<u>Reading Municipal Light Board of Commissioners</u>
Audit Committee Minutes
October 29, 2015

Start Time of Regular Session: 6:55 p.m.
End Time of Regular Session: 7: 35 p.m.

<u>Committee Members:</u>
Philip B. Pacino, Chairman **Dave Hennessy, Commissioner**

<u>Commission Members:</u>
Thomas O'Rourke **John Stempeck**

<u>Staff:</u>
Hamid Jaffari, Director of Engineering and Operations **Jeanne Foti, Executive Assistant**
Robert Fournier, Accounting/Business Manager **Jane Parenteau, Integrated Resources Director**

<u>Town of Reading Audit Committee:</u>
Mark Dockser, Chair **Steve Herrick, Member**
Paul McNeice, Vice Chair of the Finance Comm

<u>Guests:</u>
Karen Snow, Melanson Heath

Call Meeting to Order.
Chairman Pacino called the meeting to order at 6:55 pm.

Town of Reading Audit Committee called the meeting to order at 7:05 pm.

Melanson Heath Audit Findings
Ms. Snow introduced herself as the manager of the RMLD Audit. Ms. Snow stated that the good news is there is not a lot to discuss this year other than the one new thing is the GASB 68. Other than that everything is about the same. She started at the beginning of the report. It is an unqualified audit opinion. Ms. Snow explained the wording of this Auditor's Report has not changed and again, Reading has a clean unqualified audit opinion.

Mr. Hennessy asked what "unqualified" meant. Ms. Snow explained that it is the highest opinion any company/organization can receive. There are no exceptions; there are no problems; everything is good. Mr. Pacino added no departures from standards.

Ms. Snow continued. The management's discussion and analysis on pages 3 to 5 of the Report is a narrative overview of the Financial Statement. Ms. Snow stated that she generally does not go through this although it is a good section to read because it provides basic highlights of the results for the year. Ms. Snow stated that she will skip straight through to the Financial Statement which starts on page 6 with the Statement of Net Position for the Balance Sheet. This is the assets, liabilities and equity or net position. Ms. Snow reiterated there is not much going on this year that is different than in the past. The receivables are fine; they went down a little this year, but not by much. There is a note disclosure on page 18 that gives detail of what makes up that receivable amount. It is made up of both billed receivables and unbilled receivables for customer accounts and some miscellaneous receivables. The good news is about 93% of those receivable are current, less than sixty days past due. The RMLD is in good shape and consistent with prior years.

Mr. Dockser asked what is "uncollectible?" Ms. Snow explained that uncollectible is a reserve. RMLD's write offs each year are nowhere near that reserve. That reserve is much higher than RMLD's annual write offs. The RMLD's write offs did not change from last year. It is the same.

Continuing, Ms. Snow stated that Restricted Cash and Restricted Investments on page 17, provides detail of the balances in all the various restrictive cash and investment accounts that the RMLD has. There is an explanation of what each one of those accounts is for and this year we have comparatives in there to show how it changed from one year to the next.

Melanson Heath Audit Findings
Ms. Snow explained it is up overall about $3.1 million which is fairly substantial. Ms. Snow said that most of that is the Deferred Fuel Reserve that fluctuates up and down depending upon the cost of the fuel portion of the power bills.

Mr. McNeice asked if the fuel reserve is a function of the estimate of what the fuel cost might be and what it actually is, the difference between those rates. Ms. Snow answered, yes, it is the cumulative where RMLD recovered more than the purchased power costs. This fluctuates every year because some years RMLD is giving back money through credits on the bills and other years RMLD is charging on the bills. It does fluctuate when trying to estimate the fuel which is a very volatile number. The RMLD typically target $3 to $4 million. The cost of oil has been down, the cost of fuel has been down, but that could change at any time. This protects the customers.

Mr. Herrick asked what the lag time between the fuel charges being set on the bills. Ms. Parenteau replied that it is one and a half months. Currently, the fuel charge is being set for November. RMLD has just finalized September. October is still open and RMLD is working on November. Ms. Parenteau elaborated that within the New England region in the wintertime, natural gas is a straight commodity and that has had substantial impact on winter prices. That reserve has been bumped up in order that RMLD can levelize and not spike up those payments for our customers. The RMLD needed a little higher reserve to get us through the winter period.

Mr. Herrick clarified that if we look at this in May we would see a much lower number? Ms. Parenteau agreed.

Mr. Dockser stated that the Depreciation Fund is up $1.3 million which is another big jump. Ms. Snow stated that the depreciation rate did not change. It was 3%, but RMLD put money in a construction fund. That money was used first before tapping into the Depreciation Fund. In this particular year, the change in capital assets was only $270,000. It wasn't that big. The RMLD did not have any major projects. The fund was able to build up a little more of a balance. There is no debt on the books. This is being used to fund all the capital construction with cash that is one of the reserves. The construction fund is also a reserve to help fund those capital needs. RMLD is in good shape and does not have to borrow.

Mr. Herrick asked when there is a big storm with lots of infrastructure damage that comes out of this fund or another fund. Mr. Fournier replied that those damages come out of the Operating Fund because that is all part of maintenance. Ms. Snow pointed out that with big storms, there is sometimes FEMA reimbursements. If the RMLD were to build a new substation or had to upgrade transformers those type of things would be funded out of these accounts.

Ms. Snow stated that there are a few new numbers on the Statement of Net Position this year explaining that one of them is called, The Deferred Outflows of Resources. This is new terminology as well as the first year seeing it. Ms. Snow stated that it is basically deferring recognition of outflows or payments. There is a note disclosure on pages 19 to 20, Note 9 that details what those defer outflows are. The biggest portion of it has to do with GASB 68 where this year RMLD was required to recognize its portion of Reading Contributory Retirement's Unfunded Pension Liability. The $1.5 million is the contribution that RMLD made to the Pension Trust in fiscal year 2015, but the contribution was not actually made until after the net pension liability measurement date of December 31, 2014. Due to the fact that the contribution was not made until after that date, Ms. Snow explained she had to defer recognition of that expense until next year. That is a deferred outflow of resources. Then there is also a very small piece of it that there was a change in the net pension liability due to change in investment earnings. That is deferred and recognized over a five year period of time.

Mr. Pacino asked is that in a Statement of Net Position somewhere, the deferred outflow of resources? Ms. Snow answered, yes, the Statement of Outflow of Resources is right before the Total Asset, right below Assets. It is an "Asset like account", but is not called an Asset.

Mr. Stempeck asked if that is a percent each for that amount equal to the portion of the RMLD invested in the Pension Fund. Ms. Snow answered yes, it is essentially what RMLD contributed to the Pension Fund in fiscal year 2015.

Mr. Herrick asked if it is an actual contribution not just recognition of liability. Ms. Snow answered, yes, it is an actual contribution shown on page 10 under the Pension Trust Financial Statements. It shows $1.5 million is a contribution to the Pension Trust in fiscal year 2015, but because the Pension Liability is measured as of December 31, 2014.

Melanson Heath Audit Findings
Ms. Snow explained that the RMLD did not make the contribution until after that. That is when it can be recognized. Normally, that would be RMLD's Pension Expense for the year, but because the contribution was not made until after the measurement date, it cannot be recognized until next year. What we really did was recognize last year's contribution to the Pension Trust as a Pension Expense this year. It is very complicated, but that is it in a nutshell.

Ms. Snow explained the second number that is new this year is also related to GASB 68. It is on page 6 Net Pension Liability. Ms. Snow continued. This is brand new this year and is $4.5 million which is RMLD's portion of the Town's Retirement System's Unfunded Liability for the pension. There is an a very extensive note on pages 24 to 29 Note 17 that describes the contributory retirement system and what the benefits are, what RMLD's portion of the unfunded liability is which is 28.25%. The RMLD is unique because there is a Pension Trust. Contained in the note disclosure on page 26 is a reconciliation of what the actuary determined. RMLD's Net Pension Liability is determined after taking into account the assets in RMLD's Pension's Trust. When the actuary calculated RMLD's net pension liability, they did not take into account the assets in this trust because they are not part of the pool of assets that the retirement system holds. They did not consider them part of the pool because in their view the assets have to be available to pay the benefits for all retirees, not just RMLD employees. RMLD's Trust is restricted to the benefit of RMLD employees. This was discussed with Bob Fournier and with RMLD management because we could have presented this in two different ways. We could have presented the gross liability on RMLD's Statement of Net Position and then disclosed the net liability and the notes or, what we choose was to disclose the net liability in the Statement of Net Position and then do a reconciliation in the notes. We felt that it was appropriate since RMLD has an irrevocable trust and those assets cannot be used for any other reason than RMLD's retirees. It was appropriate to net down that liability by the amount of those assets, there is a reconciliation on page 26.

Mr. Stempeck asked what the Unfunded Pension Liability is for the Town of Reading. Ms. Snow replied that it is approximately $29 million and RMLD's portion is 28.25% of that amount. Their actuary calculated that RMLD's net pension liability was about $8.5 million, but then Melanson and Heath took the assets that are in the Pension Trust and rolled them back to the December 31, 2014, measurement date then subtracted that number from the $8.5 million amount to come up with the $4.5 million.

Mr. Pacino stated that money is actually in the RMLD's Pension Fund. The Town cannot go in and tap into it. Ms. Snow agreed stating that it is an irrevocable trust and is restricted to the benefit of RMLD's employees. The Town cannot touch that Trust. Mr. Pacino clarified that no creditor can come along and grab that money. Ms. Snow answered, no, that is why Melanson & Heath believed it was appropriate to report it this way because it is irrevocable and cannot be touched for any other purpose. Even the RMLD Board couldn't change the purpose of the Trust because it is written into the language of the Trust that nothing can be done with that. It has to be for the benefit of the retirees of the employees.

Mr. Herrick stated that $1.5 million was paid into that Trust with a net unfunded $4.5 million. Obviously, something can be added to that. Is this the plan the $1.5 million annually RMLD pays into this until RMLD is fully funded. Ms. Snow explained RMLD has an actuary valuation performed every two years for the Pension Trust Fund and the actuary calculates how much RMLD needs to contribute to that Trust in order to cover the annual assessment for the Town of Reading for the Pension. The Pensions are on a schedule to be funded by the year 2028. The assessments RMLD pays every year are scheduled to fully fund that Pension Lability for the whole Retirement System by 2028. With that being said, Ms. Snow stated that she recently heard rumors that it is being pushed time frame further into the future because of the current market conditions and losses in the market.

Mr. Stempeck stated that it just strikes him that at this rate really gets RMLD a lot closer because that is a huge bite on this side. Ms. Snow agreed, yes, it is a large number, but is small in comparison to what most other communities will have for a number.

Mr. Pacino stated that the commission's feeling has always been that it's trying to fund that as we go along depending upon what available resources are available. Mr. Herrick stated that once we get to a certain holding pattern, the fund should have self funding involved then the annual contribution can be curtailed way down. Ms. Snow agreed, noting that is the theory, to accumulate enough assets that they are self- perpetuating that the investment earnings on those assets are able to pay the benefits. Stempeck added that it is a function of the interest rate and longevity.

Melanson Heath Audit Findings
Mr. Stempeck added that from a strategic perspective to consider to funding as much as possible. Mr. Dockser said that the town will have a similar conversation.

Ms. Snow reported that RMLD does have the OPEB liability and does not have an Unfunded OPEB liability. The OPEB is on Note 16 on Pages 21-24 and that is the other big unfunded liability. RMLD does not have an unfunded liability on the Statement of Net Position because RMLD has an actuarial valuation which specifies what is needed to contribute every year to the OPEB Trust Fund. RMLD contributes every year what is required to contribute to fund it. At this point in time there is no unfunded OPEB Liability. OPEB (Other Post-Employment Benefits) which is essentially health benefits that is paid to employees after they retire. Ms. Snow reiterated, RMLD is in good shape because there is no unfunded liability. Although in 2017 just like this Net Pension Liability had to be recognized all at once, they are changing the rules OPEB, which was being recognized over thirty years will have to all go on the Statement, as well. Thus in two years, RMLD will have another big liability going on the books and will not have thirty years to recognize it. They will be more consistent and make it be recognized all at once. This is another big change in two years, but again RMLD has the OPEB Trust Fund. There are assets accumulating in that trust fund being contributing to every year. Mr. Jaffari clarified, that is the $345,382. Ms. Snow agreed, the $345,382 is due to the OPEB Trust Fund and it means RMLD did not move that cash before June 30, 2015, but did make the contribution.

Ms. Snow stated that on page 7, the Statement of Revenues, Expenses and Changes in Net Positions or Income Statement which shows the operating results for the year, revenues were up about 5.4%. The operating revenues based on kilowatt hours increases was a very small increase in kilowatt hours about .2%, but the rates were raised which brought the operating revenues up a little bit. Ms. Snow explained that traditionally at the top under Operating Revenues, Melanson & Heath broken out the Fuel Charge Adjustment and the Purchase Power Adjustment. The Fuel Adjustment is the difference between what the customers have been charged for fuel for the year and what the cost of the fuel was. That is a temporary timing issue. In 2015, RMLD unbundled its Purchase Power Capacity and Transmission Charges from its Base Rates. RMLD is now passing that cost straight on to the customers as well. RMLD is not only passing the fuel cost directly on, RMLD is also passing Capacity and Transmission as well those are no longer imbedded in the base rates. There is a big swing in 2014 where capacity and transmission adjustment. In 2014, it was $3.1 million and this year it is $27,000. This is due to the fact that last year in 2014, the base rate which involved more estimating of what the purchase power adjustment was. There were big swings in the collections on the purchase power adjustment. Now it is much clearer about estimating the capacity and transmission and linking it directly to RMLD is charging on the power bills. Ms. Snow stated that the reason for that is because capacity is increasing significantly over the next few years and RMLD wants to pass that cost directly through to the customer. By January 1, 2017, capacity will be triple. Mr. Stempeck added that the RMLD wants to be transparent to the customer and that was the major reason for doing it this way.

Mr. Herrick clarified that this represents something as recent as 2014 that is a big number. Is that a typical number for prior years that would have been seen or does this number bob over all the place? Ms. Snow replied that this number bobs all over the place; again, based on estimates and power costs along with the adjustment to try match those up. It would have been fluctuating. Some years it would be negative and some years it would be positive. It would fluctuate every year. But again, going forward, that should be a very small swing because RMLD is able to react more quickly, bill that and pass that through.

Ms. Snow stated that the Operating Revenues are about $85 million, Operating Expenses $80 million which was up about 1.3%. The operating income very healthy $4.6 million. Ms. Snow noted that the operating income is actually higher than it was before the GASB 68 Liability was recorded. The operating income was about $3.9, almost $4 million dollars, but RMLD actually had a swing in the Net Pension Liability of $666,000 what it would have been in 2014 if it was booked and what it was in 2015 it actually went down. In affect it actually had a positive effect on the Net Income. One thing to be aware of is this Net Pension Liability appears to be very volatile. RMLD might be seeing some big swings when the Liability is recorded every year between what it is one year and what is is in the next year. It can have an effect on the Net Income because $666,000 is in RMLD's favor this year. In other words RMLD's expenses were reduced by $666,000, but it could be the opposite next year if the market does poorly and that meant if Pension Liability goes up that could be an opposite. To give an idea of that Ms. Snow explained on page 29, there is a Sensitivity Analysis.

Melanson Heath Audit Findings
When performing an actuarial valuation for GASB 68 an interest rate/discount rate is used. That discount rate is 7.75%. Essentially they expect RMLD to earn 7.75% on investments and if there is a 1% decrease in that discount rate, RMLD earns 1% less which significantly increases RMLD Liability from $4.5 million up to $7.5 million, a huge increase in RMLD's liability. On the other end, if RMLD earned 1% more an even bigger swing RMLD would have actually had a net asset because there wouldn't have been an unfunded liability. Huge swings depending upon market and the positions of the assets based on that discount rate. Ms. Snow explained they are going to allow RMLD to defer some of those changes and recognize them over a period of time, but not all of them. From one year to the next you will be seeing some volatility over the Operating Income based on those changes.

Mr. Stempeck commented that all corporations are facing this. Ms. Snow replied, yes. Government is one of the last entities to put this on their balance sheet. Corporations have had to recognize this for years. This is getting governments up to speed. The long term expected rate of returns are on page 28. They have an asset allocation and what they expect the returns to be, but if the market takes a dive like it did in 2008, all bets are off and that is out the window because if the market goes down 20% everybody is hurting.

Mr. McNeice asked if it is allocated among those lines. Ms. Snow stated that it is actually recorded within the Operating Expenses under the operating category. That is where Pension Expenses is recorded. Mr. Docker asked if that is why that number if up this year. Ms. Snow replied that the number is actually down this year. It is up, but that is not related to GASB 68. It is up because RMLD actually have higher operating expenses this year, but RMLD actually recognized in the books before we booked GASB 68. There was Pension Expense of $1.5 million. GASB 68 entry was recorded the Pension Expense went down to $833,000. Those Operating Expenses actually went down, so RMLD's Net Income was actually lower than it was before the GASB 68 was booked.

Mr. Dockser asked what if that was taken out and we looked at the real operating expense. Ms. Snow stated that they were higher this year than they were last year because RMLD has been doing a lot of maintenance, being very proactive in doing more maintenance so costs have gone up. They were up 5.5%, but before GASB 68 they were probably up more like 8%, GASB 68 lowered it.

Mr. Dockser asked if that number makes sense even with the maintenance activities. Mr. Jaffari answered, yes it does make sense, because there are substations that haven't been tested in a long time. It took time to catch up. Mr. Pacino stated that RMLD perfumed a Reliability Report and identified some areas to be addressed.

Ms. Snow stated that even after all that RMLD still had an operating income of $4.6 million which is a healthy operating income. Although down from the prior year, but still a definitely a healthy operating income. Ms. Snow then stated a non operating expenses were $1.4 million. The bottom line change in net position was $3.2 million for the year. Still a very solid year for RMLD.

Mr. Dockser asked Ms. Snow to walk through the Return on Investment is to the Town of Reading. Ms. Snow stated that another word for the Return on Investment to the Town of Reading is "A Payment in Lieu of Taxes." Essentially, RMLD does not pay taxes to the Town. There is an agreement. Mr. Pacino stated that basically RMLD volunteer payments to the town and those go to each of the four towns and that is under the Twenty Year Agreement. It is based upon the amount of net plant multiplied by the amount of usage that is in each town. The $2.3 million is the return in investment to the Town of Reading and that is actually paid out. Ms. Snow stated that there is an agreement that was made with the Town of Reading and it is adjusted every year. This is an actual Return on Investment not a payment in lieu of taxes and it increases every year by the rate of the CPI.

Ms. Snow stated that those were the only changes from prior years. Everything else was basically the same. There is no management letter for Fiscal Year 2015. In past years, there were no issues, no significant deficiencies, no material weaknesses in internal control; so no management letter.

Mr. O'Rourke asked what is the current CPI? Ms. Snow stated that it averages approximately 1.2% to1.3%. It is very low.

Melanson Heath Audit Findings
Mr. Dockser asked if Ms. Snow could walk through the RECs one more time stating if he read it correctly, RMLD sold some and some expired. Ms. Snow explained that essentially the RECs with value are sold and the ones with no real value are left to expire. When the RECs are sold, it reduces the purchase power costs. Thus there is no revenue on the income statement for that it nets down the purchase power costs because you are paying a higher cost for green energy. That cost is reduced by the proceeds of the REC sales.

Mr. Herrick asked if RMLD were a private utility what the requirements would be on us. Would we be buying RECs that are appropriate if we were not municipally-owned? Ms. Snow explained that RMLD is not subject to the same requirements. This is done voluntarily. RMLD voluntarily chooses to purchase green power and give that option to RMLD customers which costs more money because green power costs more money. Imbedded in those contracts is the RECs. Purchasing that power RMLD then gets the RECs. Ms. Snow continued. Then RMLD has the option of selling those RECs or holding them and letting them expire. RMLD has chosen to sell those that have value.

Mr. Dockser asked that if RMLD weren't a municipal utility any idea what the requirement would be because we are basically selling these back to people that are not complying, correct? Ms. Snow agreed and stated the requirements for municipals would be the same. You would probably have requirements that you would have to meet and if those requirements were not met then you would be out there having to purchase these RECs to make that up.

Mr. Dockser stated that he is trying to understand what other utilities have to do. Ms. Snow explained that they have certain requirements they have to meet. If they don't meet those requirements then they have to go out on the market and purchase these RECs in order to meet them.

Ms. Parenteau stated that the RMLD has certain resources that are qualified to meet some of those requirements. Ms. Parenteau noted, for example the state requirement is now coming up to close to 15% and RMLD is not quite there, but it would significantly increase RMLD's Purchase Power Expenses and that is a straight path through to customers.

Mr. Dockser stated that the RMLD sold $665,265 worth last fiscal year. Ms. Snow replied, correct which reduced RMLD's power costs.

Mr. Herrick asked where the REC income showed up on the income statement. Ms. Snow stated is it not in revenues. It reduces the purchase power costs. What you see is power costs. There is actually net of that revenue that you got from selling those RECs. The rationale again for that is because you are paying a higher costs for that green power you are just going to put it right back into that. If you weren't purchasing it, if you were purchasing it from a different non green energy source, it wouldn't cost you as much.

Mr. Pacino made a motion that the Town of Reading Audit Committee accept the Audit as presented by Melanson and Heath seconded by Mr. Dockser.
Motion carried 4:0:0.

Mr. Pacino made a motion that the RMLD Board of Commissions accept the Audit as presented by Melanson and Heath seconded by Mr. Hennessy.
Motion carried 2:0:0.

Mr. Dockser asked if there are areas that we should cycle through on a somewhat regular basis in terms of looking at particular areas digging a little deeper. On the Town Audit side we have identified eight to ten areas total and each year we look at two to three of them and make sure everything is good. Ms. Snow asked if that meant numbers or internal controls. Mr. Dockser stated that he means a combination of both and capital management, asset control, the Town has a ton of projects.

Ms. Snow stated that RMLD does not have as much because it's not as complex as the Town although, however, we do routinely look at different areas at different years. For example, this year we looked at the billing cycle and we did testing on the internal controls of the billing because obviously the billing is wrong then everything is wrong. We looked at the internal controls of the billing from the reading of the meters through to the actual billing cycle and the rates that are on those bills and did testing.

Melanson Heath Audit Findings
Ms. Snow continued. We cycle next year maybe it will be inventory and we will test the controls over inventory or test controls over fixed assets in the capitalization policy because again, we want to make sure we are not capitalizing things that should be expensed. Every year we are looking at those different broad areas and mixing them up.

Mr. Dockser asked if there were any issues found. There were no material issue and no significant issues that came up. We found a few minor issues that were brought to management's attention, but it wasn't anything that rose to the level that had to be reported in any formal management letter.

Mr. Pacino added that RMLD just went through a Sales Tax Audit from the Commonwealth of Massachusetts and passed with no differences.

Mr. .Dockser asked does the flow of money with people who pay with cash go into the Town Treasury first. Ms. Snow stated, no, everything goes into the RMLD and then gets turned over to the Town. RMLD tests that every year; a cash out is tested every year. Part of the Audit is going into the Customer Service and pick a random day and we test the flow of cash coming in all the way through to the general ledger. RMLD temporary puts it into a bank account and then turns it over twice a week to the towns.

At 7:35 p.m. Mr. Pacino made a motion to adjourn the meeting.
Motion carried 2:0:0.

At 7:35 p.m. Mr. Dockser made a motion to adjourn the meeting.
Motion carried 4:0:0.