

**Montpelier Citizens Review Committee
Report**



**Presented to the Montpelier City Council
by
The Montpelier Citizens Financial Review Committee**

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The Montpelier Citizens Financial Review Committee was created at the request of the City Council in response to public reaction to the announcement of an overpayment made to Scott Construction in December 2004. The Committee was tasked to examine all relevant financial transactions, controls and policies that were in place in December 2004, subsequent changes that were made after the overpayment was discovered and to hire a CPA firm to review the city's financial controls, policies, and safeguards and determine if they are adequate and meet professional accounting standards.

During an October 14, 2009, public meeting of the City Council it was suggested that State Auditor of Accounts Thomas M. Salmon, CPA, be invited to play a role in clarifying the events of December 2004 and thereafter, up to and including the public announcement of the issue.

Salmon met with city officials on November 11, 2009, and a result of that meeting was the creation of the Citizens Financial Review Committee and the decision to hire an outside CPA firm to review the city's financial systems. A five person Citizens Committee was appointed on November 18, 2009. The Committee has met every Monday since, and has a goal of having a report ready for city officials in mid-January 2010.

An informational meeting was held on November 16, 2009, where city residents outlined their concerns over the need for results from the Citizens Review Committee. The general consensus was for a review of the Scott Construction transactions with special emphasis on making sure an understanding of what happened with recommendations for reform that would assure Montpelier citizens that their government would be protected from future activities of this nature and allow for a sense of trust to be re-gained in city hall activities. The list of specific concerns can be found in Appendix I.

The Committee issued a request for proposals, reviewed firms that expressed interest in the project, and hired the accounting firm of Cota CPA, PC, of Williston to conduct the review. Members of the Committee met with Ray Cota and Justin Wolcott to go over the scope of the project and to provide them with a list of questions prepared by the full Citizens Financial Review Committee.

I. History:

In early December 2004, the city received a bill from Scott Construction of Newport, the firm hired for a \$755,352.89 water project on Memorial Drive, seeking payment of \$85,774.70 for work performed. We know the city made an error and sent Scott Construction a check for \$548,110.83, which amounted to an overpayment of \$462,336.13. It seems from documents reviewed that the "previous payments" amount transferred to the warrant as the amount due, rather than the true amount due. A hand written correction of the amount due, the numbers were much larger than any others on the invoice, which allowed the larger number to be picked up. Under the financial system at that time, the original document, while inside the warrant jacket, was not prominently displayed, and even if reviewed, the larger, hand written number still stood out. Thus the error went undetected by the department head, the city's financial office, the city manager, and the mayor and City Council, which had approved the payment voucher for \$548,110.83. In fact, due to a number of circumstances, the error wasn't found for nearly two years.

We now know that Scott Construction deposited the overpayment check the day it was issued and that the funds were used to pay down other Scott Construction debts. We should note at this point that even though Scott Construction submitted a bill for \$85,774.70 and received and cashed a payment check for \$548,110.83, forthcoming Scott Construction invoices submitted for payment on the Memorial Drive project, made no mention of the actual payment, but instead listed the amount supposed to be paid.

The city's Financial Department, seeking to reconcile an apparent deficit in the water fund, discovered the error on October 11, 2006. Finance Director Sandy Gallup informed City Manager William Fraser who told Mayor Mary Hooper of the overpayment on October 13, 2006. Fraser notified the City Council by memorandum on October 27, 2006, detailing the overpayment and actions that had been taken. Those actions included a decision by Fraser to contact Attorney Steve Stitzel, a partner in one of three law firms used by the city for legal assistance, on October 12, 2006, for advice on how to proceed and two separate mailings to Scott Construction, demanding reimbursement of the overpayment.

It is clear through examination of correspondence, e-mails, memorandums, and reports that the city's principal goal was the recovery of the \$462,336.13 overpayment to Scott Construction. Between October 13, 2006, when a notice of the overpayment was first sent to Scott Construction and January 25, 2007, when the City Council agreed to accept the promissory note formalizing the debt, there were a series of executive sessions to discuss the issue and what steps should be taken to collect the money. City officials indicated they kept the matter confidential because they were concerned a lawsuit or other public attempt to recoup the money would result in a run on Scott's assets by other creditors and the city would be unable to recover the funds.

On February 9, 2007, Finance Director Sandy Gallup provided the City Council with updated financial controls to address concerns raised by the Scott matter. On February 21, 2007, the City Council reviewed and discussed these controls in open session. Also during the February 21 meeting the Council received the audit report for the year ending June 30, 2006, and voted 5-0 to accept the report, which included the funds due from Scott construction as a receivable in the water fund.

Between February 2007 and April 2008, Scott Construction made regular monthly payments of \$7,445.89 which diminished any potential impact on the city's water fund. However, the situation began to unravel in April 2008 when Scott Construction failed to make its April payment of \$7,445.89. Scott asked for an extension, but then missed the May payment as well, promising to become current by June. At this point Scott was two payments behind and in early June, instead of payment for the three months as promised, he sent a check for one month's payment, which was returned by the bank for non-sufficient funds.

Between June 2008 and February 2009, there was a series of meetings and back-and-forth correspondence between City officials and Scott and his attorney regarding the development of a revised payment plan and a new promissory note secured by New Hampshire property owned by Scott Construction. The property's assessed value far exceeded Scott's mortgage on it. The new note was signed on February 24, 2009. Scott was late with his March payment, citing confusion over the date of the note payment. He never made his April payment, and on April 30, 2009, the city filed suit against Scott Construction. In May Attorney Stitzel filed additional motions for

attachments on Scott's properties and bank accounts, and on June 16, 2009, the Washington County Superior Court issued a default judgment and writ of attachment against Scott for \$397,079.90.

It was about this time that the city got the bad news. The bank in New Hampshire holding the mortgage on Scott's security property foreclosed. The bank sold the property at auction for far less than the assessed value. After the New Hampshire bank recouped its own mortgage, the small balance remaining went to the Chittenden Bank, which held an overlying position as creditor to Scott Construction, leaving the city with nothing. Then Chittenden Bank foreclosed on Scott's Vermont assets, and on October 7, 2009, Attorney Stitzel advised the city that the money owed by Scott Construction seemed uncollectible.

Documents provided the Committee show that in July 2009, after the City had filed suit against Scott Construction and received a judgment from the court, City officials began to discuss via e-mail how to deal with the press and public once the events surrounding the overpayments and the City's attempts to recover the funds became known. Those documents show the Mayor suggested that she and/or the City Manager be the spokesperson for the City and the Council in explaining the City's actions and preparing a document explaining what happened and what City officials had done to recover public funds. On October 8, 2009, City Manager Fraser prepared a summary of the events of the overpayment and the City's attempts over the previous three years to recoup the money from Scott Construction, and was sent to the Council for review. The thought was to have Fraser's summary printed in the Bridge and, perhaps, the Times Argus. Both Fraser and Mayor Hooper met with Sue Allen of the Times Argus on October 9, 2009. Allen's story appeared on the front page of the October 10, 2009, edition of the Argus. The City purchased a full page ad in the October 10, 2009, Argus and printed Fraser's summary. The October 15, 2009, issue of the Bridge also carried a story regarding the issue on the City's page.

The City Council held the first of a series of public hearings, including a hearing on the open meeting law that included Allen Gilbert from the Vermont Chapter of the American Civil Liberties Union, Attorney Jim Barlow from the Vermont League of Cities and Towns and former Deputy Secretary of State Paul Gillies on October 14, 2009, and fielded numerous questions from city residents about the situation. A Citizens Committee was formed to review the relevant financial policies and procedures that were in place in December 2004 when the overpayment to Scott Construction was made, the changes in policy and procedures that have been since implemented by the City and what additional steps may be necessary to insure similar errors don't happen in the future.

The Committee spent the time since its formation on November 18, 2009, reviewing several hundred documents provided by the City that have helped the Committee better understand the time line, thought process, and actions of City officials from the date the overpayment was discovered on October 11, 2006, to October 10, 2009, when the incident became public. Reviewing those documents resulted in a series of questions in several core areas. The Committee met on November 21, 2009, with Mayor Hooper, City Manager Fraser, and Attorney Stitzel to further discuss those issues. Several council members were also in attendance.

On December 11, 2009, the City received word that it would recover the full amount of the

judgment against Scott from City's insurance policy.

II. Core issues:

I A question raised at the October 14, 2009, public hearing was why City officials sought counsel from Attorney Stitzel instead of City Attorney Paul Giuliani. The Committee wanted to have a better understanding of why the City Manager made that choice. The Committee also wanted a better understanding of the City Attorney's defined role, and to what extent the City Attorney is kept informed of all general legal proceeding

i) City Manager Fraser explained for the past 14 years the City maintained regular relationships with three law firms and multiple attorneys in each law office, and that each firm and attorney handles different work depending on the issue, need and expertise. He indicated that although the firm of McKee, Giuliani & Cleveland acts as the City Attorney of record because of its local proximity and history, that designation was primarily for service purposes and that the City doesn't function with a single city attorney. Fraser said work is assigned to attorneys at his discretion based on circumstances, and that work is not cross referenced with other law offices unless necessary. Though there is no one single law office that is a repository for all City legal matters, City Attorney Giuliani is kept informed of matters on a regular basis. Fraser indicated he called Attorney Stitzel on the morning of October 12, 2006, because he believed Stitzel's firm was best positioned to assist the City in the Scott matter. Fraser did not call Attorney Giuliani about the Scott matter at that time, but stated he discussed the issue with Attorney Glenn Howland, a partner of McKee, Giuliani & Cleveland, who was at City Hall on another matter. In addition, Fraser said Attorney Giuliani receives all weekly information packets that are provided the City Council, and that the Scott matter was referenced 48 times in those reports over a the three year period. While the Committee understands how the current process allows for the greatest flexibility and utilization of expertise, it remained concerned that there is no central repository for all of the City's legal matters. Perhaps a weekly legal report to the Council copied to the City Attorney of record might alleviate the concern, or there may be other more appropriate measures, depending of the level of legal activity at any given time.

II The next core issue the Committee thought needed additional comment from City officials was the decision to list the overpayment as a "receivable" in the water fund, what the purpose was for listing the overpayment as a receivable, and at what point in the process did that decision occur.

i) City Manager Fraser answered that the City never instructed the auditors to list the overpayment as a receivable. The note Scott signed promising to repay the City was signed in January 2007, and that following standard and appropriate accounting procedures, the City's Finance Office booked the note as a receivable. He explained that audit work for the year ending June 30, 2007, commenced in October 2007, nine months after the note was signed. After seeing the note listed

in the receivables, the auditor asked for a copy of the note and observed that all payments had been made by Scott to date. They properly confirmed this as a receivable asset and correctly noted the loan and terms in the audit report. He added that the only real benefit of this being a receivable was that the City did not have to raise water rates to cover the money.

- ii) Documents, however, suggest there were discussions between City officials and its auditors long before the promissory note was signed in January 2007. In his memorandum to the City Council dated October 27, 2006, in which Fraser first outlined the overpayment to Scott Construction he wrote: “At this time, the auditors, based on Attorney Stitzel’s assessment that Scott is legally liable for payment, are handling this as a ‘receivable’ in the water fund balance so that it is not contributing to any deficit. In any situation like this, of course, there is risk that the money will not be collected. Given the large amount involved, this would have serious implications for the water fund.” The Committee was curious as to why City Manager Fraser wrote in his October 27, 2006, memorandum to the City Council indicating the auditors were handling the overpayment to Scott as a receivable more than three months before the City had an agreement from Scott to repay the funds. However, subsequent information from the firm of Cota CPA, PC, verified the appropriateness of this action within accounting's Generally Accepted Accounting Principles (GAAP).

III Another core issue relates to the decision to extend to Scott Construction what amounted to a long-term, low-interest, unsecured loan instead of seeking immediate repayment. In addition, the Committee had questions about the City’s authority to issue loans to private businesses.

- i) Both Fraser and Mayor Hooper emphasized the City’s top priority in dealing with Scott Construction was recovery of the public’s money. Both said no one from the City was particularly excited about entering into a long-term note with Scott Construction, and would never had done so in advance. But in this case the “loan” had been made inadvertently and (having used the money to pay off other debts) Scott did not have the money in place to pay the City back immediately and was unable to obtain funds from his bank for this purpose. Fraser said the City was faced with bad choices and the promissory note appeared at the time to be the best of the bad choices.
- ii) The Mayor and City Manager referred the question on municipal authority to Attorney Stitzel, but said the City operates many loan funds for housing, ADA improvements, business assistance and community development. Attorney Stitzel said that while the City has several loan programs, the note with Scott Construction didn’t fall under any of them. He said the City had limited options in dealing with Scott and that it was important to get some documentation showing Scott admitting he owed the City the money. He said he viewed the note signed by Scott as a settlement in lieu of litigation that was a clear, enforceable, legal notice that bolstered the City’s position for future litigation. The Committee understands and acknowledges the City Manager and Mayor were acting on legal

advice from Attorney Stitzel.

- iii) The Committee understands the City's desire to collect the overpayment from Scott, but in the clear vision of hindsight, asks the City to carefully consider before again entering into "loan" agreements such as the promissory note it extended to Scott Construction.

IV The final area of concern, and one of perhaps greatest magnitude to several members of the Committee, relates to the open meeting law. The State's open meeting law is designed to ensure that meetings of public bodies like the City Council are open to the public. There are, however, exceptions, and the Legislature has recognized a number of issues that may be discussed behind closed doors in executive session. Litigation or potential litigation is one category that can be considered in executive session. Votes to go into executive session must be made in the public portion of a meeting, and no decisions or actions can be taken in executive session - other than real estate which is the sole exception - and any action ultimately must be taken in open meeting

- i) City officials maintain they used executive sessions judiciously and according to the law. In response to questions on December 21, 2009, regarding the City's use of executive session to discuss Scott Construction, City Manager Fraser provided the Committee with a copy of the law and said it seemed obvious that the Scott matter falls squarely within the provisions of the open meeting law regarding litigation or pending litigation. He said the matter was discussed in executive session eight times in a three year period, three times when the matter first came up - November 8, 2006, December 13, 2006, and January 25, 2007 - and five times in 2008-2009 when collection, property security, and litigation were discussed - April 30, 2008, September 24, 2008, November 5, 2008, April 29, 2009 and June 10, 2009. However, documents provided by the City suggest that the City Council also discussed Scott Construction in executive session on October 8, 2008, even though Scott Construction was not part of the October 8, 2008, meeting agenda, and again on October 22, 2008. In a late night e-mail to Attorney Stitzel Fraser wrote: "Its 10:20 on Wednesday night, Tom (Councilman Golonka) and I just briefed the council on SCI discussions. They were really mad when they heard about the other corporations and particularly the Pembroke land purchase. I would say that their patience has worn thin." Subsequent information shows a motion made in open session on October 8, 2008, to go into executive session for this meeting.
- ii) The City Manager indicated the City has not held specific training on the open meeting law for new council members, though a summary of the open meeting law and public records law was included with orientation materials that are given to every Council member every year. He noted the City Council conducted a workshop on the open meeting and public records laws last month, and that the consensus was that an annual review of the laws would be a good idea.
- iii) The Committee believes City officials should go one step further and

contract with the Vermont League of Cities and Towns to conduct an educational program on the open meeting law for all senior City officials and members of the City Council. That is because a review of the documents provided by the City raises questions about the use of executive sessions in the Scott matter. Some Committee members question the use of “a legal matter” descriptor to cover all discussions related to Scott Construction. Look to Appendix II for more details of the individual incidents .

III. Lessons learned and Recommendations:

Hopefully, City officials and the City Council gained from this unfortunate experience because without question there are lessons to be learned.

First and foremost, in the opinion of the Committee, is that public officials ought to learn/know that nothing done behind closed doors is worth the price you pay when the issue becomes public. In this case City officials were focused on the recovery of the \$462,336.13 overpayment to Scott Construction of Newport, and in the process, under Attorney Stitzel’s direction, determined public disclosure of the mistake would compromise the City’s ability to recover the money. When the story broke in the Times Argus on October 10, 2009 - nearly three years to the day the overpayment was first discovered by City officials - many residents of the community were outraged, not by the fact a mistake had been made, but by the perception that City officials tried to cover it up.

Full disclosure of the public’s business is important to taxpayers. The community really does care about the daily goings-on of its City government and wants to be involved and their opinions to matter. City officials have maintained the decision to grant Scott Construction an unsecured loan to repay the \$462,336.13 debt was done in open session of the January 25, 2007, meeting of the City Council, and that the action is recorded in the minutes of that meeting.

While it is true the Council approved the promissory note in open session and the minutes reflect that action, there was no discussion in public of what the promissory note was for, the amount or terms of the note, or any background information that explained why Scott Construction was agreeing to pay the City \$462,336.13 plus interest. The Committee acknowledges the concern of the City that widespread disclosure of the details of this situation would force Scott into bankruptcy, thus eliminating all hope of recovery of the funds, though they remain concerned that such a choice needed to be made.

The portion of the January 25, 2007, City Council minutes regarding the promissory note take up only four lines (a single paragraph) of a document that is 19 legal size pages long and primarily deals with the 2008 budget. It is the Committee’s opinion that reading the minutes of the January 25, 2007, meeting of the City Council would leave the average taxpayer clueless regarding the significance of the promissory note.

Hindsight is usually 20-20, and City officials have said they were faced with bad choices, and while that is true, in the opinion of the Committee some of those choices the City faced were the result of earlier decisions made by City officials. For example, when the City first demanded Scott return the overpayment within 30-days or face legal action, they could have refused to work

with him further to recoup the funds.

A lesson for City officials to learn, in the opinion of the Committee, is that everybody the City does business with is not necessarily an honest person. Simply put, Scott Construction walked away with \$462,336.13 of the City's money and used it for his own purposes for nearly two years. The Committee believes the City should pursue that matter with state's attorney.

Other than Scott Construction, there are no villains here. The Committee believes that well intentioned people made mistakes and difficult choices, but they did so believing their actions were in best interest of the taxpayers.

Lastly, the Committee is well aware of the public relations template for crisis management, but believes the actions taken by government officials in this case did little to help taxpayers understand the situation, how it happened, why it wasn't discovered for two years, and why it took three years to tell the public. It may well have exacerbated the lack of trust voiced by some members of the community in government officials. Though some members of the Committee feel the situation was withheld from the public much longer than desired, others feel the City's actions were based on a desire to collect the funds before news caused any collection to be untenable. Regardless, the Committee feels the City Council is not just a small group of people. They are the voices and opinions of the community who places its trust in them to remember their charge.

The City Manager, Mayor and City Council acted in what they considered the best interests of those they serve. Hindsight does show some decisions were perhaps not the best choice, but these mistakes will allow the City to learn and improve their processes. The Cota Report, as a companion to this document, shall help the City improve their processes, so as to ensure the systems will catch an error of this magnitude before it occurs.

Finally, the Committee suggests an Audit or Finance Committee would be an excellent addition to the internal control processes of the City. Such a committee might consist of one or two City Council members and one or two community members of appropriate qualification, such as a CPA, business accountant or bank officer. Such a committee's charge might include selection, through competitive procurement process, the contract auditor for contract period. At minimum, the committee could participate in interviews of audit firms the next time the audit is put out to bid. But most importantly, an Audit Committee could improve communication around audit issues, and can help ensure that management follows up to resolve Audit Findings or issues stated in the Internal Control Report or Management Letter. Periodically, they can review internal control policies and procedures to ensure continued best practices. The Cota Report provides a similar recommendation.

Additionally, the Committee recommends the City adopt all of the recommendations included in the Cota Report and report back to the taxpayers by including details of the implementation of the Cota Report's recommendations in the City's 2011 annual report.

The Montpelier Citizens Review Committee would like to take this opportunity to thank the

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members of the City Council for placing their trust in this open process. They would like to thank City Manager William Fraser and Mayor Mary Hooper for their cooperation and open discourse during the Committee's deliberations. The Committee would like to thank State Auditor Thomas M. Salmon, CPA, for facilitating the Committee's efforts and the staff of the State Auditor's office for their hard work in assisting the Committee in its endeavor. Finally, the Committee would like to thank the people of the City of Montpelier for their faith in an open citizen-led review of a difficult experience for this City.

Definition of What Success Is
(derived from Citizen input during the November 16, 2009, open meeting)

Appendix I

- A stronger Montpelier.
- A definable finished product.
- Repair the deficit in public trust.
- Objectively: We know what happened. Subjectively: Leadership is trustworthy and capable.
- Transparency in government.
- Earn trust back; Error prevention so that we have the best possible control to catch such an error in the future.
- A community that is happy. We need to review what happened with the Scott transaction. We need to review what has changed and whether improvements have been made.
- Permanent establishment of a strong municipal financial management system.
- Systems clarity. Improvement of all types of communications for city officials. Flow charts of payment cycles. Legal communications/activity, and management of attorneys.
- Review of overpayment failures.
- Ultimately, a comprehensive government wide review process looking at transactions, legal decisions, internal controls, audit review, and systems analysis going beyond financial.
- Montpelier will be a city that has good, strong management over cash, departments, and oversight including addressing the warrant signing which is not effective.
- Statutes reflect the best model for management (example: there are no elected auditors in Montpelier, no audit committee, elected treasurers not part of anyone's chain of command.
- A stronger trust level in Montpelier, its city management and its finances

➤ **Open Meeting Issues**

(details of section **II** IV iii, page 7)

Appendix II

- We now know that the city manager discussed the Scott Construction issue with the City Council on November 8, 2006. The manager's time line indicates the executive session was warned as a "legal matter." But a review of the minutes of the November 8, 2006, meeting do NOT include any mention of an executive session to discuss Scott Construction or any "legal matter." The minutes show the Council went into executive session only to consider a loan from the City's Business Loan Fund to a local business.
- It should be noted that nowhere in the minutes of the January 25, 2007, is there any mention of the reason for the promissory note with Scott Construction, the amount or terms of the note, or any of the background information that would help explain why Scott owed the city the money.