

FOLLOW UP ON THE LOST MONEY

Bridge Article for October 15, 2009

By William Fraser, City Manager

I am finishing this article on Monday morning the 12th. Therefore it will be completed and sent to the Bridge for its Monday publishing deadline in advance of the City Council Meeting on Wednesday the 14th. It will appear in print on Thursday the 15th - the day after the meeting. Recognizing that limitation, I don't know whether some or all of this information will be covered or if different conclusions or decisions will be reached at that meeting. I am posting this article on the city's website as soon as it is finished, however, so that it is publicly available before the meeting.

Last Wednesday, October 7th, the City's attorneys informed us that a probable loss in the water fund of nearly \$400,000 was, in fact, uncollectible despite efforts by the city to retrieve the funds. I spent Thursday the 8th pulling information together and drafting a detailed statement. The statement was circulated for review and comment among the Mayor and City Council members and our attorney to assure accuracy. On Friday the 9th I made editing revisions, posted it on the city's website and sent it to the Times Argus for publishing on Saturday the 10th. This was released as quickly as possible once we got the news.

Since this announcement there have understandably been a lot of comments and questions, concerns and accusations, criticism and disappointment. I would like to personally thank all of the people who have spoken to me or raised issues either privately or publicly – those who have offered support and understanding as well as those who have called for investigations and resignations. All of this is part of the essential public discourse on a matter of this magnitude.

In an attempt to respond to some questions that have been posed, I am going to separate the issue into three components – (1) the issuance of the erroneous check (2) the attempts at collection and (3) the disclosure of information. I will not be able to run this past the Mayor and City Council and, therefore, do not presume to speak for them. I offer my perspective from having been closely involved. There may be repetition from the earlier statement but my goal is clarity.

(1) How did the mistake happen? A bill from Scott Construction for \$85,774.70 on a water line project was approved for payment in December of 2004. Signatories on that correct bill were a representative of Scott Construction, the city's contracted project engineer from Dufresne-Henry and me. The bill was sent through the accounts payable process.

The city typically pays its bills every two weeks. In a bill paying week the account clerk in each department prepares all the bills and, at that time, typed all the warrant jackets. The amounts due from bills were transferred manually to "warrant jackets", a sheet of paper which included the vendor name, ID number, the account number that funds were being charged to, etc. This warrant jacket was folded lengthwise with the actual bill inside and the typed information on the outside. The group of bills/warrants – which were approvals to pay – were then reviewed and signed by the Department Head. The signed warrants were forwarded to the Finance Department who took all the bills from all the departments and prepared master check payment manifests. At the time, all budget verification was done at the department level.

The completed manifest, containing a print out of all checks to be issued with vendor names (but not including the physical warrants/bills) is signed by the Council and Manager in what is somewhat of a pro forma exercise. The signed manifest goes to the Treasurer who actually issues the check and assures that enough money is in the city's bank accounts to cover the checks. The Treasurer does not see each bill for each check, she takes her payment authority from the approved warrants and manifest.

In this case, the account clerk read the incorrect number on the bill from Scott Construction and typed the "paid to date" amount (\$548,110.83) on the warrant. This was an innocent mistake, albeit a very large one, made by an otherwise conscientious and reliable employee with no history of errors or problems.

The incorrect warrant jacket, with the correct bill inside of it, was forwarded to the Department Head who, in this case was Public Works Director Steve Gray. Mr. Gray signed the incorrect warrant, thereby signaling payment approval, and the department's bills were forwarded to the Finance Department. At that time, the Finance Director was Jana Bagwell. The Finance Department performed its normal tasks and moved the payment forward.

The \$548,110.83 amount was entered on the check manifest and the rest of the process was completed. On December 22, 2004 the check was issued to Scott Construction in the erroneous amount and, according to the canceled check, deposited into Scott's account the next day.

Why wasn't this caught sooner? There were several complicating factors. One was that Scott was performing two different projects for the city at the same time. Second, the city did not get another payment request from Scott for either project until September of 2005 and for this particular project until May of 2006. There was no activity on this account and no immediate or obvious reason to look more closely. Additionally the activity had crossed into a new fiscal year. At that time, expenses for capital projects were credited directly to the balance sheet as assets and in this case both water projects had been combined into one. By the time concerns with this project surfaced, there was a new Public Works Director and new Finance Director so continuity and familiarity was lost.

The city has since eliminated use of the warrant jackets, brought more of the payable work into the finance department, required that all bills over \$25,000 are personally reviewed, calculated and signed by the Finance Director and that all payments over \$5,000 have the city manager's signature on them. Additional minor process, review and recording improvements have also been made.

Why didn't the auditor catch this? The audit work for the fiscal year ending June 30, 2005 was done in October of 2005 – 10 months after the check had been issued. The city was told that this specific bill was pulled as a result of its amount and that auditor confirmed that it had gone through the proper financial controls, contained the proper signatures and had been duly authorized. I can't answer for them but Sullivan & Powers is a highly regarded municipal auditing firm. They perform audits for as many or more Vermont municipal governments than

any other accounting firm. They have provided the city with good advice and suggestions for improvements to financial systems over the years.

As described in my earlier article, the specific error was discovered by new Finance Director Sandra Gallup a year later on October 11, 2006 when reconciling the accounts for the fiscal year ending June 30, 2006 in conjunction with the audit that year. It was found because the water fund had an inexplicably high deficit and she, new Public Works Director Todd Law and I had been trying to pinpoint the cause since the summer.

Once the mistake was discovered were people fired because of this? The two key management people who would have overseen direct review and issued authorization for this payment were Public Works Director Steve Gray and Finance Director Jana Bagwell. Both had been retired and no longer in city employment when the mistake was discovered. Both served the city honorably and with great dedication and great results during their tenures.

The account clerk who made the transposition error was Virginia Mackey. It was my decision not to fire an otherwise fine employee who had made a human mistake 20 months earlier. The error was costly, no doubt, but not done willfully, maliciously, with bad intent or personal gain nor did she have any history of sloppy or inattentive work. She, like all of us, felt terribly about this. She still works for the city and does a good job. Firing her would not get the money back.

(2) What were the collection efforts? I have previously gone into this matter in great detail so I will try not to repeat myself.

Did city officials treat this carelessly because it was “not their money”? No, the City has taken this extremely seriously from the day we learned about it. In fact, the top priority for the city has been to get the citizen’s money back. Neither the Council nor the Manager caused the problem but immediately tried to correct it.

From the day that I first learned about this issue and to the present, the city has consulted highly regarded municipal attorney Steven Stitzel every step of the way. He has advised us about contacting Scott, he has advised us about various collection options and instruments, he has been involved in all of our negotiations concerning notes, securities, payments and ultimately our suit for attachment, subpoena for Scott’s financial records and the like. He has advised us on procedural matters, legal obligations and strategic decisions.

Did Scott Construction have a bond for the job? I am currently tracking this down. A performance bond or, in some cases, letter of credit for a contractor is generally put in place to provide a surety that the work will be completed. If the contractor walks off in the middle of the job, the bond is invoked to provide funds to complete the job. In this case, final payment was made to Scott in August of 2006. By October of 2006 when this was discovered, it is possible that the bond had already been released.

How did Scott get this job? Scott Construction obtained the job through a formal bid process. As mentioned before, they actually did two different projects simultaneously for the city. They have worked for the city in the past on CSO projects, water/sewer projects and some subcontract work

on the Fire Station expansion. They worked on both public and private projects of this nature in Vermont and New England for many years.

Did anyone look at Scott's financial statements? The city obtained financial statements from the company when negotiations began in late 2006 and early 2007. At that time, their outstanding debt and line of credit with Chittenden was nowhere near as substantial as it apparently grew to be in 2009. When these discussions were taking place, Scott had regular work for 2007 and commitments through 2008. No one foresaw the financial meltdown of 2008 which dried up construction work and resulted in the cancellation of Scott's planned 2008 revenues. In 2008, Scott signed legal documents stating that he had sufficient unencumbered property equity to secure the city's note.

What about legal costs and water rates? The refinanced note for \$393,534.05 signed in February of 2009 included all back interest and legal fees to date. On June 16, 2009 the Washington County Superior Court issued a judgment against Scott and in favor of the City for \$397,079.90. This included the note plus additional interest and fees accrued since February. Obviously the city has incurred some additional legal costs since June but the bulk of the fees are included in these numbers. Because this money had been included on the balance sheet as a receivable asset, this loss has not increased the present water rates. We are looking for means to minimize the impact of this loss into the future – this could include sale of assets, delay of equipment purchases or projects, budget reduction and continued efforts at collection.

(3) Why is this only being widely disclosed now? Some have charged that this was a cover up to protect city officials. Neither the City Council nor the City Manager directly made this mistake and therefore had nothing to gain personally or professionally by hiding it. When the mistake was discovered, I reported it to the Mayor, our attorney was consulted and the Council briefed. The council's (and my) sole goal from that point forward was to get the money back for the water rate payers.

The issue of when and how broadly to disclose this was a constant source of discussion and concern amongst the council and me. There were differing opinions among city officials as there may be differing opinions in the community. Based on the information available to us in real time as the process was unfolding in 2007 and 2008, the group's decision was that this money was a collectible asset. We believed that the best path to assuring collection was to maintain stability for Scott in the financial markets thereby avoiding bankruptcy for him and resulting lack of collection for the city. Reasonable people can and will disagree whether that was the correct decision but it was made based on what was felt to be the best interests of the public. In 2007 payments were being received regularly and this appeared to be a performing asset and a problem solved. In 2008 the city was actively considering litigation and did not wish to compromise its legal position. That problem seemed to be resolved by early 2009 when a security interest in property was obtained. The notes have always been fully disclosed in the city's financial statements.

It's possible that we were wrong to value collection over broad disclosure. The belief at the time, based on the body of information, was that it was one choice against the other. Obviously

we did not collect all the money so more broad disclosure, in hindsight, could not have made the outcome much worse.

Until last week we were still in a position in court to secure the money. Once we learned on Wednesday the 7th that the money would need to be written off, we took immediate action to write and release a full explanation by Friday the 9th. We acknowledge that for some, and perhaps many, that is too late – perhaps three years too late. Fair enough. That is a legitimate complaint.

This was caused by a human error, compounded by an unusual project circumstance and billing schedule. It was exacerbated by a contractor who did not immediately return the money and late detection of the overpayment. Once found, City officials took immediate and thorough, yet unsuccessful, action to recover the money. There was no attempt or need for any cover up. Speaking for myself and, I believe for the Mayor and City Council members, we are sincerely sorry that this error occurred, that we were not successful in collecting the public's funds and if we have offended or caused mistrust by the manner in which the money was pursued. We will answer all questions that anyone has and provide whatever information we can.

Thank you for reading this article and for your interest in Montpelier city government. If you have questions or comments regarding this or any city issue, please feel free to contact me at wfraser@montpelier-vt.org or 223-9502.