

Reading Municipal Light Board of Commissioners
Audit Committee Regular Session Minutes
October 2, 2014

Start Time of Regular Session: 6:35 p.m.
End Time of Regular Session: 7: 30 p.m.

Committee Members:

Philip B. Pacino, Chairman Thomas O'Rourke

Commission Members:

David Talbot

Staff:

Coleen O'Brien, General Manager	Jeanne Foti, Executive Assistant
Robert Fournier, Accounting/Business Manager	Hamid Jaffari, Director of Engineering and Operation's
Jane Parenteau, Integrated Resources Director	

Town of Reading Audit Committee:

Mark Dockser, Chair Peter Lydecker

Town of Reading Board of Selectmen:

Marsie West

Town of Reading School Committee

Jeanne Borawski

Guests:

Frank Biron, Karen Snow and Zack Fentross, Melanson Heath

Citizens' Advisory Board:

George Hooper

Call Meeting to Order.

Chairman Pacino called the meeting to order at 6:35 pm.

Town of Reading Audit Committee called the meeting to order at 6:35 pm.

Melanson Heath Audit Findings

Ms. Snow stated that she would be presenting the Financial Statements. She pointed out that there is one error in the Financial Statements on page twenty eight, Note 20 - the last sentence it is incorrect. Ms. Snow said that this speaks to RMLD's unfunded pension liability, the \$5.3 million in the Pension Trust as of June 30 is actually included the actuaries number in the actuarial value of assets, this is does not offset, the liability is net of that number. This change will be made before the Financials are finalized. Mr. Dockser clarified that the last part of the sentence where it states that the "\$5.3 million is partially offsetting the \$9 million" is incorrect. Ms. Snow agreed, that is correct. Mr. Biron said to take out the last five words "to partially offset this liability "is inaccurate.

Ms. Snow then explained, page one, the Independent Auditors' Report which addresses that the RMLD's Financial Statements are materially correct, which in are in accordance with Generally Accepted Accounting principles and as in year's past is a clean opinion. It is an unqualified opinion. The Financial Statements are materially correct. The opinion is found on page two. The highest opinion one can receive is unqualified. Pages three to five represent a narrative overview of the Financial Statements. This provides a quick overview.

Ms. Snow then addressed the Financial Statements found on page six which address fiscal years 2013 and 2014. Ms. Snow said that the biggest change dollar wise was in the Unrestricted Cash and Short Term Investments. It is a timing issue because the payment on the Pension Trust was not paid out until after June 30.

Melanson Heath Audit Findings

Ms. Snow explained that it is due to the timing of the billing and when cash gets paid out. There is a change in receivables of \$500,000 from the prior year to this year. Note 4 on page eighteen provides what makes up the receivable number, it is billed and unbilled customer receivables as well as miscellaneous receivables. Customer account receivables were down to \$350,000 and \$162,000 in other receivables. The RMLD wrote off some old uncollectible receivables this year. Ms. Snow reported that ninety two percent of your billed receivables are current which is the same as last year. Ms. Snow pointed out that there is a seven percent increase in the Restricted Cash and Short Term Investments, there is a note on page seventeen. The biggest swing in the individual restricted accounts is in the Depreciation Cash which went up \$1.4 million, Deferred Fuel Reserve \$1.5 million and Construction went down \$500,000 because the RMLD chose to put in \$1 million as opposed to \$1.5 million in the prior year. Mr. O'Rourke asked about the benchmark of the ninety two percent in receivables to others in the industry. Ms. Snow replied that for municipal utilities it is pretty standard. Mr. Dockser asked under restricted, it is restricted because it is targeted to a particular activity. Ms. Snow agreed, it is for a particular purpose which is found on page seventeen. Mr. Dockser asked about the Sick Leave benefits and Restricted Investments in 2013, it is zero balance. Ms. Snow responded that is because there were no investments in 2013 because it was all cash and short term investments. In 2014 some of the money was invested in corporate bonds to make a better return on that money. There were no other big swings in assets. The Depreciation Expense equaled the Fixed Asset Additions the difference was \$312. Ms. Snow pointed out that the RMLD does not have any long term debt outstanding. The RMLD has not had to bond or borrow for capital and acquisitions to date which has been funded out of current earnings, reserves and depreciation cash. The RMLD is in a strong position. One of the biggest liabilities is the amount due to the Pension Trust found on page nine which is the amount the RMLD contributes to the Pension Trust. It is the amount that the actuary determined that was required for 2014 and the full amount was contributed. The cash did not go out to after the year end. The only long term liability the RMLD has is the accrued vacation and sick time which is significant at \$2.8 to \$3.0 million which is going down as employees retire. The benefits accrued to current employees are not as nearly generous. That liability will drop when long term employees retire. Mr. Dockser asked if this will go to zero. Ms. Snow responded that it will never go to zero because you are always going to have some accrued leave time. It will not be as high because it was unlimited now it is capped, the liability will remain stable. Ms. West inquired on leave balances for new employees. Ms. O'Brien explained depending on the bargaining unit, employees get thirty days or sixty days, she has zero. Ms. O'Brien said they are looking at this as part of the organizational study to see if this liability can be addressed sooner. Ms. Snow said that Restricted Cash is set aside to offset that liability.

Mr. Biron pointed out that in next year's Financial Statement there will be an additional liability. There is a new accounting standard, Government Accounting Standard Board (GASB) 68 which deals with pension plans. Up until now, RMLD as well as all other municipalities in the United States, if funded to the level the actuary stated, no liability is reported on your balance sheet. This will change next year because GASB 68 states that whatever your share of that unfunded liability is will have to be reported in the Financial Statements. Ms. Snow explained that this liability will be \$7 to \$8 million after taking into account the \$1.3 contribution in fiscal year 2014. It is a large number, but is lower than others. The Town of Reading's contribution is larger because it is larger entity. RMLD has been putting money aside in the Pension Trust and has been funding this. If the market stays strong, the investment earnings will take care of some of that liability. There is no doubt that it is going to be a large liability on the books. Ms. West said that we already have that liability; it is a matter of acknowledging it.

Mr. Biron pointed out that in 2018, there is going to be another GASB for the Other Post Employment Benefits (OPEB) the health insurance benefits. Based on the actuaries each year, the whole liability will be reported in 2018. Ms. Snow pointed out that on page twenty nine there is a schedule which shows the retirement and OPEB unfunded liability. The OPEB funded liability is \$6 million at June 30, 2014 which is pretty healthy. The OPEB Trust has been set up and has been funded every year based on the amount in the actuarial valuation. Theoretically, over thirty years you would be fully funded.

Ms. Snow then addressed the Change in Net Position. Kilowatt hour sales were down two percent and the electric sales were down. The RMLD had temporary over collection in the Fuel Charge and the Purchase Power Adjustment. There is a big change in the Purchase Power Adjustment due to the unbundling of rates which occurred on July 1, 2014, a portion was captured in fiscal year 2014 because of the unbilled accruals. The customers who billed in July for their June electric service are captured in a portion of the Purchase Power Adjustment. It is an increase from last year.

Melanson Heath Audit Findings

Mr. Talbot entered the meeting at this point.

Ms. Snow explained that temporary over collections where the RMLD is recouping the cost from the customer for the cost of the fuel, capacity and transmission, those cost are passed through to the customer. This adjustment is worked out to match those costs. There will always be temporary under or over collection. The target for the fuel is \$2 to \$3 million and is over a bit for June 30, 2014 and will be adjusted in fiscal year 2015 to maintain that stability. This has been set up in order that the customers do not feel a large increase due to the increases in fuel, capacity or transmission. Because of the over collections, you are off three percent on the Operating Revenues. Operating Expenses remain stable. Purchase Power went down \$600,000 a portion of that is because the RMLD sold Renewable Energy Certificates \$800,000 which is found in Note 18 pages twenty six to twenty seven. The proceeds from REC's are recorded against the Purchase Power Expense. Purchase Power remained relatively stable. Operating Income was up \$1.8 million, Non Operating Revenue and Expenses, the largest part of the payment to the town \$2.3 million in fiscal year 2014. The change in Net Position or Net Income \$3.5 million which is 6.4% - 6.5% of the allowable 8% return. Ms. Snow pointed out that 6.5% is a good solid return.

Mr. Dockser asked the loss on disposal on capital assets what does that represent. Ms. Snow explained that is when surplus equipment that is disposed of it represents the difference between the depreciation expense taken to date on that asset and the cost of the asset when it was on the books. If the cost is higher than the depreciation then it is a loss on the disposal. If the depreciation and cost are equal no loss, it is 1:1. Mr. Biron added the write off of the book value. Mr. Dockser clarified this happens at the point when it gets disposed of. Ms. Snow agreed. Mr. Dockser asked does that tell us we are not depreciating correctly; he wants to understand the mismatch of 2013 which was three times 2014. Mr. Fournier explained that this pertains to the meter and transformers. The transformers have a twenty to twenty five year life span; however, if it blows after five years, that loss needs to be recognized since it did not depreciate its full life. The RMLD just completed its residential meter change and some of those meters were not fully depreciated. It is a combination of transformers and meters that make up the bulk of the number. Mr. Dockser asked if it hovers plus or minus \$200,000 annually unless there is an exceptionally bad year. Mr. Fournier explained that the \$385,000 the RMLD was in the middle of the meter change out, thus the higher loss.

Mr. Dockser had a question on the balance sheet, Restricted for Depreciation Fund why does that vary so substantially. Ms. Snow explained that it is a direct offset to how much you have in restricted depreciation cash. You are required to depreciate at least three percent annually and that three percent goes into your depreciation fund which can go as high as five percent. The RMLD has traditionally taken three percent. That money goes into the depreciation fund, funding capital acquisitions and construction improvements out of that a portion of that comes out of the depreciation fund, another comes out of the construction reserve. If the depreciation increases that means less of the money was spent on capital assets this year then you put in. The RMLD put in more than it took out this year. The capital assets did not change that much this year, it was even. There was \$1.5 million in the construction reserve used first before the depreciation fund was hit, there is a little bit of a higher cushion this year in the depreciation fund. The RMLD has a pretty ambitious capital improvement program going forward and that will help you fund that.

Ms. Snow then addressed cash flow statement. The net cash provided by operating activities is adequate to cover operating needs. Pages nine and ten are the Fiduciary Financial Statements, Pension Trust and OPEB Trust. This year almost \$1.4 million went into the Pension Trust and almost equal amount came out to pay the town for the fiscal year 2014 cost. There were higher investment earnings this year because last year it was all cash. The OPEB was funded in the amount of \$434,000. Both of these payments were made on the amount that the actuary determined. Ms. Snow said there are notes to the Financial Statements that provide more detail on the numbers.

Mr. Dockser clarified that there is more money in the construction reserve fund where is that found. Ms. Snow responded that it is found on page seventeen. She noted that this year it is \$1 million; however, it was \$1.5 million last year. Ms. Snow said that they will add comparatives in next year's report.

Ms. Borawski asked on page fifteen on the movement to investments, the bonds are listed with the rating, who makes that decision of all the investments. Ms. Snow responded that it is the General Manager in consultation with the Town Treasurer. The Town Treasurer has custody, has the cash in essence.

Melanson Heath Audit Findings

Ms. Snow said that she had a conversation with the prior General Manager, Vinnie Cameron because there is \$18 million worth of reserves that were not earning anything, earning $\frac{1}{2}$ of 1%. Ms. West said that Mr. Cameron was performing a search to have someone invest the money which is not necessary if you are working with the town. Ms. O'Brien explained that Mr. Cameron was going to do something private, then she and Mr. Fournier had worked with the Town Treasurer to set it out short and long term investments.

Mr. Lydecker asked relative to the unfunded pension liability, will it be fully funded in thirty years. Ms. Snow responded that theoretically it was supposed to be fully funded in thirty years and not sure when the thirty year funding cycle ends. When the market took a really bad down turn as in 2008, they extended the funding schedule. They recognized that the organization lost a huge amount of money out of your assets. You cannot ask the customers to absorb the cost of the downturn in the market. Mr. Biron said that it is supposed to be fully funded by 2025-2026.

Ms. West asked about the aggressive capital campaign and the magnitude of that. Ms. O'Brien responded that \$5 million was put into that and there was a capital plan in place when she arrived. Ms. O'Brien switched the capital plan because there was a lack of maintenance in place; it went from capital to expense to incorporate maintenance activities that were not present. The organizational study and reliability study will lie out for twenty years capital improvements for the system and it will become clear what has to be done in year one, five and ten for the infrastructure to meet the capacity requirements. In the Wilmington area where Target is being built, that is an area there is growth and will need a substation. That was not captured because until the reliability study comes in she was trying to finish the capital projects listed prior to her hire. The RMLD is has been focusing on getting maintenance up and running. All the substations are being done because they have not been done in ten years. Ms. West asked how often substations have to be done. Ms. O'Brien responded that substations are done typically every three years depending on the transformers or circuit breakers, not replacements, maintenance activities. There is also maintenance of the lines and upgrading construction standards. The change is from reactive to proactive, which went more on expense versus capital. That will adjust once the studies come in about eighteen weeks if awarded this evening.

Ms. Borwaski asked on page seven, electric sales, they are down, expenses are stable, what does that mean? Mr. Fournier said that sales are down. Ms. Borawski said that sales are down and operating expenses are the same at what point is that a problem. Mr. Fournier said that this is why the RMLD proposed the rate increase because the RMLD is expecting sales to be flat, looking at the rate increase, operating budget expense are pretty high and we have activities that we did not fulfill yet. Eventually, operating expenses will be increasing and the rate increase that occurred earlier in the calendar year, it will help RMLD fund the operating activities.

Ms. West said that the maintenance expenses will be going up due to the proactive maintenance. Ms. O'Brien said that the proactive maintenance is a contributing factor, but there are currently seven vacancies between retirements and a couple of resignations. Ms. Snow added that there always are increases in pension and health costs. That is the biggest jump was pension and benefit expenses of \$685,000.

Mr. Hooper asked on page seven interest income, it shows a nice increase. Ms. Snow responded that is investment income and unrealized gains on your investments. It went up from \$24,000 to \$121,000 and the increase is the reflection of investing in the bonds, a better return and unrealized investments.

Chairman Pacino asked if there is going to be a Management Letter. Ms. Snow responded there is no Management Letter this year as in year past; there were no issues that represented significant deficiencies or material weaknesses in internal control. There were minor housekeeping issues that they spoke to Ms. O'Brien and Mr. Fournier about while at the RMLD and nothing that needed to be reported on.

Mr. Dockser said that there are a number of vacancies where they there in 2014. Ms. O'Brien responded yes and the positions are still vacant. There were four lineworkers retire, Facilities Maintenance Manager resign and Energy Efficiency Engineer vacancy. Ms. O'Brien stated that the organizational study is looking at the appropriate amount of employees for efficient work processes for a utility this size.

Melanson Heath Audit Findings

Ms. O'Brien stated that at one point the RMLD had ninety five employees, there are currently in the low seventies. The RMLD does not need the organizational study to show the staffing need, and are working hard to get interviews; there will be three linemen position filled within the next few weeks. Mr. Dockser said that if there were not vacancies the number would have been a lot higher than \$11.5 million for operating. Ms. Snow added that benefits such as pension and benefits went up \$685,000. Mr. O'Rourke pointed out that is offset by overtime for the linemen if there are four vacancies that would increase the overtime.

Ms. West said that she understood that there was a couple billing issues this year. This is something that does not require a Management Letter. Ms. West said there was something to do with NSTAR and Middleton. Ms. Snow added that those were prior year's issue. Ms. Snow pointed out that on page seven, \$327,297 Purchase Power Refund that was prior year revenue. That is where Middleton Light paid the RMLD back for the RMLD overpaying them in whole last year. Ms. Snow said that the NSTAR issue with the radial lines was four years ago. Ms. Snow said that they do routinely test purchased power invoices and do a specific test for purchase power. They pull all invoices to ensure they are approved they cannot tell they are correct, if they are approved by Ms. Parenteau and the engineers then they are correct.

Ms. West asked if any procedural changes were made to ensure that they do not happen in the future. Mr. Biron responded that he is aware that the RMLD had a special study conducted. Mr. Fournier added that the RMLD had a special audit conducted by a firm from Maine on the purchase power process and did not find anything. Ms. West stated that the RMLD did not make any changes as a result of this. Ms. Snow said that they now have controls in place that every one of those invoices have two signatures in Ms. Parenteau's department prior to getting to the warrant. The General Manager and Board approve the warrant. Ms. Parenteau added that the Berry Dunn audit requested that we have more internal meetings with her group and engineering which take place on a regular basis so that there is more internal communication. There are four or five elements in place as a result of the recommendations in the audit.

Mr. Talbot stated that relative to sales there are three major structural changes that will help and profoundly hurt sales and the business. The first is the rapid adoption of electric cars, charging cars is good for sales. Ms. O'Brien and Ms. Parenteau are working on getting charging stations. Second, the International Energy Agency this week came out with sharply higher predictions for what photovoltaics will be doing from niche by 2050 providing twenty seven percent of the world's electricity. There is a project at Lincoln Sudbury High School in which there are canopies in the parking lots. It is approximately \$2 million savings for twenty years. If they are doing this we are losing sales. If we can figure how RMLD can go back into generation after one hundred years of not doing it. It is a radical change to what RMLD is doing, we do not generate now. Ms. O'Brien in the studies she is calling for will position the RMLD how to know that. The third is that with the communications capacity that Ms. O'Brien is working on, the RMLD will finally be able to attack the peak in a substantive way. The peak will be addressed by new deals with large customers and better demand side management that is enabled by information technology. These are three big areas that are going change how the RMLD has been doing things for the past decades.

Mr. Dockser said that not just on the residential side, commercial, and town, school, other. Mr. Talbot commented that the schools and homeowners can do this. Ms. Parenteau explained that they are working with commercial customers in the towns the RMLD serves. Ms. Parenteau pointed out that when the commercial customers put up the photovoltaics erodes RMLD's revenue. We work with them and do not allow third party developers to come in RMLD's service territory and sell our customers power. They are having them develop the project and incorporate the power into RMLD's portfolio in order that everyone benefits, the revenues are not reduced and taking advantage of the solar that is in RMLD's territory. RMLD is currently looking at a canopy in Wilmington, which is a 600KW car port. We are trying to structure this where it makes good business sense for the RMLD. It also makes sense for the customer because they are obtaining their sustainability requirements. The town may receive additional PILOT payments for the revenue. The RMLD is trying to work collaboratively with the customers, towns and developers to make these projects succeed.

Ms. O'Brien stated that there will be a lot of challenges coming down the road with capacity and transmission increases because of the infrastructure that is not getting to the end of the pipeline. It is part of the strategic planning on how can balance the revenue and keep this golden egg. Mr. Talbot said that NSTAR has just asked for the thirty seven percent rate increase.

Melanson Heath Audit Findings

Ms. West asked if the RMLD has been involved with the gas pipeline into New England. Ms. O'Brien responded that the RMLD did not make a formal statement. However, she and Ms. Parenteau in the cable television presentation they did on the unbundling of RMLD's bill and how to read the bill, a call in question was to ask her about that. Ms. O'Brien said that they spoke to the fact that electricity prices are tied directly to gas prices. If they are bringing that into the region it will help to keep the electricity prices down because it is based on supply and demand. That is the only relationship she made on that comment.

Mr. Pacino made a motion that the Audit Committee recommend that the Board Commissioners accept the audit as presented Mr. O'Rourke seconded the motion.

Motion carried 2:0:0.

Mr. Dockser made a motion to accept the audit, Ms. Borawski seconded the motion.

Motion carried 3:0:0.

At 7:30 Mr. Pacino made a motion to adjourn the meeting.

Motion carried 2:0:0.

Mr. Dockser made a motion to adjourn the meeting.

Motion carried 2:0:0.