



BOARD OF ALDERMEN
SHELTON, CONNECTICUT
SPECIAL MEETING MINUTES
THURSDAY, JANUARY 31, 2019

CALL TO ORDER/PLEDGE OF ALLEGIANCE

Mayor Lauretti called the Special Meeting of the Board of Aldermen to order at 6:30 p.m. All those present rose and pledged allegiance to the Flag of the United States of America.

ROLL CALL

Alderman John F. Anglace, Jr., President – present
Alderman Eric McPherson, Vice President- present
Alderman Cris Balamaci – present
Alderman Jim Capra - not present
Alderman David Gidwani – not present
Alderman Stanley Kudej – not present
Alderman Noreen McGorty – present
Alderman Anthony Simonetti - present

ADMINISTRATION

Mark Lauretti, Mayor (departed at 7:28 pm)
Attorney Fran Teodosio, Corporation Counsel
Paul Hiller, Finance Director
Ray O'Leary, Treasurer
Lynne Piscitelli, Assistant Finance Director

ALSO PRESENT:

Dave Cappelletti, Auditor, Clermont & Associates, LLC.

AGENDA ITEMS

1. OVER-EXPENDITURE FOR HIGHWAYS & BRIDGES

Alderman Anglace MOVED to establish a new expenditure account for the Highways & Bridges Department titled School Bus Parts & Repairs Account #001-3200-712.40-54.

Further authorize over-expenditures in this account through the end of the current fiscal year. Seconded by Alderman Simonetti.

Mayor Lauretti: I believe there was some correspondence that was given to board members. For anyone who has any questions I will try and answer them as best as I can.

A voice vote was taken and the motion passed 5-0.

2. REPORT OF THE AUDITOR

Mayor Lauretti asked Dave Cappelletti, Auditor, Clermont & Associates, LLC. to come to the podium to give his report of the city audit.

Dave Cappelletti: Hello, I am Dave Cappelletti of Clermont Associates and I was the auditor for the fiscal year 2018 and I will just start by presenting the financial statements to you. I'm going to start with the larger book, which is the financial statements. And again, our financial statements were an unmodified opinion on the financial statements as a whole. We do report one finding tonight that we will want to go over in detail. I will start with that after I go through the financial statements, otherwise I usually start with you on exhibit F, which is the budget to actual report on page 10.

Mayor Lauretti: The budget to actual report?

Dave Cappelletti: I'm sorry, the budget to actual statement of revenue and expenses, Exhibit F on page 10. Overall what we want to see here is a comparison of your revenue and expenses in the general fund. Your revenues were under received less of \$1.8 million however, you saved some funds in your expenditures which came down to a \$1.5 million-dollar deficit. However, you contributed some funds surplus's so overall you did \$4.7 million better than expected or budgeted for the fiscal year. Below are some changes to your unassigned fund balance. So through the year you made special appropriations to capital appropriations, you designated some funds to the prior year and then we also have another one which I call a change in unexpended funds, which I will get to in the findings which basically brought down the amount of funds available to appropriate to zero. Ok, so that's the lowest your fund balance is and moving forward you don't have any general fund monies available to appropriate outside of the general operating budget. Does everyone understand that?

Mayor Lauretti: A position we have never been in before.

Dave Cappelletti: Exactly, yes.

Mayor Lauretti: At least in my time.

Dave Cappelletti: Yes, and I will explain, so the big change here that was unexpected was the \$2.5 million dollars that I will explain in the finding. Other than that, your operations were favorable. And when I say that it's because you saved \$4.7 million over your, what you were expected. If there's no questions I'm just going to move forward to Schedule C and D which are pages 7 and 8. In here are all of the general funds in to the rest of all your government funds. We break it down to your general funds, capital projects which are your long-term projects and bonding projects and then the other governmental funds which is just the smaller funds that are actually added in the back of the financial statements. So, if we have any questions there, we could just look into the back of the schedules. And again I want to point out that you have your general fund balance is at \$6.5 million, however, \$3.8 of it was appropriated to your subsequent budget so that's your current year budget you are in now and then \$ 2.7 million I designated as non-spendable and what that basically means is that you have assets in your general fund that aren't available to spend on your current resources. The largest portion of those would be your pre-paid expenses, your inventories and something I call advance to other funds and basically that is a fund outside the general fund that has spent money that owes the general fund funds but doesn't have the ability to pay it back at this time. OK? So, as far as the financial statement of the governmentals is there any questions or concerns besides the unassigned fund balance being zero because we could go back to that in detail.

Mayor Lauretti: Could we go back to your last statement and just clarify that a little bit more? We talked about the general fund and monies that are owed to the general fund just give the board some examples of what that might be?

Dave Cappelletti: Yes, so normally the account that says advances to other funds, normally that account is used in government when you loan money to a project outside of the general fund and don't expect the money to be received back in the current period. So, an example with this would be a start-up program that you started, maybe at the community center, and they'll pay back funds to the general fund over the long term, over one year. Or they don't have the ability, so this was basically a line item that the auditor put it in, simply because the auditor felt the fund that it was borrowed to or didn't have the funds in the current period to pay back the funds.

Mayor Lauretti: Would it be fair to say that this category also includes some of our building projects that we fund and we expect a reimbursement from the state on?

Dave Cappelletti: Yes, so on those funds, what we do when we expect a reimbursement from a third party, what we do is we defer that, so we don't even recognize the revenues in that situation. So in that situation I would say an example would be school building projects, where you would have large state grants that fund these and we don't recognize that money until it's either received or available to liquidate current assets within the current period, which normally is 60-90 days after year end. You do have some receivables from the state that are recognized simply for that reason. So in situations where we were expecting grants or other receivables from third vendors but they are not received, what we do in there is we record an opposite that's basically unavailable receipts which would be included under deferred inflows or resources. An example of that would be taxes that weren't collected in 60 days of the year end. In situations like that you have delinquent taxes that aren't available to liquidate current liabilities, so how we do that is we take it out of that revenue and we put it into a liability until we receive the money. Does that make sense?

Mayor Lauretti: Yes, I think it does. I just want everybody to understand that there is several building projects that we have funded with the idea that we are going to be reimbursed a percentage of that cost by the State of Connecticut. An example would be the Sunnyside School roof which was approximately \$1.3 million, Paul?

Paul Hiller: Just under that.

Mayor Lauretti: And our reimbursement rate for that was 39%?

Dave Cappelletti: Yes, I will just follow up with that to. So, those receivables aren't included in the financial statements. There are two things that we like to see when we record a receivable in here and that is that we know what the actual amount is and that it's also available, attainable. So, for the Sunnyside School, I don't think we know the exact amount available, it's been approved but we haven't applied for the money yet. That is what we are trying to say. We don't know the exact amount of the receivable yet but there is one that does exist and you do expect to receive it in the subsequent period or thereafter. I think what the Mayor's getting to, what the Mayor is saying is correct, is that there's off balance sheet assets that aren't included in these financial statements simply because we go on something called the modified accrual basis of accounting which measures basically resources available compared to liabilities that have to be incurred. We only record the assets that are available to spend.

Mayor Lauretti: I think it's important to recognize it because it does have an impact on our general fund. It does have an impact on our cash flow and we need to be cognizant of that. Also, many municipalities, if any municipalities around the state, don't fund things like that, so we've been in a position where we've been able to do that. There is a cost savings to us, you know every time we don't have to go out to the bond market we save significant money and cost. You know anytime you can pay cash you put yourself in an enviable position. We've been doing that for several years now and it does, the reimbursements don't come as quickly as we need them to maintain cash flow and (inaudible) for balance. So, if I said something wrong there then you could correct me.

Dave Cappelletti: No, I think that's a correct view and also, you also were talking about the general fund which usually is the operating account and then we are also talking about the capital projects which is your long-term programs. So, if you look into your capital projects at the bottom of page 7 under fund balance you will see negative \$5.4 million but you do have approvals to bond on that money. They have been authorized just not issued yet. So, there is bonding available in that fund. As far as the financial statement is there anything in particular that we wanted to go through a little bit more in depth or any one program? Usually during the overview of the financial statements, I go through the exhibits and then behind the exhibit is the notes that gives you a little bit more detail and wording to what's in the financial statements and what's behind the notes are schedules which gives a little more detail to the numbers. You are welcome to look at any of those if you have any questions.

Mayor Lauretti: Anybody have any questions?

Dave Cappelletti: OK, so then if there's no questions here we will just move on to the single audit portion section which is in your smaller book. Basically, the federal state single audit in accordance with government auditing standards requires us to measure internal controls and compliance in three areas and that's basically under federal grants you receive, the state grants you receive are audited separately and then also we have to make an opinion on the compliance as the financial statements as a whole and internal control issues. Then for this year we did report one condition in internal controls. I will just go directly towards that. There were no findings as far as federal and state grants are concerned. So, on the smaller booklet I will probably just read from or refer to page 9 and 10 which is the finding. So, if I could I will just read through the condition one time then I will go through it in a little more detail and then we will go through some of the effects it's causing and what we need to be aware of as we work through our 2018/19 fiscal year. So, the condition that I wrote was the Board of Education has incurred losses in several special revenue funds over the years that accumulated a net loss of \$3.1 million. The largest portion of the accumulated deficit included the Board of Education recognizing a State grant which is the State of Connecticut's Excess Cost Sharing Grant, that was previously noted in the approved budget. The Board of Education also maintains several special revenue funds with smaller fund deficits as costs were incurred beyond the fund's total revenue recognized in these programs over several years. The education programs with deficit areas are as follows, and I listed them, These funds are not fully maintained on the general ledger system. Only expenditures are included in the Board of Education's general ledger system but balance sheet account items such as cash and fund balances are not maintained in their ledger system.

Dave Cappelletti: Why I'm bringing this to you today really is because of the state excess cost grant. Because that's the largest grant here. If you are not familiar with that grant it's basically part of the cost sharing, special portion of the cost sharing grant that allows the state to fund additional excess costs for spending on special needs children I believe. So, there is two different ways of recording this. One is to net the expenses against the Board of Education's expenses and ask for an appropriation of the net amount. Another way that some towns and cities do this is to budget an amount, that amount is included in the budget of the revenues and approve the education expense at the gross amount. So, in this situation, the Board of Education have a proposed and operating capital budget. Do you guys review this at all or have you seen it while you do your budget?

No responses - heads shaking no.

Dave Cappelletti: I'll be referring to that from time to time. That's their budget that they get approved by their Board of Ed and that is what they work off of. Basically, when preparing their budget in the 2017 and 2018 year, they netted their amounts against the excess costs. However, when it was approved by the Board of Alderman, they assumed their costs included the revenues from the State. So, this is pretty confusing but basically the amount they expended or expected to expend, they assumed that they could spend this grant in excess of their appropriation. As I looked through the budget approved by the Board of Alderman and the budget making authority, that wasn't the case. I saw that the excess cost is included in your revenues, so when you approved the budget you saw that as a revenue item. And you didn't have any additional funds to appropriate if that wasn't the case. So, this is a pretty confusing area, I think, but in the end how I interpreted this was that the first thing I noticed in my audit is that the Board of Education overspent their appropriation. So,

that's a compliance problem. You are not allowed to spend over your appropriation. So, the next thing that I asked is why did they do that? And when I looked through it, I saw that they spent funds out of a grant that was recorded and recognized at the city level and it was included in the city's budget and so what I determined was that there was an internal control deficiency. When I look at internal controls there are multiple areas we like to look at. Whether it be monitoring, communication, or oversight. We want to make sure all these areas, environmental...and so where my finding was written up was some things that I noticed was one, it was approved and no one noticed that it was at its net value. So, the city operated as if it was a different amount than what the Board of Education assumed. As I looked through the Board of Education, I thought how would they have caught that, how would we have caught that? It shouldn't have come down to the auditor at the end, it should have been caught during the year at some point. So, who was responsible for that, and the way that the city is set up is that you do not have a budget officer. You have a Finance Director who basically helps approve the budget, makes sure the funds are available to spend, then also maintains the general ledger but doesn't provide any purchase order approvals. So, then I turn to the Board of Education again, because this is the area where the Board of Education approves their own purchase orders. So, we had to look to them to say where are their internal control deficiencies? And so that's basically the write up, and we also found other areas of much smaller amounts where this is occurring without us recognizing it. I guess that's a confusing description, I do want you to know the end result is that we don't have any funds available, so just so you know how I recorded it is that there were multiple ways I could have recorded it, how I did record it as some of the financial statement, did a couple of things. One, it describes that the Board of Education didn't overspend their general fund appropriation but overspent a grant that they didn't receive. So, the problem was not in the general fund it was outside of the general fund, it was basically they spent money from a grant that they didn't receive or have the ability to receive. Number two, I do want you to realize that the general fund right now does not have enough funds to fund your 2018/19 budget as it was approved. And what that means is that the money I felt was not available to be returned to the general fund, on a current year basis, took away from the amount that you appropriated to the 2018/19 fiscal year, your carry over surplus. So, going forward on 2018/19 we have to find some reduction in the general fund budget. Historically you have always had budget surpluses of multiple millions of dollars, so I think that's going to be the easiest part. And then number two you have to realize that you have been on a track of authorizing the expenses of general funds for capital projects, we probably can't do that any longer because there is no funds available to do that and thirdly, I believe the Board of Education is on a track of spending funds, again for 2018, and I haven't looked at it but I would assume that they are spending funds that was not appropriated again in 2018. So, there has to be a discussion between the Town and the Board of Education to let them know that they need to find ways to reduce their budget or a budget amendment has to be made on the town side.

Alderman Simonetti: Say that last statement again?

Dave Cappelletti: I think the Board of Education, if they are still using their gross, their larger number for their expenses, we are already half way through the 2018/19 year and they are in a situation where they normally do spend their complete appropriations or come close to, but they don't have those funds available in the 18/19 year to do that, and the city does not have the position to appropriate those funds because there is nothing available. So, there are some, there is some work that has to be done to the 2018/19 budget.

Mayor Lauretti: As I look at the general audit here where everyone is listed in terms of expenditures and revenues it doesn't really reflect what the actual expenditure of the Board of Education was in 17/18 based on what you are saying.

Dave Cappelletti: Yes, so the Board of Education is broken down just like the city as general fund expenses, and then they also have a special education or non-major expenses and some of them are listed here. So, they have a general fund that they expend from, they also expend from the School Lunch Program, the educational grants which includes several federal and state grants, within that I put the state excess cost grant. Also they have the Summer School Program, they also have a School Rental Program, which is a fund they maintain to reimburse expenses based on renting the schools. So, there is several areas that they spent money outside the general fund. In this finding here, what I am saying is that what I see from time to time, not time to time, but consistently, is that they record expenses to those funds that are more than they receive. So, a simple example of this is that if you rent the school for \$1000, they will routinely spend \$1200, I mean these are not real numbers. So, what happens is that they build up deficits outside the general fund. And they don't maintain that. The only one who maintains that is the audit report. These are smaller amounts I have commented on them outside of a finding in the past, but in general what makes it now a finding is that the excess cost is so large and significant to the financial statements.

Mayor Lauretti: Yes, but the excess cost grant is not in the same category as the other grants you have listed here. i.e. the school rental?

Dave Cappelletti: No, the closest that the states excess cost would be included in...so how do other towns and cities record the excess cost? There are multiple ways, there are some towns and cities that will record it as a non-major program, and what that allows the Board of Education to do is to take a deficit one year and a surplus the next and even out over time. To do that outside the general fund is fine, except where I have a comment or when I have to sit and talk to either management or when I see multiple deficits over several years. Usually outside the general fund we always want that fund to approach zero. This situation is correct in that both the City and the Board of Education included the State Excess Cost Grant in the general fund, the auditor pulled it out of the general fund and the two main reasons I did that was to show the internal control and the problem that happened here was because of that one grant, and not because of the general fund appropriations, and then number two I recorded it as a non-spendable fund balance in the general fund, which basically makes means there is an asset in the general fund that isn't available. I will do that for one year so that the Alderman and the Board of Education could talk on how they will either refund this money or during next year's financial statements will have to recognize the loss in the general fund. So, it was time for the Board of Alderman, the budget making authority and the Board of Education to discuss this matter before we actually put it where it's going to finally be.

Mayor Lauretti: I don't understand why it wouldn't be noted in both sections of the audit, because if you look on page 10 that you reference in the first portion of the presentation, where it lists all the revenues and all the expenditures of each department, the \$71,470,000 does not reflect the actual expenditure of the Board of Education.

Dave Cappelletti: No, it wouldn't.

Mayor Lauretti: So, to me that's misleading.

Dave Cappelletti: Yes, so if we did an audit just of the Board of Education, we will see expenses in several different areas. It's always been that way. The idea that the auditor made an audit adjustment to pull a grant out of the general fund, or recommended to, and put it into the grant account was simply to show that the problem was the expenditures under the grant, #1 and also there is internal control weaknesses at the Board of Education level when things are occurring outside of the general fund. So, how the Board of Education records expenses into these funds are basically netting them against the general fund instead of keeping a separate account. That's causing problems as far as transparency. What I am trying to say is that the auditors came and found this month's after the fiscal year, when someone should have found it during the fiscal year. But it took us a lot of untangling to realize what was happening. So, what we are trying to do here in the financial statements is to show the true problem of the internal control weaknesses.

Mayor Lauretti: I would think you would be able to do that by recognizing it in both areas because it is an actual expenditure?

Dave Cappelletti: Yes, so on page 10 of the financial statements it is shown, It's shown underneath the operating, because another thing I did want to show, if we could just move back to page 10...

Mayor Lauretti: In which one of your books?

Dave Cappelletti: The larger book, the financial statements.

Mayor Lauretti: The financial report?

Dave Cappelletti: Yes, the financial report.

Mayor Lauretti: Page 10?

Dave Cappelletti: Yes page 10. OK, what I wanted to show here is that the city was able to control their expenses even though their revenues were down. They did underspend their appropriations by \$4.7 million, I mean that was true. The first thing down below, changes in nonexpendable, that \$2.5, the large portion of that is because of the Board of Education. That's where that shows that expense, and I wanted to get it out of the normal operating account and put it into a separate area so that's something we could concentrate on separately.

Mayor Lauretti: I think that's what is making it so confusing is that it's not, it says changes in nonexpendable \$2.5 million. The average person wouldn't have a clue what that is.

Dave Cappelletti: No without the discussion, they would not. There is a footnote down explaining it but you are correct. Anytime you use an advance account and a change in nonspendables, you are looking at probably a more experienced person reviewing the financial statement to understand truly what those are.

Mayor Lauretti: OK questions?

Alderman Anglace: Dave you are saying we don't have any surplus to start the budget with next year or rather this year?

Dave Cappelletti: The 2018/19 year, the surplus you had available was \$3 million (exact amount inaudible) So that's less than the amount you appropriated for the current year budget. Right now if we include these three, the \$3,840,000 into your current budget you are going to have an unbalanced budget, does that make sense John?

Alderman Anglace: I'm not sure anything makes sense.

Dave Cappelletti: OK.

Mayor Lauretti: The budget as it's approved is not out of balance, what's out of balance is continued expenditures beyond what was approved back in May with our original budget.

Dave Cappelletti: Yes. If every department used every appropriation so that you have a zero surplus or deficit, a zero surplus at the end of 18/19, the city would not have enough money to fund that. But the normal operating budget for the City of Shelton has always had large surpluses, so I wouldn't put any alert or finding on that but I would say that we are going to have to find some savings like the City of Shelton historically has done.

Mayor Lauretti: Yeah, I am not sure I follow you when you say "we." I mean because this situation doesn't occur on the city side of the budget.

Dave Cappelletti: Well what happens here is that the assets of the city have diminished more than what was expected. So, when the budget was made for 2018 the budget making authority assumed they had more cash on hand than they have now. Does that make sense?

Mayor Lauretti: No, to me it doesn't make any sense.

Dave Cappelletti: Oh, so money left, whether it was on the city side or the BOE side, cash that was expected in the account at the beginning of year was not there. So you are down the \$2.5 million that you expected to be there. So, when you passed the budget...

Mayor Lauretti: You have identified the reason for that, have you not?

Dave Cappelletti: Yes.

Mayor Lauretti: And the reason specifically is what?

Dave Cappelletti: Yes, the internal control finding was that the expenses on the Board of Education...the Board of Education had expended more than was appropriated underneath the city's operating budget.

Mayor Lauretti: Over-spended? Say that again.

Dave Cappelletti: The Board of Education over-expended their appropriation of the originally approved budget by the city's budget making authority. This went on throughout the year without anyone noticing it.

Mayor Lauretti: So, it begs the question what's different last year than from any other year that we've been doing this, and you have been the auditor for how many years now?

Dave Cappelletti: Yeah, so historically this grant was recorded on the general fund side, as far back as I could remember.

Mayor Lauretti: As a revenue?

Dave Cappelletti: Yes. One year there was discussion and it was changed that the Board of Education would receive this, I believe that was in 2015. They would receive this money against their appropriated budget. The following year, 2016, they decided not to do that anymore and brought it back to the city side, that revenue amount. Then in 2017 & 2018 it was continued on the budget to be recorded on the city side. However, in 2017 & 2018 fiscal years, the Board of Education for some reason had picked it up on their side. I spoke with their (BOE) management, I spoke with the city's management, I spoke with John Anglace and the Mayor, to find if there was any discussions with them during this period and not one person, nor could I find anything in writing anywhere that there was a discussion anywhere that this was going to be recorded differently in these years. In 2015, that was part of the negotiation, so I understand why the Board of Education did it in that one year. I do remember there was discussion in 2016 bringing that back.

Mayor Lauretti: That's part of the budget making process in 2015?

Dave Cappelletti: Yes, exactly.

Mayor Lauretti: Because for as long as I could remember this has always been budgeted and received by the city from the state as revenue.

Dave Cappelletti: Yes.

Mayor Lauretti: Just like the ECS money.

Dave Cappelletti: Yes. Just so you know, the superintendent, through his attorneys, did send me a disagreement on the finding and one of the findings that they are disagreeing with is there is a state statute that requires that these funds be recorded to the Board of Education against their funds. So, when you read through that statute and the use of it, in the State of Connecticut, if they budgeted \$1.5 million and received \$1.5 million, if they were to budget \$1.5 and receive \$2.5 then I would feel they have an argument to get the funds that were originally budgeted. So, I could see them understanding that. What the state statute basically says is that if funds are received over the budget amount then the Board of Education would receive that money directly and it would not go to the city.

Mayor Lauretti: Or a portion there of?

Dave Cappelletti: Yes. But there is clear communication that they expected to receive the \$1.5, however as I said, they put a budget together that I don't think is reviewed by the budget making authority, or presented to the budget making authority. Also, we recorded in the original budget a revenue in that line item of that amount so there was a reasonable expectation, I think by the budget making authority, that those funds at the appropriation requested included that revenue.

Mayor Lauretti: Well I think it's pretty clear. You approve a budget and the respectable line items in that budget are approved, and the Board of Education has an approved dollar amount, and we do the same thing with revenues. I mean that hasn't changed in my lifetime.

Dave Cappelletti: Yeah so...

Mayor Lauretti: Have we done it wrong all this time?

Dave Cappelletti: So, like I said, other cities in the State of Connecticut, there is a split on how this is recorded. The majority of cities this size do record it the way that the City of Shelton does. I don't think you are doing it incorrectly. I think as long as it's presented and consistent and transparent there isn't a reason why it shouldn't be recorded the way it is. So, one of the areas of the internal control finding is communication, because this wasn't communicated properly. The second part of this oversight was that once the budget making authority approved the budget no one reviewed the budget to see exactly what the appropriation was and/or reached out to the budget making authority for a budget amendment to correct this. So those are the areas that I think should have been done during this year and because the city does not have a budget manager basically the purchase orders are approved on the city side for the city, and the BOE for the BOE. So, the person who approved those purchase orders should have recognized that this appropriation was incorrect.

Mayor Lauretti: I don't know, you are saying a couple different things that don't add up in my mind.

Dave Cappelletti: So, when you approve a purchase order the person who approves the purchase order has the ability to approve purchases to the amount appropriated by the budget making authority. That person should have read the budget, should have recognized the budget and that person who signed off on these purchase orders is saying that this is within our budget. So, whoever signed those orders to say, yes, we could spend this money and I understand my budget, didn't review the budget properly.

Alderman Balamaci: So, you're saying there's no reconciliation report that they do, I'm confused?

Dave Cappelletti: Well there's also the issue of that. I would think that during this time the approved budget was not understood or reviewed by the individual or department who was approving the budget.

Mayor Lauretti: I don't understand how you could stand up here and say that because this budget process has been the same process for the last 30 years, no different, all of a sudden, our general fund is down \$2.5 million and we had no notice of it?

Dave Cappelletti: That's what's concerning.

Mayor Lauretti: Well, that's concerning to the budget making authority and myself as the administrator.

Dave Cappelletti: Yes.

Mayor Lauretti: I mean because this has never happened before.

Dave Cappelletti: No, I have not...

Mayor Lauretti: I don't ever recall this happening, and what you are saying is that it can't happen again this year because there isn't money there to accommodate it.

Dave Cappelletti: That's exactly true.

Mayor Lauretti: So, simple is pretty simple for me, when we approve a budget and everyone has a line item with a number that says this is what your budget is that's what everybody has done, with the exception of, I guess, last year. Right or wrong?

Dave Cappelletti: This started in 2017 and continued through 2018.

Mayor Lauretti: So, the last 2 years then?

Dave Cappelletti: Last year we spoke about it in a management comment, and this year it is a significant finding. Before then there was agreement on this on how to (inaudible).

Mayor Lauretti: There was never a disagreement?

Dave Cappelletti: I never said...

Mayor Lauretti: There was never a disagreement?

Dave Cappelletti: Yes.

Mayor Lauretti: I mean if you didn't do it that way what's the sense of having a budget process and approving a budget, I mean people will just go out and spend...

Dave Cappelletti: Yes, it should have been reviewed and if it wasn't understood there should have been some comment made to the budget making authority.

Mayor Lauretti: When you say it wasn't understood, it's pretty clear, at least from my standpoint. Crystal clear. So, you lost me when you say it wasn't understood. How could it not be understood?

Dave Cappelletti: Well yeah, I mean like I said, looking through these procedures we are counting it as an internal control finding rather than a compliance finding which is, a compliance finding would be that an individual or group of individuals broke the law, which does not allow anyone to approve an expenditure above their appropriation. That happened here but I think the reason was because of a lack of internal controls, not because of a...

Mayor Lauretti: So, the internal controls to me is pretty simple, that has got to be on this end, because we are the general fund.

Dave Cappelletti: Yeah, I mean moving forward I would expect there would be more monitoring.

Mayor Lauretti: Paul, I think it is time you get into the discussion. I mean how does someone spend \$1.3 million more than what they were approved?

Dave Cappelletti: The finance director is here but when I was writing my finding on the true causes of this and as I read through what the Finance Director's responsibilities were and what his duties are, is to 1: maintain the books of the city on behalf of the budget making authority and number 2: is he acts as an assistant treasurer. Basically, his duties include making sure the funds are available to spend. What I was looking at was who is responsible for the budget? With all of his procedures and his responsibilities you wouldn't see that on this side. I mean Paul, the finance director, is welcome to speak to that but that's why my finding is written the way it was. We are trying to find the areas of weakness that need to be improved. Whether it be more monitoring on the city side so the Board of Education gets warnings when they get close to their appropriation or whether it's the Board of Education side to fully understand the budget and to make sure they spend within the appropriations. Did you want to add to that Paul?

Paul Hiller: I guess the only thing that really concerns me, if you look at this on page 9, and you look at the current year loss which is roughly, well particularly on the State Excess Cost Grant, which is roughly \$1,052,000. There is an accumulated loss of \$2,776,000 million, which was not reported to this board or to other authorities within the city last year. So as Dave said, yes, the 17/18 budget, but why now? I guess is my question.

Mayor Lauretti: Yeah, I mean if the same thing happened last year why didn't we have this discussion last year?

Dave Cappelletti: The big difference between a management comment, which we made last year on this, and a significant finding this year, is that it now has affected the general fund. Now it should be read in conjunction with the financial statements. It is the reason why the general fund has no funds available to appropriate. So, what was once a fixable problem with the weaknesses is now a more difficult problem to correct.

Mayor Lauretti: So, they basically, what you are saying if there was \$5 million dollars of surplus money in the general fund this may have gone another year without anybody picking it up, the only reason why it's picked up on is because we've run out of cash?

Dave Cappelletti: Yes, and the other thing is that...

Mayor Lauretti: That's crazy.

Dave Cappelletti: Yes, and the other thing is that it's happened two years in a row. Like I said before is when I see a deficit outside the general fund for one year, I usually comment on it and give it an ability to reinvest itself to come back up, then if I see a trend then it's more than a comment which is another reason why it's being commented on because it is a trend and it's also budgeted this way. I do have the 18/19 budget for the Board of Education and I have reviewed your 18/19 year and I feel this is the third year this is also happening. We have a long-term trend that needs to be corrected

Alderman Anglace: I'm sitting here somewhere between understanding and totally confused. I see on page 9 that to maybe understand it a little clearer, the State Excess Cost Grant is just one of maybe 5 accounts that are in the same category that have been overspent that have created a deficit. School Lunch Program, current year was \$15,871 in deficit accumulated loss of \$178,000. How could we provide oversight to make sure that does not happen on the School Lunch Program? I mean you are talking about us providing oversight. Before you answer look down below, school rental, lighting and facility, \$19,000 and \$114,000 cumulative. I mean oversight? What kind of oversight could I provide to tell them they have got to charge more for when they rent a facility to cover all the costs? Because that's pretty obvious, what that is if I interpret that correctly. Now, one of the other things that infuriates me is that you talk several years, we have never, once we appropriate the budget to the Board of Education they sit down and adopt a budget, we have never, never, never been given a copy of that budget or asked to come in to discuss it or look at it. We are going to make that mandatory, this year, we are going to change things. Number one, there's going to be no dog and pony show this year. They are going to submit a budget in line item format, an item by item, the same way the city does so everybody could see it and it's all on the table. Then when they set their budget, we will definitely schedule a meeting with them and go in and have a meeting and sit down and see where they are assigning the money. Then we will meet as necessary throughout the year to take another look at what's going on. Maybe we will pick up something but you can't keep us in the dark and then come in with the audit and find this stuff and it's exposed and we are out of cash. For God Sakes, \$3.1 million we would have had to raise taxes, a special tax revenue to maintain that, to pay that off, maybe a half a mil.

Mayor Lauretti: If the School Rental Program goes in the arrears, to the tune of \$114,000, how is it being paid for?

Dave Cappelletti: The cash physically comes from the general fund.

Mayor Lauretti: So, to John's point, how would we have any warning that's occurring?

Dave Cappelletti: Like I said is that when recognized in this finding and writing up this finding we try to find where the internal control weaknesses are, and one of the internal control weaknesses we did find is that these numbers are from my report only, they are not maintained anywhere else. It's carried over from year to year. Basically, I take what was spent under that program compared to what was received and the difference adds to that deficit. What I normally would do is then sit down with the Board of Finance.

Mayor Lauretti: What expense do they have in the School Rental Program, if your renting a building that's already in place where are the expenses coming into play?

Dave Cappelletti: I mean, maybe the details should be more for the finance department at the BOE, but legally what that is supposed to be is the cost associated for renting the building which also would include not only direct costs, such as custodial, but it's also allowable costs that could also be maintenance, such as waxing floors or changing light bulbs. So, they are able to build up a little bit of a surplus in those accounts by state statute so when they want to do capital maintenance, they could use that money for that. So, yes, you would always expect that there would be a surplus in that account simply because when they charge, they should charge a little more.

Mayor Lauretti: It's a revenue stream, there is a revenue stream here. So, for the life of me how does the general fund get depleted that dollar amount?

Dave Cappelletti: Yes. like I said, annually I do sit down with the Finance Director at the Board of Education to go over these accounts. I will tell you that the School Lunch Program did take a big loss in one year and they are correcting that now with our comments. So, there are some areas here that are larger but like I said in general these are not normally large numbers. There are things I go over with the Finance Director of the BOE and I check up on it in the next year to make sure the issues are corrected. As far as the School Rental, they usually have just small losses, and one year they will have a gain. But yes, as far as looking into them any further, unless I see something significant, we just make sure they approach zero all the time. But like I said, it's one of the areas of internal control weakness, the Board of Education expenses outside of the general fund. It's basically outside of the general fund, what I'm saying is they are expecting to receive a revenue line and they don't necessarily match the expenses with those revenue lines appropriately, and they don't have the system or general ledger to show that they are not doing that. They mostly operate a Uni system and they use it as a purchase order, expense system not as a general ledger, so that would be something, and we've commented on that, that they correct that. That's been over the years we have commented on those issues.

Mayor Lauretti: Well, Paul, I will tell you that sometime next week you will be sending a notice to every department in the city that this is their appropriation and 10 cents past that will not be recognized by the city and we will have to do something to shut the city accounts down so it can't be accessed. Simple as that. That's what's going to happen. With that I've got to leave, you can take it from here.

Alderman Anglace: Have you concluded Dave?

Dave Cappelletti: Have I concluded? So as far as my presentation I went through everything I thought we wanted to go through but I really do want everyone up on the stage to understand what happened and specifically the consequences. I also want people to recognize moving forward what has to happen, and you know one thing that has to happen is that it's going to be a tighter than normal budget year, we should probably have discussions with the Board of Education specifically on the 18/19 budget to determine what is their appropriation. I think it's something we have to do as soon as possible. The next step is to change internal controls so 1: it is recognizable when this happens and then moving forward after that, we are talking to the Finance Director of the City, make sure the funds are

available and also aware of what the budget is, so he is not so much a budget director but someone who probably gives notice, have a line of communication so the BOE realizes where they stand on the city side of expenses. Then after that I think communication while making the budget, I think the workshop with the BOE, the Finance Director with the board should present this budget to the budget making authority so they could truly understand it. What we have to realize in this finding also is that the budget making authorities are volunteers, they are not professionals in this area and the budget should be made and presented as if anyone in the city could understand this and if not then it needs more communication. The people who are making the budget should have some professional abilities, I mean, specifically the BOE finance director must be approved by not only the city but also the state. So, this is someone that should be educated in this area, they should be able to explain the more difficult parts of the budget. I think that meeting before the budget is approved would greatly help both sides.

Alderman Anglace: OK.

Alderman Simonetti: Mr. Cappelletti, thank you this evening. So, we receive a budget sheet, at least once a month from the Budget Director for the city side, and it will have little discrepancies here and there, \$500 or a \$100, but nothing worth a great amount of money. Normally it's for expended more because they had to buy more equipment or more tires or something simple, nothing where they have really gone over the budget that far in any one department, and usually not until near the end of the year, and usually we find another department that did not spend their \$500 that they were going to spend on going to a seminar, or something like that so that evens out there. Does the Board of Education have that kind of a system that their Finance Director and their finance people could look at every time?

Dave Cappelletti: Yes. I don't think that's a problem. The Board of Education reviews a budget to actual report, a very detailed budget to actual report on a routine basis that's provided to them by the finance department, so they are aware.

Alderman Simonetti: Their finance department?

Dave Cappelletti: Yes.

Alderman Simonetti: OK.

Dave Cappelletti: Yes, but what happens in this situation, is the budget making authority appoints the (inaudible) individual to oversee the budget line, the budget. So basically, you review the city's budget to actual report, but the Board of Education line on that is never correct. It's only the amount that's provided to the Board of Education but the expenses in that line include all the expenses for school lunch, it's a lot more. So, one of the questions you may ask is that why did the city even provide this money to the Board of Education and what has been a procedure, which maybe we should take a look at, is that the money has been provided to the Board of Education and then the Board of Education then reimburses them for other revenue sources. OK? Such as grants, like large grants. So first the city spends the money, the Board of Education requests the money from the state. When they receive that money then several checks, literally two or three a year, are written back to the

city, and usually months after that expense. So, it's probably a procedure we should look at and change, so the line item on the city side for the Board of Education is more accurate.

Alderman Simonetti: So, are you saying the 2019 budget for the city is not enough money to finish the year or just Board of Education side or both?

Dave Cappelletti: Both. What I am trying to say here, the 18/19 budget that was approved, we don't have the assets available to, if 100% of those appropriations were used. That's the bad news, but the good news is, or the better news to that is the city has historically shown \$4 plus million dollars in budget surpluses. That's more than your assets not available, so I had to reduce it by \$1.3 million.

Alderman Simonetti: Is your findings, what you find, going to affect our rating for when we do borrow or bond?

Dave Cappelletti: It has affected it in the past, so one of the things the City of Shelton has been doing has been reducing their general fund balance in an effort to reduce the debt, so you have done that, you have lost ratings because of your reduced fund balance already. Two things that are probably going to be questioned by the rating agency, and this depends highly on interview of management on how they can interpret this, is two questions they will ask is 1: How did the budget unexpectedly go down, because I think that's something who's investing in the city would want to know, and number 2: they might bring in the low fund balance again. Historically they like a balance between 8 & 12%, you are in a high growth area so you get a little luck with that, you've been well below that for several years so that's been lowering your rating in the past and will be questioned again I think. Like I said, this is something that the rating agencies would bring to.

Alderman Simonetti: So, we have five months to straighten this out is what you are saying? February, March, April, May, June.

Dave Cappelletti: I would say you have five months to correct the 2018/2019 budget, but it's probably important that you do it sooner than five months simply because half the year is done. I think the biggest issue here is the communication with the Board of Education. I think other departments are okay with their appropriations in the 2018/2019 year, but I think this is going to be a big surprise to the Board of Education and whether they are able to spend the portion of the expenses that they thought they had in the excess cost grant. For the 2018/2019 year they put in \$1.5 million worth of expenses in the current budget that is really taking it out. So, there is a question about whether their appropriation is reduced by \$1.5 million and they historically, I don't remember them ever having a surplus of \$1.5 million. That needs to either be increased or significant adjustments need to be made over at the Board of Education. I would think either a budget amendment or something needs to be made to correct that issue.

Alderman Simonetti: Thank you very much.

Alderman Anglace: Any further questions for Dave?

Alderman McPherson: Yes, I just have one, if you could enlighten us on, in the small book on page 10, the clause where it says the Board of Education did not understand the City's

appropriation to the Board of Education nor did they reconcile activity, and they did not maintain full accounts. How would a Finance Director, I guess this goes back two years, so how could a Finance Director not understand? Could you enlighten us a little bit on that?

Dave Cappelletti: Sure, so the Board of Education put together their own proposed budget, and that was approved and they worked off of that. So, you had that budget and they worked under that budget and had oversight of that budget and recorded on that budget to their board. They diligently looked at it, I mean there is no problem with them working under a budget. The area here of concern was that what they thought was appropriated by the budget making authority of the city, how much money the city was giving over, did not agree with their budget. It was the way it was approved on this side. So, two things probably should have happened, like I said, again before the budget was approved by the budget making authority, they should have presented this because this is a pretty detailed report. And it's pretty well written and it is line detailed like John was saying and so that probably should have been presented. Like I said, the budget making authority is not government finance professionals. So, they would need to do that. And then also it should have been reviewed afterwards to make sure that it was approved properly before they spent the money. Do you understand what I am saying? So, there is two areas that needed to happen. And the second thing you said there is the reconciliation, ok, so what's happened for years and years, the amount of money that is spent under the Board of Education that is recorded at the city's side, because that's where the budget making authority designated their accounts be kept. We need some way to reconcile that routinely and quickly so that we could see where they stand on this side. They keep a budget, they keep a budget to actual reports, they work under those but as far as the appropriation of the city's budget, it really matters what happens on the city side. So, you would say that the general ledger of the city is the city and this is just a system they use for management purposes. But the legal budget is maintained on the city side. So that should be reconciled over here. And then number 3: we have had a long history of small problem funds outside of the general fund at the Board of Education, and so again what I recommended in the past, both in findings and in management letters and verbally was that they set up an account, a balance sheet and income statement, so they know historical trends of how they are doing over years. So that things such as The School Rental, when it goes deficit two or three years in a row, they recognize that and they could make corrections. It shouldn't be waiting until the external auditor comes in and says this has been happening. We want to see some internal controls on that. Historically those have been smaller issues. I will tell you when they have been large they have noticed them. Especially with the School Lunch Program, there has been significant changes over the last 8 years, whether outsourcing it or changing vendors, they have actively managed these, but I think it would be better for them to keep a full set of books. So those are the three areas of those causes.

Alderman McPherson: Thank you.

Dave Cappelletti: You are welcome.

Alderman Anglace: Anyone else have any observations? Dave, thank you very much for your report, we appreciate your candidness and will have continued dialogue. I want the record to show that the City Treasurer Ray O'Leary is here tonight and I think he's going to play a greater role in this whole thing.

Dave Cappelletti: I know I brought some difficult issues to you tonight so please feel free, I will make sure I am available if anyone has any questions individually so I could help this could get resolved.

Alderman McPherson: Thank you.

ADJOURNMENT

Alderman Anglace MOVED to adjourn at approximately 7:40 p.m.

SECONDED by Alderman McPherson. A voice vote was taken and the motion PASSED unanimously.

Respectfully Submitted,

Amy Rogers

Amy Rogers, Clerk
Board of Aldermen

DATE APPROVED: _____ BY: _____

Mayor Mark A. Lauretti