

FINANCIAL AUDIT ADVISORY COMMITTEE

REPORT

Tuesday, October 11, 2016

Present: Councilor Fuller (Chair), Councilor Danberg, Councilor Auchincloss, Tony Logalbo David Spector, Robert Fox and Howard Merkwowitz

Also present: David Wilkinson (Comptroller), Sue Dzikowski (Director of Finance; School Department), and Matthew Hunt (CPA; Clifton, Larson, & Allen, LLC)

Update on External Audit

The Committee received an update from Matthew Hunt of Clifton, Larson & Allen (CLA) on this year's ongoing external audit. Mr. Hunt reported that all of the primary fieldwork is almost complete. The audit is on track to meet all deadlines. The open items include the Accrued Health Claims IBNR, Workers' Compensation actuarial valuation, third party audit confirmations and the Newton Commonwealth Foundation report and representation letter. The auditor should have both the Health Claims IBNR and the Workers' Compensation Valuation by the end of October. There is some additional work needed on major federal grants and some work on the audit of the City's payroll process, which the Committee identified as a focus of this year's audit. Once the auditors have all the required information, there will be manager and partner reviews.

CLA expects to provide the first draft of the Comprehensive Annual Financial Report (CAFR) to Comptroller David Wilkinson sometime in early November to mid-November with the expectation that the final report will be issued in early to mid-December prior to the Financial Audit Advisory Committee exit conference with CLA (scheduled for December 13). The draft management letter and draft single audit report will also be provided before the exit conference. The final management letter and final single audit report will be issued in late December or early January before CLA meets with the Finance Committee for its exit conference sometime in January or early February.

Mr. Hunt reviewed the impacts of Government Accounting Standards Board (GASB) Statement 68 implementation, which requires the City to report on its net pension liability. The City's net pension liability for FY 16 is \$317,071,646, which is an increase of over \$18 million since FY 15. One of the main reasons the liability is going up is that the investment markets did not perform as well as expected in 2015. The City is currently using a 7.35% discount rate. The presentation includes discount rate sensitivity numbers based on a decrease or increase of 1%. The City's discount is on the conservative side comparative to other retirement systems. The proportionate share is similar to the FY 15 share at slightly over 99%. The Housing Authority makes up the remaining percentage.

GASB decided that not all of the changes that take place in pension liability are expensed in one year. There are certain elements of the pension liability that are deferred over time.

FINANCIAL AUDIT ADVISORY COMMITTEE REPORT

Tuesday, October 11, 2016

Page 2

Deferred outflows at the end of FY 16 were about \$32,289,000, which is broken down into components. One of the major components of deferred outflows is changes of assumptions, such as retirement rates, discount rates and mortality rates. GASB decided that instead of taking the changes in assumptions and applying it all to the liability at once that those would get spread out over time. Therefore, the changes in assumptions result in \$15.4 million in deferred outflows, which can be attributed to a change in the mortality rates that Newton's Retirement System is using. The second major component is the expected vs actual investment income. Because the investment markets did not perform as well as expected based on the discount rate, there is a deferred outflow of \$15.5 million. These two components are amortized over five to six years. The deferred inflows include the difference between the expected vs actual experience when it comes to the actuarial valuations from last year's to this year's valuation, as there were fewer retirements and disabilities than expected resulting in a positive impact of \$3.2 million spread out over an approximate six-year period. There is also a slight change in the proportionate pension liability share resulting in a deferred inflow of \$57,000.

The Committee discussed if the City's discount rate should be lower than the current 7.35% to truly reflect what the Retirement System is earning on its investments. It is up to the Retirement Board to set the discount rate but the Committee could provide the Board with its suggestions related to setting a discount rate. It was stated that Moody's Investment Services is using a 4.5% discount rate when evaluating pension liability. It would be helpful to have input from the Pension Reserve Investment Management Board on the long-term investment picture.

The update included a review of the draft OPEB Trust Fund financial statements and the net OPEB obligation. The OPEB trust fund contains \$3.6 million. The increase to the fund was \$1.5 million based on contributions (\$1.4 million) and investment income (\$78,000). It is the ninth year of the OPEB accrual for GASB 45. According to the most recent valuation, the unfunded actuarial accrued liability is \$719.2 million. This is an increase of \$17.7 million. This substantial increase from the previous year was primarily due to increases in medical cost trends. In terms of the net OPEB obligation at the end of the year, it is a little over \$261.8 million, which reflects an increase of \$29.4 million from the prior year. Currently the reported OPEB liability is the difference between the actuarial required contribution and the pay as you go amounts that the City has been paying. In 2018, the difference between the actuarial liability and the net position will be reported as part of the financial statements. The City will be changing its discount rate from 2% to 4.5% but the City will report its full liability. The City may want to consider working with the League of Women Voter to setup workshops on pension and OPEB liabilities to raise community awareness of the issues. Eventually the City is going to have to make choices related to funding benefits.

The Committee requested that the auditor test the city's payroll system with a focus on new hires, transfers between departments, and terminations. The auditor will take some samples each of these different payroll system changes and see if there are any control issues. The tests will include making sure that all new hires are set up in the payroll system based on approved documentation and in accordance with agreements. The auditors will do the same for departmental transfers and make sure that any change in pay resulting from the transfer was

FINANCIAL AUDIT ADVISORY COMMITTEE REPORT

Tuesday, October 11, 2016

Page 3

calculated appropriately. In addition, the auditor will look at whether the proper documentation was filed and that access rights are no longer available for any terminated employee. Through the testing, the auditor will look to see if processing is done in a timely fashion. The auditor expects to do the testing over the next month. Mr. Hunt believes that the testing will result in recommendations to implement some additional controls for payroll.

Mr. Hunt concluded his update of the audit. He will join the Committee in December to discuss the draft management letter and the draft single audit report. Comptroller David Wilkinson stated that all of the fieldwork associated with the audit went very well.

Risk Assessment

The auditor's Management Letter has contained a comment related to risk assessment and monitoring for a number of years because of a new auditing standard requiring the auditor to frame an audit from a risk-based approach. From the auditor's perspective, it is important for the City to look at asset misappropriation and financial reporting risks. The auditor is looking for the city to come up with an annual program to assess risk, document the assessments, and to monitor the risk assessment program every year. CLA is willing to remove the comment because it is really best practice and if the City has concluded that it appreciates the benefits of risk assessment, but resources are not available to dedicate to risk assessment.

The Administration takes risk assessment seriously and there are ongoing discussions related to broad areas of risk. The administration is willing to meet with the Financial Audit Advisory Committee annually to discuss risk assessment. The City is also open to hiring a consultant if there is a specific area of risk that needs to be looked at in depth. Mr. Hunt stated that CLA does not require a formal policy. Any meeting minutes that indicate that there is an annual review of risks, how the City is monitoring risks, and what controls are in place.

The Committee adjourned at 9:30 AM. The next meeting is scheduled for Tuesday, December 13, 2016 at 8:15 AM.

Respectfully submitted,

Ruthanne Fuller, Chair