

Town of Concord Financial Audit Advisory Committee Report to the Select Board January 11, 2016

The Financial Audit Advisory Committee (FAAC) has completed its work for the current auditing cycle and as required in its charge, is reporting to the Select Board. We met five times in 2015 and once in 2016 to organize ourselves and to review auditing reports for both the Municipal Light Plant and the Town.

Reporting Structure

The Municipal Light Plant, a department of the Town, is separately audited on a December 31 fiscal year basis for the purpose of its required reporting to the Massachusetts Department of Public Utilities. The Town is audited on a June 30 fiscal year reporting basis, in accordance with state law. The audited financial statements of the Municipal Light Plant are incorporated into the Town's annual financial statements. The Concord Public School Department is also a part of the Town's annual audit and financial statements. There are no other component units of the Town.

The Concord-Carlisle Regional School District (CCRS) is a separate governmental jurisdiction and is responsible for its own annual audit examination and issuance of audited financial statements on a June 30 fiscal year basis. The Town of Concord FAAC has no jurisdiction to oversee the CCRSD audit process.

External Auditor

The firm of Melanson Heath and Company currently is engaged to perform the annual audit examination of the Municipal Light Plant, the Town of Concord and the CCRSD.

Duties of the Town of Concord FAAC

As a reminder, the duties of the FAAC are:

- Recommend to the Town Manager the selection of the independent external auditor;
- Review the arrangements for, scope and progress of the annual audit;
- Review the draft audited financial statements and consider the management letter recommendations and management's response;
- Review internal accounting and control procedures as necessary;
- Participate in presentation of the annual audited financial statements by the external auditor at a public meeting of the Board of Selectmen (now the Select Board).
- Prepare such reports and recommendations to the Board of Selectmen (now the Select Board) from time to time, within its assigned scope, as it may deem to be in the best interest of the Town.

We believe that with the submission of this report and the attendance at the Select Board meeting on Monday, January 11th, the committee has discharged its duties, with the exception of the first item. That is, we have not as yet recommended to the Town Manager the selection of an independent external auditor. This will occur when and if the FAAC deems it to be in the best interest of the Town to solicit new proposals and initiate the process to select and appoint a new external audit firm.

Report on the activities of the FAAC

Our report has four components: 1) comments on the audit process and management letter, 2) comments on the financial statements, 3) the effectiveness of the FAAC, and 4) possible changes to the FAAC Charge issued by the Select Board.

1. Audit Process and Management Letter:

As the report from Melanson Heath & Company indicates, the auditing process for both the Town and the Light Plant went smoothly and were completed in a timely manner. The audit committee complimented the Town and the Light Plant for the availability of required information and the cooperation of Town and Light Plant personnel. And, in our conversations with the audit team it was clear that our financial management team is highly regarded. The external auditors added a new person to this year's team, but this seemed to have caused no issues with the level of communication between the audit firm and town staff.

The Independent Auditor's report (page 10) indicates:

"In our opinion, based on our audit, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business – type activities, each major fund, and the aggregate remaining fund information of the Town of Concord Massachusetts, as of June 30, 2015, (except for the Concord Contributory Retirement System and Municipal Light Plant, which are as of and for the year ending December 31, 2014)..."

The same general conclusion was reached for the Light Plant.

The Independent Auditor's Management Letter contained a carry-over recommendation from the previous year that the "Town annually audit the Student Activity Funds, in accordance with the DESE's *Student Activity Fund Guidelines* issued in 2014." The Town's response was, "The Concord Public School Department commenced audit planning in 2015 for the Concord Middle School student activity funds in response to DESE Guidelines issued in 2014. After an assessment of the student activity funds, a determination of need will be made for audit services provided either by an outside independent auditor or by an internal auditor approved by the Concord Public School Committee. All recommendations and actions will conform with the DESE Guidelines."

The letter also contained a new recommendation:

“... that the Town prepare for the single audit changes by training staff and establishing... documented policies and procedures.”

The Town responded by stating, “The Town recognizes the Single Audit changes and will take the necessary actions to implement these new requirements. “

Both of these recommendations relate not to the financial statements themselves but rather to internal controls within the Town. In the report, the auditors state:

“...the auditor considers internal control relevant to the entity’s preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity’s internal control.”

This should not be understood to suggest that internal controls are either lacking or insufficient. If there were any material deficiencies in the Town or the Light Plant’s internal controls, they would have been mentioned in the report and would have been included as necessary actions in the management letter. Similar language is contained in the Light Plant management letter.

The Light Plant’s management letter contained nine recommendations for strengthening internal controls. For eight of these recommendations, The Light Plant has either already implemented the changes recommended or has agreed to take action to strengthen internal controls. The ninth recommendation involved access to the general ledger by a terminated employee. The light plant responded that,

“Management follows the Town's IT protocol for terminated employees which immediately locks former employees, whether terminated, retired or resigned, from access to any computer systems or any facilities. The instance identified by the auditor was a solitary variance from normal policy and was a short-term arrangement done with the knowledge and assistance of the IT Director and solely for the benefit of management.”

2. Comments on the Financial Statements

As expected, the Financial Statements contained in the audit report are extensive and comprehensive. In its presentation to the Select Board, the external auditors will highlight a number of statements they believe are significant. The FAAC has identified four issues to which special attention should be devoted.

- a. Unrestricted Net position. On page 27 of the report, the next to last line of the first column, Governmental Activities, is Unrestricted Net Position and shows a negative amount of \$779,997. The Board should fully understand

how this number originates and its significance. (See section 2c).

- b. OPEB liabilities. On page 27 of the report under the category heading *liabilities* is the entry, Net OPEB obligation. This number does not, in fact, state the Town's full liabilities, but rather, it is the shortfall from FY09 to date of the Town's combined payments for current retirees and its OPEB Trust Fund contributions compared to the Annual Required Contribution determined by actuarial valuation of its long-term unfunded liability. This reporting is in accordance with the currently applicable OPEB reporting standard, Governmental Accounting Standards Board (GASB) Statement #45.
- c. Changes in accounting regulations, GASB Statements 67 and 68. The website below provides detailed information about two important changes that took effect with the June 30, 2015 financial statements regarding the reporting of long-term unfunded pension system liabilities, Government Accounting Standard Board Statements, numbers 67 and 68:
<http://www.gasb.org/jsp/GASB/Page/GASBSectionPage&cid=1176163528472>.

The statements revise and establish new financial **reporting** requirements for local government that provide pension benefits to employees. The most apparent impact is the entry shown on page 27 for "Net pension liability" in the Noncurrent liabilities section. This new entry in the Statement of Net Position (page 27) reports the full long-term unfunded pension liability on June 30, 2015 (using the market value of pension system assets) even though the Town has always fully met its annual required contribution based on an actuarial funding schedule.

This entry, then, is the source of the negative Unrestricted Net Position in the Governmental Activities column noted above. A negative number signifies that we have not yet met our long-term liabilities fully; the size of this negative number provides a sense of the magnitude of the problem that must be faced in future budgets. The change in this number in future years will provide information at a glance regarding how each year's results have reduced or increased our long-term liabilities.

- d. Capital Expenditures and Depreciation. The Town's physical assets depreciate and each year the Town makes capital expenditures – adding new assets and improving others. While normal budgeting and reporting do not record depreciation of general assets (our streets and buildings, for example), the Balance Sheet on page 27 does record the impact of such non-cash expense. On page 33 of the Report, both debt retirement and depreciation amounts for FY2015 are reported. As reported, debt principal repayments were greater than depreciation expense, indicating (broadly) that the Town's net assets base is increasing. This should be viewed positively. Long-term positive trends are also apparent in the 10-year table

on page 110 of the Town's Comprehensive Annual Financial Report.

3. Effectiveness of the FAAC

A significant question the Committee seeks to address is its effectiveness. In establishing the Committee, its charge notes that it is to assist the Board, the Town and the CPS officials "... in the continuous review and improvement of fiscal accountability matters. The basic question is, has it? The Finance Director, Tony Logalbo, has noted that the committee's existence and meeting schedule has prompted more timely preparation of materials. While that is a positive outcome, this is the committee's first year of operation and much of its time has been devoted to getting organized and carrying out its specific duties. The view of the committee is that the question will be more effectively addressed at the end of the next audit cycle.

4. Possible Changes in the FAAC Charge

A question asked even before the committee began this year's process was whether or not the CCRSD would be interested in participating in this process by including oversight of its audit process as part of the FAAC charge. The regional school district administration has expressed its willingness to participate and the matter will be on the regional school committee's agenda in late January. If the regional school committee agrees to participate, the FAAC may propose changes to its charge and the Select Board will be asked to consider adoption of those changes. However, this change will likely not be proposed until the completion of next year's audit cycle. In addition, at the FAAC's next meeting, we will review the committee's draft Meeting Schedule and Objectives memorandum which articulates the timing of meetings and our objectives for each session. It is possible that when the FAAC reviews this document, additional changes in its charter will be proposed. If so, we will, again, seek approval from the Select Board.

The FAAC would like to thank Scott McIntire, Partner, and Sara Corduck, Audit Engagement Manager of Melanson Heath & Company for the presentations to the committee. The FAAC would also like to thank the Town's Finance Director, Tony Logalbo, and the entire finance team for their attention to the committee's requests and in assisting us in understanding both the audit process and the financial statements report.

The Committee:

Michael Lawson, Chair
Arthur Fulman
Wallace Johnston
Thomas Piper
James Terry
Carol Wilson