CITY OF SHEPHERDSVILLE
SPECIAL MEETING
Thursday, February 23, 2012

A special meeting of the City Council with Bob Ryan to conduct the audit exit conference for fiscal year end June 30, 2011.

In attendance were Council members Bernie Brown, Don Cundiff, Larry Hatfield and Corky Miller.

Mayor Ellis called the meeting to order at 5:00 and stated the purpose of this special meeting is for CPA Bob Ryan to conduct the audit exit conference.

Bob Ryan: First I've got a couple questions. Last year and year before there were four projects that was carried forward as construction in progress. I just want to know if they are still construction in progress or they're completed. Beech Grove Bypass. Mayor Ellis stated it was still in progress. It hasn't even been started yet. It's still in the planning stages at this time. Bob Ryan: Beech Grove sidewalks. Mayor Ellis: That should be already completed. We haven't done anything on those. City Clerk: We've got money available but the problem with that was we couldn't get all of the easements. The people just didn't want us in their front yard so we stopped on that and actually recently the KYTC contacted me wanting to know if we are ever going to finish the project or to close it. So it's still open. Larry Hatfield: The Beech Grove Road Bypass, the State has taken that over. Bob Ryan: Highway 480 Cedar Grove. Mayor Ellis: What part of it because I know some of it is completed now. Bob Ryan: That's all I have. Mayor Ellis: It's completed as far as I know. Bob Ryan: Amphitheater? Mayor Ellis: It's supposed to be complete, but it's not. It's completed as far as I'm done. Bob Ryan: Ball fields? Mayor Ellis: Baseball diamonds are still continuing to be worked on but we've got volunteers that are doing that now. Bob Ryan: Salt River Interceptor? Larry Hatfield: No it's not done. It's scheduled to be done the end of this year. Bob Ryan: Wastewater Treatment Plant? Larry Hatfield: The actual treatment plant is done. The press building is not. Bob Ryan: That's part of the plant? Larry: Yes. Bob Ryan: South Bullitt Interceptor? Larry: It's complete. Bob Ryan: As of June 30, 2011? Larry: Yes. Bob Ryan: Okay. I'll make an adjustment on those on the balance sheet. I did a little outline here of the comments for the exit conference. The first comment, number one is that management should prepare an accounting policies and procedures manual for use by City personnel in order to establish levels of authority, responsibility for duties and consistency in the reporting of its cash receipts and disbursements. This puts something permanent in place; change over in personnel, the new person coming in has documentation to look at as how receipts should be recorded, disbursements are to be recorded, and even if this is a new person and a new transaction for whatever comes up they have this reference to go to. So that would be my first recommendation is that this be put into place. Let me back up a little bit. There were two things that I would have put on here but they have already been taken care of and that is you have the new accounting software, QuickBooks. KVS is on its last legs but you do have the new and then you have changed your system of filing invoices. It used to be if you wanted to see what you paid Louisville Water Company for the year you went to January, February, March, April, now you just have a file that says Louisville Water Company. It's more efficient that way. Those two have already been taken care of. Don Cundiff: As far as the accounting policy and procedures, do you have any kind of recommendation of format, is there any kind of standard format that you would recommend or how would we best go about getting that done. Bob Ryan: The Kentucky Cities Financial Manual. It's old but good accounting principles do now change. This is basically a good start. I would recommend that you call DLG and get this. Patton was Governor when this was written. Larry: We've got people that's putting together some of this stuff so that will probably be a good time to do all that at one time. Bob Ryan: These are books I don't go out in the field without. They're in my library when I got in the field. The other one is Kentucky Municipal Statutory Law. It's not been updated since 2002 but most of the laws in here are in place. It's another good reference to have in your library here. You can also get that at DLG. The Legislative Research Commission might have that.

Kentucky League of Cities puts out a real good manual too. In conjunction with this, you're accounting procedures manual would define what your chart of accounts is, what constitutes revenue and how you break it down, and then it would define what goes into that revenue account. It would have all your expenses broken down and what gets posted to this particular expense account. If an asset is purchased and it's over, let's say you spend $50 for a calculator. A calculator is going to last forever and ever and ever. You don't want to put that on the depreciation schedule. So you would say a purchase in excess of $1000 would be considered maybe a capital purchase; as long as it has a life of two or more years. Things like that would go in your manual. Number two is that all bank accounts should be reconciled as soon as possible at the end of the month and there should be a complete explanation for all reconciling items. This would be things that have gone through the bank account that were not normally a deposit or a check; a return check charge, a charge by the bank for doing electronic transfer or something. These bank reconciliations should be made available to Council at a timely manner after the first of the month so the Council knows how much money is in each bank account at the end of that period. The City Treasurer should prepare monthly financial statements for council members and those should be prepared in a timely manner. Larry Hatfield: Would it be safe to say that we should have a P&L by the 10th of every month. Bob Ryan: I was just about to say that if a financial statement for the month of January is in your hands in April, that's not very good. It's better than nothing but there might be something in there that is too late to act on. Bank accounts should be reconciled. City Clerk: It depends on when you get the bank statements Larry; the 10th may be too soon. Sometimes our bank statements don't come in before the 8th or the 9th. Bob Ryan: You can get them on line. My personal account, the first of the month I download it. I get an online statement from Republic Bank and by 5:00 that afternoon I've got my account reconciled. Larry: The P&L don't have the bank statement does it? Bob Ryan: No. The bank statement is a document that supports the balance that shows on the balance sheet. Larry: The P&L we should have every month how much money came in and what our expenses was. Bob Ryan: Yes. I would say that it would be reasonable to expect it by the second meeting of that month. If you want it by the first meeting of the month that's putting a lot of pressure on somebody to get it out and also go through her normal routine each day that has to be done on a daily basis. Larry: Right. That would be fine. Bob Ryan: But it's not unreasonable to expect it by the second meeting of the month. Don Cundiff: This can be done by QuickBooks and the information that's in there? We don't need anything else other than what we've got as far as QuickBooks as far as getting that for us. Correct? Bob Ryan: Yes. Number four is management should establish proper purchasing procedures; purchase orders should be used, receipt and report should accompany vendors statements documenting goods being paid for have been received. A lot of times goods are delivered at some place other than City Hall and Gayla gets an invoice and she's paying x number of dollars for 100 pounds of chemicals. Well what evidence is on hand that somebody at the plant actually received those chemicals and signed for them? So any time goods are being received a receipt and report should be signed by somebody receiving those and hand it to Gayla so that she can match it up with the invoice. Larry: That invoice should not be paid until that is matched. Bob Ryan: Right. An invoice should not be paid until there is proper documentation supporting its payment. Which leads to number 5, which says that KRS 65.140 says that local governments are required to pay for goods and services within 30 days? And if there is some discrepancy in the bill that 30 days can be extended by notifying the vendor that for some reason or other there is a question concerning the bill. But notice has to be given to the vendor that payment will not be made in 30 days because of a valid reason. Number six, management needs to establish sinking funds, reserve and replacement funds and depreciation funds that are required by certain debt agreements between the City and various financial institutions. Presently the City is not in compliance with various financial institution agreements because of the lack of the sinking funds that are required by the agreements. Larry: I think the, tell me if I'm wrong, but I think using CDs as a reserve is crazy. I don't think a CD should be used for reserve due to the fact it's too easy to get to. Bob Ryan: It's a lot easier to get to cash just sitting in a checking account than it is a CD. Larry: No, I mean I think it should be put into the bond fund itself with the bond people shouldn't it? Bob Ryan: No. Whatever bank you have you would have an account set up that is restricted. Whenever Council sits up the account in its authorization to set it up you say this account is restricted as a sinking fund for the payment of ABC debt. And then if the interest payment is due every six months then you look at the interest payment that's due in June and one-sixth of that is deposited each month in the sinking fund and if the annual payment on principle is due once a year then one-twelfth of that is deposited into the sinking fund each month. Larry: I was thinking on one of our bonds they automatically sweep $30,000 off the Louisville payment. I was just wondering why you couldn't sweep an additional percent to cover your reserve. That's what I was going by. We have one bond, maybe two, I'm not sure, that there's automatically $30,000 a month that's swept for that bond payment and put into an account. And we can't get to it. So that's why I was thinking the sinking fund would be done pretty much the same way but evidently I'm getting confused. Bob Ryan: You've given the authority to somebody to sweep your account. You don't have to do that you can just set up the bank account and on a certain date whenever Gayla's writing checks to pay the bills on that date she knows that along with paying these bills I've got to write this check to go into the sinking fund for payment of the principle and interest on a particular debt. Now in that instance it would be a regular like checking account. A reserve and replacement sinking fund or a depreciation fund is required when somebody puts up x number of dollars for you to go out and build this big asset they want to make sure that asset is being maintained. So the debt agreement will say to protect the asset and to keep it whole and sound I want you to set aside x number of dollars. Now you can do that and this is going to accumulate to a stated amount in the agreement. In that case you can put that money in a short term CD or something where it's going to draw some sort of interest or into a money market fund. The likelihood of drawing on that is not going to be that great because number one your asset that you've just built is new and it's just going to require some on-going maintenance of a small nature. Nothing any major. So you can put the money in a CD or something and at that time when a major improvement is required or overhaul and maintenance get the money out of the CD. Don Cundiff: Maybe possibly have some sort of mechanism set up where before money is taken out, unless it's a regular interval, it would require approval from the Council because I think we got into some instances where funds were taken out of funds that the Council was not aware of. More than two people can't say let's go cash that in to pay something else. So we could put some additional restrictions on it. Bob Ryan: Require two or more signatures. Don: It needs more than two I think. Bernie Brown: Sitting up a monthly schedule for the sinking fund payments. Can that information be put on the monthly financial reports? There's no problem in doing that, is there? Bob Ryan. Yes when you list your bills that you're paying that month one of the things on the list would be Bond A sinking fund payment, Bond B sinking fund payment. Larry: Do we know exactly how many bonds we're not in compliance on? Bob Ryan: To answer your question, the taxable general obligation bond Series A, tax exempt general obligation bond Series B, the Kentucky Rural Finance Corporation revenue bonds, the Kentucky Infrastructure note payable dated June 2002, and KIA note payable dated September 2009 all require sinking funds, depreciation reserve repair and maintenance. Bernie: Is that information going to be included in your audit report? Bob Ryan: Yes sir, right not it's Note F. Larry: Is all of that sewer? Bob Ryan: No. The tax exempt and the taxable bond are City. That the $600,000 and the $1.4 million bond. Kentucky Statute 66.480 requires that financial institutions that are used as depositories for City funds provide collateral for funds that exceed $250,000. That's all combined funds. If you have ten accounts at PBI Bank their balances are all added together. FDIC, of course, insured up to $250,000 but if you have a balance that exceeds that, since these are public funds that financial institution is required to go into the market and buy something as collateral to cover the excess exposure. How that happens is you put the money in PBI Bank and you're getting all your money coming in from whatever sources, and during the month at any given time your balance in that bank account on a particular day exceeds $250,000 PBI is supposed to go and buy like, a Jefferson County Revenue Bond and ABC Bank, a third party holds that bond. PBI doesn't hold it. ABC bank holds that bond so should something happen to PBI Bank, PBI Bank can't cash this bond in to cover itself. That bond is being held by a third party to insure the funds of the City of Shepherdsville. This was something that was mentioned by the auditors in their exit conference in 2010. Don Cundiff: I know last year we did place some additional securities for that. After the meeting with them I went back and that was done. City Clerk: First Tennessee is who I get reports for from PBI. Bob Ryan: I didn't get any notification on anything like that. That's already done? Don: It was done last year. City Clerk: I've already done that. Bob Ryan: Good. The City has pledged the same collateral, general revenue taxes as collateral on several debt obligations. This is not really the fault of the City. February 14th I went down to the County Courthouse and asked to see what debts are recorded of the City of Shepherdsville that is public record. They couldn't pull up anything. That tells me that these people that are loaning money to the City are not going to the Court House and making these debts and collateral public knowledge which they would want to do this so that if the City put up tax revenues as collateral on this debt, and I lend them money I want to go down to the Court House and look and the collateral has already been pledged; you've got to give me something else guys. So the collateral has been pledged with tax revenues have been pledged with Peoples Bank of Bullitt County Bank three times, and KIA twice and the real property taxes have been pledged with the Series C bond anticipation note. These people haven't done their homework. They have not done what is required of them to go and I think the legal term is called perfecting. Mayor Ellis: Do you think we need to go down there and do it ourselves? Bob Ryan: No. When something happens whose first in line? In reviewing the minutes from July 1, 2011 through Valentine's Day, I saw that the City was going to use some mineral and LGEA money for parks. I'm not so sure you can do that. Larry: I have another issue too; we're paying this railroad crossing out of LGEA or MAP. City Clerk: No it comes out of general fund. Mayor Ellis: Sewer is being reimbursed for last year because it came out of there by mistake but it will come out of general fund. Larry: I thought you said you were going to take it out of MAP? City Clerk: That can't be done, no sir. Bob Ryan: It can't? The railroad crossing is on the road. Larry: I was going to say if we're going to do that we need to get a letter from them approving it. That's supposed to be for repair of the roads. City Clerk: I can contact KLC and see if it can be paid out of MAP. Larry: They've actually done no work on this crossing so that's why if we're going to take it out of the road fund I think we need to get a letter from them because I don't think they are going to let us do that. That's for blacktopping and street repair. Bob Ryan: How does repairing a railroad crossing not be part of fixing a road? Larry: It's not being repaired. Its money being put in to a fund for when it does need repaired. Bernie: The LGEA money that was used in the park, you checked on that didn't you and that was okay. City Clerk: Yes I checked on it and was told it was okay. Bob Ryan: Would that fall under recreation? Mayor Ellis: Yes. Bob Ryan: Okay. Bullitt County is what's called an impact county. In doing the audit I worked with KVS accounting system and it was not the best but it was all I had to work with. In doing that to the general fund I had to make 114 journal entries to get to the point where I felt very comfortable about the numbers that I had in my work papers and the financial statements. I had to make 78 journal entries to the water-sewer fund to get it to the point where I was comfortable with the numbers and 13 journal entries to the MAP fund before I could get it to where I was comfortable. In doing that I got income statements and a balance sheet that I am comfortable with, the numbers. I've got documentation to back up the information that I have in my financial statement. Now, on the statement of activities which is like an income statement I get down to a net increase or decrease net income of the funds and to that I add the beginning balance which was what was on the June 30, 2010 income statement and my ending number should agree with my net assets on my balance sheet. It didn't. It didn't to the tune of $1 million on the general fund side negative and a positive $700,000 on the water-sewer side. You net the two together that's a $300,000 decrease in net assets of the City throughout the whole government which is only 2.63% of the total net assets of the City. This decreased on the government side of $1 million is in no way to be translated into the fact that there is a million dollars missing from the City. There is not a million dollars missing from the City. It's just the net effect of all these adjustments that things that were not in the KVS general ledger that I took those numbers and created my own QuickBooks accounting system. But in doing all these adjustments to get numbers that I had to be comfortable with I got a net figure of $300,000 that if I want to spend the rest of the year tracing back and forth I could probably come within a reasonable explanation as to how it got created. Like I said in my balance sheet I've got good documentation for the numbers that I show in my balance sheet. I have here to give you, the statements that I used as a basis for preparing the financial statements in QuickBooks. We've got water-sewer here and the comparative numbers 2010 – 2011 I think they compare pretty good year to year. It's just reporting the debt and the assets. There were assets recorded on the books that at one time whenever the depreciation schedule was prepared there were no documentation as to what these assets were. Somebody might have gone out and bought a truck back in 1965, it got posted in to the general ledger. Years have come and gone that truck is no longer there but it's in the books. And when a depreciation schedule has been prepared whatever was paid for the truck in now on the books but it's a difference of what's in the depreciation schedule. I took the depreciation schedule, the assets that were known, gave Tammy copies, then she distributed those depreciation schedules to various department heads and asked them to go over it and tell me do we have it or do we don't have it. And they came back and said we don't have this, we don't have that, so that is part of the adjustment is recording back in the general ledger and on the financial statements assets that are really on hand instead of some assets that are in the books and just rolled over from year to year to year and are just not here anymore by the fact that they were traded, sold, scraped, whatever. Then as again KVS was not the best but it's all I had to work with. There were some transfers, they were some things paid for through KVS, mainly I'm thinking about salaries here that might have been allocated to other funds. The girls that work in the office not 100% of their salary is charged to one particular fund because sometimes they are working on general fund, sometimes on water fund and sometimes on municipal aid. These transfers back and forth were not properly recorded. But even though that number is big it does net down to a smaller number, 300, which is just 2.63% of the total assets. And I reiterate $1 million is not missing. Larry: So and I reading this right in saying that the general fund had a loss for just this one year $250,508.87 from June '10 to June '11? Bob Ryan: Yes. Larry: So that $250,000 is going to go on top of the $861,000 in this audit? Bob Ryan: Yes. Larry: So we're over a million dollars loss. $861,000 plus $250,000? Bob Ryan: I'm going to report a net deficit in the general fund unrestricted. Your general fund is made up of restricted and non-restricted assets. In total there is no deficit. But there is a number on here that looks, a $4.3 million deficit but its unrestricted funds because accounting wise numbers have been set aside for net assets, capital assets, restricted for debt, etc. But the general fund itself has is not in a deficit. Larry: How can it not be in a deficit if we lost $250,000? Bob Ryan: Well because when you started out you weren't in deficit. Corky Miller: Let me see if I understand this right. When they made the budget everything started at zero. Larry: Yeah but we're talking about the previous year. We're not talking about this July. Bob Ryan: I think we need to get on the same page. Larry: That's why I'm asking you am I looking at this right. When we got our audit from 2009-2010 Stephens and Lawson reported that the general fund was in a deficit of $861,000 and if I'm wrong, I hope I am, but we have to turn that number into a positive. Bob Ryan: We're not on the same page here. That's an income statement figure and the $861,000 you're looking at is the budget. The budget that I'm going to present is part of the financial statements here show that deficit has gone away and now at the end of the year you have a $1.1 million positive. The income statement you're looking at with the $200 some thousand deficit is revenue from revenue sources reduced by expenses. The $861,000 deficit that you're looking at is in the budget which includes revenues from all sources. Principle on bond. Borrowed money. Payment of principle. Purchases of capital assets. There are two different statements with two different significants. Larry: I'm looking at page 6 of the last year fund balance June 30, 2010 $861,793 in parenthesis. That was 2009-2010. Bob Ryan: Well it went away because you borrowed $2.6 million and that becomes part of all-encompassing funds revenue to work with. Larry: My question is in real life what shape is this general fund in now? I mean borrowing this money has got to be paid back. So I'm getting real confused if I show a profit and loss for the entire year of a loss of $250,000 that tells me that we spent $250,000 more that we had in revenue. Bob Ryan: Well again if you add in the depreciation. You're not comparing apples and apples. Larry: Okay. What do I have to do to compare apples to apples? When I ran my battery business and the end of every month I had a profit and loss statement that said I man $2000, I made $5000. That statement carried over from January to February, from February to March, right on through to December. At the end of December I knew what my entire company did from day one of January. Bob Ryan: More than likely that statement was being prepared on a cash basis. Where you were recording cash coming in and cash going out. It probably did not have depreciation in there and at the end of the year you could be showing that you're making $100,000 and you take your financial statements to the CPA to have your tax returns prepared and he can make that $100,000 go away by adding in depreciation on all your capital assets that are not in the financial statement you're getting each month. Larry: I don't remember if depreciation was on there but I do know all payments were on there. Truck payment, gasoline, everything that it cost to run the company for that month. Bob Ryan: But he's going to take that financial statement and pull out the principle on those truck payments which is going to increase your income because principle is not a deductible expense and then he's going to throw in depreciation. However he decides to treat that depreciation he's going to do so to minimize your reportable taxable income. The schedule you're looking at shows a loss of $250,000 that has depreciation expense in it because that is a complete accrual financial statement. It has accrued expenses that have not been paid yet. It has accrued revenue which has not yet been received and it has depreciation which is a book entry. I believe total depreciation on the general fund, a book entry, was $598,000 and you add that back to that $250,000 loss there now you're looking at a positive number. Bernie Brown: What would things look like it we did not borrow that $2.6 million? Larry: Where would we be sitting right now if we had not of borrowed the $2.6 million? That's the number we've got to get in reality. Had we not of borrowed that money we would be broke. Bob Ryan: I think that's a fair statement. Larry: We can't continue to borrow money to operate. That's where I think I would like for us to get with Marty Brown after next Monday and sit down with the department heads, if they want to be there, we as a Council has got to know what we need to do to get this thing reversed around. We're not going to be borrowing money to make ends meet. If I'm saying that correctly. Bob Ryan: I don't mean to make light of the situation and I mentioned this one day to the Mayor, if he knew what the definition of politics was. The definition of politics is the ability to postpone a decision where when the decision is made it's no longer relevant. There are some very hard decisions that need to be made to get the City back on footing. It went through a period where, when I was doing the audit and I was compiling all the data on the debts of the City, and then I sat down and started writing the footnotes. That's brought everything together and I just thought they borrowed again. They got another note. I mean for the last 8 years it's just one after another. Larry: That's got to stop. Bob Ryan: Any business or anybody wants to have a debt to asset ratio of at least 1 to 1. Every dollar of debt that I have I've got $1 of asset to pay that debt. At June 30, 2011 last year the City itself had a pretty asset to debt ratio. It had $1.5 million in current liabilities, that's debt that had to be paid within a 12 month period. And to pay that debt it had $1.4 million in current assets, cash, accounts receivable, those things; had that cash and accounts receivable coming in that it could liquidate the debt. It was less than 1 to 1 but it was not that bad. The water-sewer operation last year had current assets of $800,000, current liabilities of $1.8 million. That would mean within a year's time it had $1.8 million in obligations to pay and $800,000 to do it. Things had probably gotten a little better since then because some debt has been retired in the meantime. Larry: We had a 66% rate increase too. Don Cundiff: Is part of that because money was being taken out of the sewer to pay for general fund too? Larry: You'll have that total probably Monday too won't you? Bob Ryan: I can give that to you now. At June 30, 2010 the City owed water-sewer $1.2 million and during year ended June 30, 2011 that increased by $700,000 to $1.8 million. Then part of that bond Series A and B that the City got for $600,000 and $1.4 million the City then paid off debts of the water sewer. So now that really nets down to $316,000 what general owes sewer. And this is a schedule on the debt that the City retired with the Series A and Series B. Larry: So the general, if we get it worked out next two years, cut that in half, in two years the general fund could be even with the water-sewer account or three years at $100,000 a year. Bob Ryan: Yes. But, it's all within one entity. It's not like you're paying a third party out here and if not in actual payment one fund could agree to forgive the debt of the other. Sometimes these due to and due from accounts they just go on forever and ever. They just keep getting adjusted by again, taking Tammy's salary and it's paid 100% out of City. Just make a journal entry due to due from to get half of it over onto the books of water-sewer. These things go back and forth and sometimes they're just never eliminated. Larry: I know what you're saying but I think that's a bad way of doing business. I think that's what's got this City the way it is right now. Bob Ryan: If the City does have the luxury of having discretionary funds it would be good to put it back in sewer but what happens if it turns around and all the sudden something happens in the City. Larry: That's exactly what we've got to think about. Bob Ryan: I've got one City that I do they have actually gone as far as setting up a note. The general fund has a legal obligation via this note to repay the funds that were advanced to it by the water-sewer. Bernie Brown: That wouldn't be a bad idea. Larry: Well when we present this to the public after Monday I'm going to strongly suggest that we sit down, and the reason I say with Marty is to get a handle on the $3.5 million that we're using to finish the interceptor plus anything else that I can think of or he can think of because this .5 occupational tax that we increased is not money we can use for operating. That money is used to go back to pay the $3.5 million. That's what's we're got to get in our heads and the department heads need to understand that's not income. That money is already set aside for the liability of the sewer. Bob Ryan: asked City Attorney Wantland; you loan me money and I put up collateral. Is that called, you take the note down to the courthouse, is that called perfecting the note. City Attorney Wantland: Perfecting is giving notice of your lien generally now done at the Secretary of State but you can do it at the courthouse. If you're asking me how to perfect, some liens have to be perfected by possessions, some have to be perfected by filing with Secretary of State, some have to be actually put on some type of document sent to the title. There are different ways of perfecting but yes that's what you're talking about. And that's basically doing notice of your lien. City Attorney Wantland: I will for the Council, Mr. Ryan and I have had numerous occasions trying to reach one another. He's very persistent and I appreciate that. Sometimes we just don't make it but you do try.

Larry Hatfield made motion to adjourn. Don Cundiff 2nd.

Meeting adjourned at 6:07 p.m.

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R. Scott Ellis III, Mayor Tammy Richmond, City Clerk