at financial statements, presentations, and some controls to ensure they are in place.

Dalal agreed. In dealing with external auditors, their objective is on the financial statement as a whole in the seven or eight weeks they are here. They look at the overall picture and don't have time to go into the generality of transactions. When auditors look at this type of subject, they look at the entire database pertaining to that subject. If external auditors went into that detail, they could not possibly finish the audit in the time allotted.

Metzler asked for a recommendation on changing external auditors.

Dalal advised that changing auditors too often results in re-training the new firm in the City's processes and that first year takes a lot of time. It's inefficient for both staff and the new firm. The industry norm is about five years, after that time, the demand that they change the partner and leading staff on the audit can be made, to keep it objective and would not require re-training.

Puente added that was one of the options discussed with John Manning. In consideration of an award and extension to Pattillo, Hill & Brown, the Committee can request that they change the partner or the audit supervisor for a different pair of eyes, if that is something the Committee would like to do.

Watts asked the City Auditor if he had worked with the external auditors.

Dalal answered that he had and would recommend extending the contract. Next year, the external auditors will take the audit report, point out the deficiencies identified, and request proof of changes or corrections in the deficiencies. If they have been corrected, that brings the risk assessment down, making the City more secure.

Watts stated that it was his understanding that the external auditors are looking at the overall picture. That is imperative and the reason why the Internal Audit Department was created, to go into the specificity of the processes. Any audit report from the Internal Audit office is independently confirmed by a financial auditor to ensure that these issues are resolved or being resolved and it's all transparent.

Puente added that in many cases, there are operational reviews that staff also shares with these auditors so they will know what is going on in the organization

Metzler advised that since the recommendation is coming from the same party that found the deficiency, he would be okay with the extension.

The Committee discussed the options of a one or two year extension to the external auditor's contract to recommend to the City Council.

Mayor Watts made a motion to recommend the renewal of the contract with Pattillo, Hill & Brown, with a one or two year option to the City Council, for their consideration. Paul Metzler seconded the motion. Motion passed unanimously.

F. Receive a report, hold a discussion and give staff direction regarding an Audit of the Procurement Card.

Umesh Dalal, City Auditor, acknowledged the value of using a procurement card (P-card) for small items or emergency purchases; however, it is still a credit card, like cash, vulnerable to misuse, and requires internal controls over the process. The City is spending about \$6 million using P-cards and is the reason for looking at this program. One issue that caught staff's attention is compliance with procurement regulations. Section 252 of the local government code requires compliance with certain things. One is being compliant with spending more than \$50,000. If more than \$50,000 is spent, sealed bids are required, to make it comparative and competition is given an equal chance. Items purchased between \$3,000 and \$50,000, requires two quotes from historically underutilized businesses.

Dalal continued. The provision is to give a fair chance to small businesses that are usually local. Staff found seven vendors with purchases that exceeded \$50,000 without sealed bids and totaled \$674,000. In addition, the City purchased approximately \$2.7 million in merchandise exceeding \$3,000 but less than \$50,000 from 327 vendors without the request of required quotes from two underutilized businesses. During this audit, it was observed that the City has not complied with procurement regulations related to food purchases.

A discussion followed on how the historically underutilized businesses were identified and where that data originated, if the purchases of \$50,000 purchases were made after the external audit, how the purchases were broken down, clarification on the difference between the requirements of the \$50,000 and above and the \$3,000 to \$50,000, when a sealed bid is required, and the Historically Underutilized Business (HUB) process for competitive bidding.

Puente added that on some purchases above \$50,000, the statute provides certain exceptions to competitive bidding with no requirement to do a bid. It is left up to the entity.

Dalal stated those exceptions were considered and did not apply to the seven vendors that exceeded the \$50,000.

Cassandra Ogden, Director of Procurement, stated that there are also exceptions for the Historically Underutilized Business requirement and are detailed in the law.

Watts asked if any of the vendors looked at applying the exceptions.

Dalal replied that the law was considered.

Dalal explained there are penalties imposed for knowingly violating the procurement statute. This is a Class B Misdemeanor punishable by \$2,000 fine and/or confinement of 180 days, making it a substantive mistake.

Dalal added that the P-card manual requires an administrator to monitor the purchases. To be in compliance with law, they are also to monitor the opportunities for finding a better price and there has been no monitoring. There is no staff dedicated to monitoring and they will need help.

The five percent discounts are worth looking into. Finding discounts on large ticket items, could mean substantial savings. Purchasing has implemented the recommendation to address this issue. Dalal added with any credit card used for purchases in the field, the supervisor approval is the only control in place. Staff found there were employee purchases in the field without approvals. If there is no review or approval, there is a possibility of abuse and there were about 842 transactions discovered that were not approved.

A discussion followed on the JP Morgan system of transaction review and approval, when this information was discovered, if it was before the external audit, how the employee transaction review/supervisory approval works, improvements implemented for employee/supervisor accountability, training opportunities for supervisors, and efforts to better work with the system in place.

Dalal reported that this audit also revealed that the City is incurring retail costs of \$412,000 for air travel, rental cars, and hotel accommodations for City conferences. In our research, we found a state travel management program available to cities and counties in Texas. In recalculating the discounts that are available using the state program and applying the discounts to the retail cost, resulted in a savings of about \$131,000, or one-third of the cost.

The travel management program is run by the State of Texas by a designated department and as a state, they can negotiate with airlines and hotel discounts. Whatever they offer is a lot cheaper than retail or even the conference negotiated price, with no cancellation fees.

Meltzer asked if there were any negatives.

Dalal answered, there were no negatives.

Puente stated that staff has looked at this program in the past. There are some limitations on airlines that would require some planning and create some challenges but the management response is that Procurement and Finance take a look at it and if it is worth looking at on a case-by-case basis.

Watts expressed concern for the use of numbers based on a claim for a rates that are not viable. We can always do better, but based on viable numbers. More detail is needed with specific examples.

Dalal advised that a future report will include that information.

Watts added that in considering the requested recommendation to City Council, at what point will staff and management have appropriate data and detail and given an opportunity to address the information in this report and at what step in the process can that be accomplished?

Langley explained that the City Auditor will provide a draft of the report to staff to review and there will be questions and answers back and forth. For most of these, management agrees with the findings, we've implemented the changes that were recommended with a couple that we can't agree to without the data. Management's comments are in the report. This is a collaborative process that we work through.

Meltzer asked if a triggering mechanism is now in place for the responsible Procurement staff to see that P-Card transactions are nearing the \$50,000 total. There didn't appear to be any structure in place to alert a different class of procurement. Do we have that in place?

Ogden answered, part of the challenge is different departments that may be spending with these different vendors without being aware of the overall spend, because they are recommended to look for contracts. Even on the P-card management side, previously we looked at that on a monthly basis not for larger amounts of time on a cumulative basis and missed some trends. We've changed that and are now looking at it monthly and cumulatively.

The Committee discussed control measures, circumstances and requirements when raising the staff P-card limits, checks and balances that are now in place, the process of decreasing the number of P-cards for City staff, the increase in spending limits for a cash rebate return side of P-card purchases, the findings of the Internal Auditor versus those of the External Auditors, and the External Auditor's contract options.

Watts expressed appreciation for the audits and the importance of hearing both sides with an example, to walk through the data flow to fully understand the process so that an informed decision can be made and avoid any unintended consequences.


Dalal stated that more accurate details and information would be included in future reports. Staff has been very cooperative and receptive during this process. No one wants to violate state law and that is why the process can be helpful. The intention is not to pinpoint wrong but report weaknesses in internal controls to improve efficiency and expediency.

Watts agreed but pointed out, before an audit report is presented to Council, there is some statement made that information was presented to management, followed by an agreement or explanations of disagreements to better understand the process.

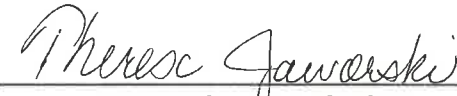
Puente suggested another Audit/Finance Committee meeting next month. Staff could come back with revised management responses, following a discussion with the City Auditor.

With no more items to consider, the meeting was adjourned at 12:07 p.m.

The Audit/Finance Committee approved the March 5, 2019, Meeting Minutes on April 16, 2019.



CHRIS WATTS, MAYOR
COMMITTEE MEMBER
CITY OF DENTON



THERESA JAWORSKI
RECORDING SECRETARY
CITY OF DENTON