APPENDIX A

CITY OF ROCKVILLE
FINANCIAL ADVISORY BOARD
FY 2024 ANNUAL REPORT

AUGUST 7, 2024

INTERNAL AUDIT FUNCTION

ISSUE: Is the current practice used by staff a sufficient alternative in place of an independent internal audit function?

CURRENT PRACTICE [provided by Kim Francisco, Deputy Chief Financial Officer]: "The Government Finance Officers' Association has published a best practice document on internal audit functions. A link to that best practice document can be accessed HERE. At a high level, this best practice states that every government should consider the feasibility of establishing a formal internal audit function. It goes on to state that if it is not feasible to establish a separate internal audit function, a government is encouraged to consider either 1) assigning internal audit responsibilities to its regular employees or 2) obtaining the services of an accounting firm (other than the independent auditor) for this purpose.

In alignment with this best practice, Rockville actually does both 1) and 2) in lieu of a formal internal audit position/office. As shared in the *[Financial Advisory Board]* Q&A document, the Accounting and Control Division is responsible for conducting internal audits and ensuring compliance with the city's internal control standards. In addition, there is $30,000 that is set aside each year in the budget of the City Clerk/Director of Council Operations for internal audits. The use of these funds varies from year to year but is budgeted to provide resources to conduct specialized internal audits if and when a matter arises that the Mayor and Council ask to be reviewed by an independent third-party. This is a cost-effective approach to dealing with matters that are unusual, of significant public interest, or may require substantial staff time. When considering any internal control measures, it is necessary to consider the size and complexity of an organization and the costs relative to the expected outcomes. Most comparably sized municipalities have taken these alternative approaches, and in the case of Rockville, this has worked well for the organization, as evidenced by many years of clean external audits without any cited internal control deficiencies or instances of fraud."

INDEPENDENT INTERNAL AUDIT FUNCTION: The Government Finance Officers' Association guidelines recommend that governmental finance operations include an internal audit component with direct access to the governing board (the Council) where feasible, not just as a function within regular accounting reporting lines. The guidelines do suggest that if it is not possible to have a dedicated internal audit function, entering task specific contracts with third party vendors, maintaining several redundant levels of internal controls and expanding the work done by external auditors can function as a substitute. However, that is a "next-best" solution and not a best-in-class approach.

Specifically, a dedicated and independently reporting internal audit function is designed to provide:

1. An independent review of accounting and operating processes and procedures apart from an organization's regular accounting staff and chain of command.
2. A deeper and more specific examination of financial records and targeted transactions than required for an external audit.
3. An assessment of general compliance with applicable laws and regulations that may apply to specific programs.

4. An overall independent evaluation of financial operating risks and development of recommendations to improve risk management.
5. An independent resource for reporting and investigating fraud or irregularity available to both staff and the Mayor and Council.
6. A review of compliance with applicable procedures and efficient functioning of the city through regular sampling and substantive testing of transactions.
7. Preparation of compliance reports and substantive testing at direction of external auditors to minimize audit costs.

THE BOARD'S RECOMMENDATION: If the Council desires a "best-in-class" and permanent internal audit function, then it must become a budget priority. The Board is not disparaging the staff's current practice, only that there is a possible next level of excellence.

FY 2024 ACTION PLAN ACCOMPLISHMENTS

1. *Annually review the City's Comprehensive Annual Financial Report, the Single Audit Report, and all other reports issued by the auditors and published in final form. The review should encompass and include any management letters and audit findings, as appropriate. [**Board**]*
    a. *Additionally review the Popular Annual Financial Report (PFAR)*

    The Board reviewed the FY 2023 Comprehensive Annual Financial Report and the FY 2023 Popular Annual Financial Report. Questions and comments regarding these two documents were forwarded to Ms. Stacey Webster, Chief Financial Officer, and Ms. Xiaojing Zhang, liaison to the Board, and the responses received adequately addressed the Board's questions. The Board found no material error or discrepancy in either report, and does not anticipate further action.

2. *Annually review the City's Financial Management Policies published in the City's budget document to evaluate whether those policies are appropriate. [**Board**]*

    Various Board members have reviewed the City's Financial Management Policies published in the budgets for FY 2021, FY 2022, FY 2023, FY 2024, and FY 2025. Those reviews found the policies to be appropriate. The Board concurs with the FY 2025 policy changes for cost recovery.

3. *Annually review the City's investment policy to evaluate whether that policy is appropriate. [**Gould/Wright**]*

    On April 24, 2024, the Financial Advisory Board, received a presentation from Ms. Stacey Webster, Chief Financial Officer and Ms. Katia Frock, PFM Asset Management, the City's investment advisor, regarding an update to the City's Investment Policy based on the State of Maryland Statute. The modifications to the Investment Policy were thoroughly discussed. The Board concurs with the modifications to the Investment Policy. The Board's conclusion was transmitted in a memorandum dated April 24, 2024, to Ms. Webster.

    Also included in the memorandum was a reminder that Section XIX of the Investment Policy requires a certification of compliance with the Investment Policy and a certification that the City has sufficient liquidity to meet its expenditure obligations for the next six months. These

certifications now appear in the subheading for the "Investment Policy and Reports" of the City's web page for Budget.

4. *Review the City's cash and investment report when published. [**Gould/Wright**]*

   As of June 30, 2024, Investment Policy Reports for the 4th Quarter of FY 2023 and the 1st, 2nd, and 3rd Quarters of FY 2024 have been posted (published) to the City's web site. These comprehensive reports prepared by the City's investment advisor, PFM Asset Management, LLC, reflect reasonable expectations for various sectors of the U.S. economy and report the results of the City's cash position and short-term investments (Portfolio Effective Duration ~2.5 years). Results reflect the volatility in the market during the last five years Investments are compliant with the State of Maryland Statute.

5. *Review the City's quarterly financial reports (QFR) to assess whether spending and revenue collection are tracking with adopted and amended budgets, analyzing variances, and to highlight problem areas, if any. [**Mack/Merrill**]*

   As of June 30, 2024, Mr. Mack and Ms. Merrill have reviewed the FY 2023 4th Quarter and FY 2024 1st, 2nd, and 3rd Quarter Financial Reports posted on the City's website. The reports are reasonable, and no further analysis is needed. The City appears to be on target with most of its expenditures and revenues. Assuming there are no unanticipated expenses during the 4th quarter, the City is likely to have a surplus in the General Fund at the end of FY 2024.

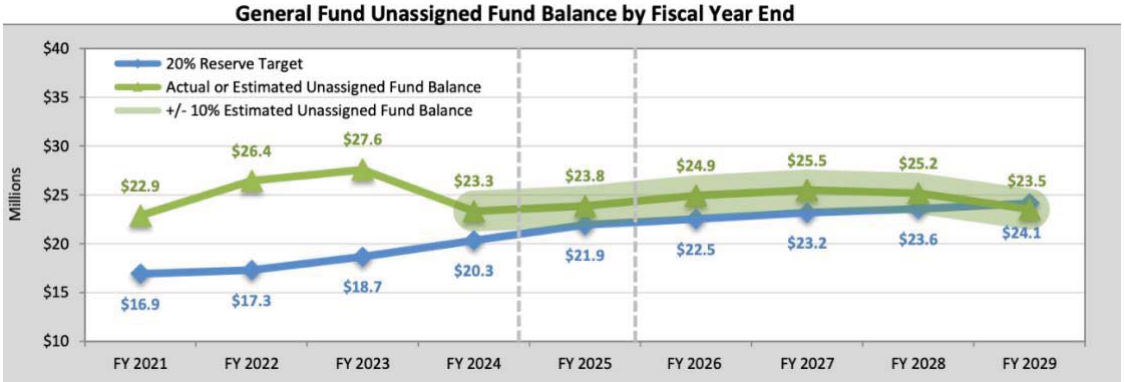
   Per the request of the Board, the City added extra columns for quarterly actuals for the specific expenditure and revenue Account Codes in the detailed spreadsheet on the website. This is very helpful for analysis of specific department expenditures and revenues on a quarterly basis in comparison to previous fiscal years.

6. *Annually provide comments and recommendations, as appropriate, regarding the next fiscal year's Operating and Capital budgets. [**Board as a whole]***

   The review of the Proposed FY 2025 Operating Budget and CIP by the Financial Advisory Board had no material findings and no recommendations. The result of the review was forwarded to the Mayor and Council via a memorandum dated March 29, 2024.

   The extensive interaction, questions, comments and responses, between the Board and the city staff is well documented. The documentation is available from Ms. Xiaojing Zhang upon request.

   In a Board meeting, Ms. Francisco, Deputy Chief Financial Officer, described the overall fiscal health of the City as excellent. She pointed out the City will not require additional sources of revenue until FY 2029 (page 65 in the budget). Of course, revenue projections must be re-visited every year.



7. *Review City actions to implement the Calyptus 2015 Purchasing Study as well as other actions the City has taken to address the Board's recommendations regarding the City's procurement activities. [**Kelly**] Mr. Kelly will re-write this. Add the importance of strategic sourcing and purchasing.*

   The Calyptus 2015 Purchasing Study recommended 29 actions the City should take to improve its procurement activities. Since then, the Mayor and Council have asked the Financial Advisory Board (Board) to oversee the City's implementation of those recommendations. In the past two years, City staff have become less responsive to the Board's oversight efforts. The FY 2023 Procurement Annual Report did not fulfil an agreement between the Mayor and Council and City staff to include effort expended on incomplete Calyptus recommendations. In addition, the report was to have actual performance results compared to performance targets as presented in the annual operating budget or otherwise requested by the Mayor and Council. The report did not address the Calyptus recommendation that the City implement a strategic sourcing program, which is key to the City's ability to save money on its procurement activities. The Board raised its concerns to the Mayor and Council, and City staff agreed to include the Calyptus recommendation on strategic sourcing in future annual reports. The City continues to push back its own target dates for producing a strategic plan for the Procurement Division, another of the incomplete Calyptus recommendations.

   One Acting City Manager expressed concerns about the Board's oversight of the City's procurement activities. He acknowledged that the City Code allows the Mayor and Council to direct the Board to review the City's procurement activities, but believes the Board is too involved in the City's operational activities. He expressed his opinion that the current Mayor and Council may not be as interested in the City's procurement activities as its immediate predecessors were.

   The Board intends to continue review of the City's effort to implement the incomplete Calyptus 2015 Purchasing Study recommendations as an action in its FY 2025 Action Plan. This will provide the Mayor and Council the opportunity to update its position on this matter.

8. *Review annual department performance measures. [**Mack**]*

   The Board forwarded a memorandum to Mr. Craig Simoneau, Acting City Manager, and Mr. David Gottesman, Assistant City Manager, dated April 24, 2024, with the following text:

"The City continues to make strides in its presentation and content of performance measures in the FY 2025 proposed budget. In FY 2024, 85% of all Raftelis recommended performance measures were added to the budget. These additions provide for a greater number of outcome and result based performance management measures, including targets. In the FY 2025 proposed budget, many of these new performance measures included results and projected figures across the 4-column presentation. In addition, fourteen new performances measures were added across several departments. Mr. David Mack has reviewed all these measures and represents well the Board's involvement with this important City initiative."

In June 2024, via an email, Mr. Gottesman informed the Board the Performance Measurements Management System under consideration was suspended until a permanent City Manager is in place. Unfortunately, months have passed with no effort expended on this initiative. The new City Manager, Mr. Jeffrey J. Mihelich, arrives mid-July, 2024.

9. *Evaluate potential financial impacts from repurposing the King Farm Farmstead and outfitting Redgate Park. Review large (>$1,000,000) expenditures and capital improvements. [**Wright**]*

   On March 13, 2024, Mr. Tim Chesnutt, Director of the Recreation and Parks Department, provided the Board with the status of both the King Farm Farmstead and Redgate Park. There has been no reuse approved by the Mayor and Council for the King Farm Farmstead.

   Mr. Chesnutt discussed the capital improvements to the King Farm Farmstead. He said utilities have been installed in specific structures. The funds spent on the King Farm Farmstead in prior years are shown in the proposed FY 2025 CIP budget on pages 282 and 283. A consulting company will present ideas to the Mayor and Council and the public has been invited to comment and express their preferences. None of the buildings are ADA compliant. The consulting services were encumbered in the FY2024 budget.

   Mr. Chesnutt reported that a Request For Proposal for design of the Red Gate Park is in place. The Red Gate Park is anticipated to go through multiple construction phases. The City received funding from the Chesapeake Bay Trust to plant more trees in the park.

   As a Master Plan for Red Gate Park is in place and the Mayor and Council must approve a repurposing of the King Farm Farmstead, the Board elects to remove this action from future Action Plans. In the future, at the direction of the Mayor and Council, the Board stands ready to conduct a strategic financial analysis or review a consultant's recommendations for either project.

10. The Community Survey reflects residents' evaluation of government services. The Board has reviewed past surveys and will advise during preparation of the draft for the next survey for alignment with the budget and Mayor and Council goals. **[Merrill]**

    The Board forwarded a memorandum dated June 26, 2024 to the Mayor and Council requesting four financial (budget) questions be included in the next Rockville Community Survey. The questions are—

    1. I receive good value in City services for the taxes I pay.
    2. I would rate the city's overall financial health as good.

3. I believe the city is effective in prioritizing spending based on community needs.
4. I am satisfied with the information provided by the city regarding its budget planning process and financial decisions.

The response to all survey questions, including the above four, should take the form of forced choice, that is

o Strongly Disagree o Disagree o Agree o Strongly Agree

Questions 1 and 2 above appeared in the survey in 2018, but not with a forced choice response. Omitting a middle choice gathers a sharper opinion from the respondent.

During FY2024, the FAB requested information during the September 20, 2023 and November 16, 2023 meeting on the timeline for the next community survey and how the FAB could review and provide input. Follow up emails in October and November 2023 were not answered. We received verbal indication that the staff feels the help of the Board in this effort impinges too deeply on their responsibilities in this area. Per the FY2025 budget, the City Manager's office will administer the city's first post-pandemic community survey (last conducted in 2018), and analyze, evaluate, and develop recommendations from the responses, comparing 'pre-pandemic' and 'post-pandemic' conditions. The FAB proposed four questions be included via a memorandum to the Mayor and Council on June 26, 2024 (see above).

As noted in the 2018 community survey report: "The results of the survey comprise a major component of Rockville's work to measure performance, and also are intended for use in planning and *resource allocation (italics added)"***.** Assuming there will now continue to be regular community surveys of city residents, the Board's review and input on the Community Survey to evaluate how it conforms to current financial performance goals will be included as part of the Board's Action Plan.

11. Conduct a comprehensive review of all City awarded grants including associated activities and processes. Report material findings regarding those activities and associated processes and recommend improvements. ***[Merrill/Kelly/Gould]***

The focus for FY 2024 was a comprehensive review of the grant process and grants administered through the Rockville Economic Development, Inc. (REDI). Members of the FAB reviewed REDI's online materials, including the City of Rockville Business Grants & Loans applications, guidelines and review processes and the agendas, and minutes for REDI's board and committee meetings. REDI staff provided a presentation to the full FAB and hosted a couple of members at their offices to provide information on REDI's activities and processes. They responded to questions provided by the Board members. The Board members doing the review noted a general improvement in documentation of meeting minutes and decisions over the last few years. REDI should continue to work to be transparent and conform to the Open Meetings Act as they continue to make decisions on grants to businesses within the City of Rockville from funds provided through the City budget.

The caregiver grants and community agency grants were reviewed during review of the FY2025 budget. As noted previously the caregiver grant process is transparent and easy to follow in

budget documentation. The community agency grants were not assessed comprehensively, the information available is not easily reviewed and the awards are more difficult to follow in the budget documentation. The Board proposes to conduct such an assessment for FY 2025.

12. Review annual revenue sources ***[Correll/Mack]***

    In a communication from Mr. David Mack to Ms. Kim Francisco regarding revenue rate Increases to address Inflation, Ms. Francisco responded that "We have not had a study of fees beyond the Water and Sewer utility rate study that is performed every three years. Fees are often evaluated and benchmarked Internally, and proposed changes are reflected in the next fiscal year's proposed budget."