# CITY OF NEW BEDFORD, MASSACHUSETTS

OTHER COMMENTS AND RECOMMENDATIONS LETTER

*For the Year Ended June 30, 2017*

**CITY OF NEW BEDFORD, MA**
*Other Comments and Recommendations Letter*

For the Year Ended June 30, 2017

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**HAGUE, SAHADY & CO., P.C.**

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To Management, the Honorable Mayor and
Members of the City Council of the City of New Bedford, Massachusetts:

In planning and performing our audit of the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of New Bedford, Massachusetts ("the City") as of and for the year ended June 30, 2017, in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting ("internal control") as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses. Given these limitations during our audit, we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The City's written response to the matters identified in our audit was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

This communication is intended solely for the information and use of management, the Honorable Mayor and City Council, federal awarding agencies and pass-through entities and is not intended to be, and should not be, used by anyone other than these specified parties.

We will review the status of these comments during our next audit engagement. We have already discussed these comments and suggestions with the City's personnel, and we will be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing the recommendations.

We appreciate the opportunity to serve you and we wish to express our gratitude and appreciation to the City's personnel for their courteous and competent assistance during the audit.

*Hague, Sahady & Co., CPAs, P.C.*

**Hague, Sahady & Co. CPAs, P.C.**

Fall River, MA
April 13, 2018

### 1.) *Cash Reconciliation with the General Ledger*

During the audit of the cash accounts, we noted a variance between the adjusted bank balances, as carried by the City Treasurer, and the total general ledger cash balances at June 30, 2017. At June 30, 2017, the adjusted bank balance exceeded the book balance by approximately $123,383 (after proposed audit adjustments). At June 30, 2016, the adjusted bank balance exceeded the book balance by approximately $252,691 (after proposed audit adjustments). The $129,309 change in the overall variance is primarily because of the Housing and Urban Development's (HUD) interception of CDBG funds in September of 2014 that was not reconciled timely by the Treasurer and the Community Development office. This transaction totaled $130,383 and was discovered and adjusted for during fiscal year 2017. The remainder of the change relates to immaterial variances noted by the treasurer's office when performing monthly reconciliations during fiscal year 2017.

The potential effects of not reconciling cash, on a timely basis, include the following: potential for a modified audit opinion (as opposed to an unmodified or "clean" opinion) should the variance result in a material misstatement in financial statements, potential misrepresentation of balances to the Massachusetts Department of Revenue for the City's free cash submission, reductions of certified free cash due to a subtraction of the cash variance, non-compliance with UMAS Guide regulations, the potential for misstatement of Federal expenditures on the City's Schedule of Expenditures of Federal Awards, and potential misappropriation of assets.

**Recommendation**

We recommend the cash variance continue to be isolated at year-end on the City's ledger. Since it appears that specific ledger accounts can be reconciled to adjusted bank accounts consistently and on a monthly basis, the City should decide if it is appropriate to write off the cash variance now isolated on the ledger. This "credit" to miscellaneous revenue could potentially increase the fiscal year 2018 certified free cash by approximately $123,383.

**Management's Response**

*By June 30, 2018, the City will have isolated the aggregated variance in cash accounts for two full fiscal years with only immaterial variances occurring, thereby demonstrating that reconciliation procedures implemented three years ago are effective in identifying and correcting all cash variances. It is the City's intent to close out the aggregated cash variance as an increase in General Fund departmental revenue in fiscal year 2018.*

***2.) Workers' Compensation Liability***

During a prior fiscal year, the City restated its government-wide financial statements (full accrual accounting basis) to reflect the estimated future liabilities of workers' compensation claims. Since the initial restatement, the City has recorded the change in this liability in its government-wide financial statements. The estimated future liabilities are based on history and injury type. Data to record this adjustment was provided by the City's third party administrator, Cook & Company Insurance Services, Inc. Per our conversation with Cook & Company, "loss runs" are generated and provided to the City's personnel department on a monthly basis.

Currently, the City funds workers' compensation on a pay-as-you go basis from annual appropriations (charged to the "general government unclassified" department in the City's general fund budget) within its modified accrual basis accounting statements. For the fiscal year ended June 30, 2017, the City paid $146,170 towards workers' compensation claims out of department 199. On the full accrual, government-wide financial statements, the City has recorded an estimated liability at June 30, 2016 of $6,799,204 and an estimated liability at June 30, 2017 of $7,821,987. Of the June 30, 2017 estimated amount, approximately $4.7 million was estimated to account for claims incurred before fiscal year 2012 spanning back as late as fiscal year 1984.

Insurance claim adjusters typically assist in estimating the cost based on examining claims with similar injuries and what they have cost in the past, and/or by the use of statistical methods. Insurers typically require the adjuster to revisit the initial estimate (i.e. "the reserve") and revise it when necessary medical or legal information has been obtained. Accurate reserving of the claim is extremely important to an employer as having too high of reserves could cause an underwriter to use dollar amounts that are too high when calculating future insurance premiums and thus may increase the insurance premiums of the employer. Reserves that are set too low could require unexpected upward adjustments to pay the correct amount when the claim is settled/concluded.

**Recommendation**

We recommend the City contact the workers' compensation division of Cook & Company Insurance Services and inquire as to (1) how often initial claim estimates are adjusted and (2) what steps the City could take to reduce any old claim estimates that are being carried by Cook & Company that have not yet been settled and are not expected/likely to be settled. After this exercise is complete, we recommend the City identify departments associated with individuals in order to split its workers' compensation liability between the governmental activities and the business-type activities for financial reporting purposes.

**Management's Response**

*The City conducts biennial reviews of all outstanding claims with Cook & Company. Further, the City, through Cook & Company, engages in a continuous effort to reevaluate these claims, which includes requiring updated medical opinions, "alive and well" checks, surveillance when warranted, and settlement negotiations when appropriate. Management acknowledges the need to allocate liabilities associated with these claims as either governmental or business-type for financial statement purposes.*

***3.) Year End Adjustments***

During the audit, we proposed year-end adjustments to various fund categories which are to be maintained under the modified accrual basis of accounting as required by GASB standards and the *Uniform Massachusetts Accounting System Guide (July 2014 Revision)* (the most recent UMAS Guide revision). For example, the following issues were noted for which we proposed the necessary audit adjustments to correct:

- Bond issuances were not posted to the capital project funds,
- Revenues were not deferred on grants that had no incurred expenditures,
- GASB 24 on-behalf payments from the Massachusetts Teachers Retirement System (MTRS) were not recorded in the general fund (for the financial statement presentation only),
- The veteran's receivable was not accrued properly in the general fund at fiscal year-end, and
- The school lunch fund was missing a receivable for amounts due from the Federal government and the Commonwealth of Massachusetts at fiscal year-end.

During the audit, we also proposed various year-end adjustments to the enterprise funds to modify the basis of accounting from the modified accrual basis as required by UMAS (period 12 in MUNIS) to the full accrual basis for GAAP financial statement purposes (period 13 in MUNIS). For example, the following issues were noted for which we proposed the necessary audit adjustments to correct:

- Adjustments to capital assets and related accumulated depreciation accounts to tie into detailed records
- Adjustments to correctly state long-term debt outstanding and the related accrued interest at fiscal year end
- Adjustments to correct compensated absences, to include the short-term versus long-term portions
- Adjustments to properly reflect other post-employment benefits and the net pension liability at fiscal year end
- Adjustments to deferred revenue accounts that have been earned on the full-accrual basis of accounting

Also, we noted through our audit testing of the City's construction in progress (CIP) and infrastructure in progress (IIP) schedules that amounts were indicated as "placed in service" against these accounts on the detailed Microsoft Excel schedule, thereby reducing those accounts. However, the corresponding depreciable asset account (CIP and IIP are non-depreciable accounts) was not increased for the amount "placed in service". Therefore, those asset accounts were understated. Since the depreciable asset accounts were not increased, depreciation was not calculated and therefore the City's depreciation expense at the Government-Wide financial statement level was understated. These errors were corrected through our revisions of the CIP and IIP Microsoft Excel schedules. We also proposed any necessary audit adjustments to either the governmental activities or the business-type activities to correctly present the non-depreciable and depreciable assets, as well as the related depreciation at fiscal year-end.

Despite the instances noted above, we did note improvement in the year-end close during the fiscal year 2017 audit versus prior audits.

**Recommendation**

We recommend the City record year-end adjustments to fund categories which are required to be maintained under the modified accrual basis of accounting as required by GASB standards and the *Uniform Massachusetts Accounting System Guide*. We also recommend that during period 13 in MUNIS, adjustments be posted to convert the basis of accounting of the enterprise funds to "full-accrual" as required by GAAP/GASB standards.

The recording of year-end adjustments will ensure proper external reporting to financial statement users including regulatory bodies such as Federal and State regulators, financial institutions and the Massachusetts Department of Revenue.

***3.) Year End Adjustments (Continued)***

**Management's Response**

*Management does not agree with the magnitude or the implied severity of reported findings, nor does it believe there is a causative relationship between those findings and the recommendations. Although accounting promulgations do not specifically define proposed adjustments, the commonly accepted implication is that such entries are the result of deviations discovered through attestation procedures that are conducted through the outside audit. However, in many of the examples provided in this finding, it was Management that presented draft adjustments or provided detailed supporting schedules that resulted in the immediate identification of adjustments required to be recorded. These entries would have been recorded by Management had they been aggregated prior to a cutoff date mutually agreed to by the City and its auditors. Further, Management's presentation of these adjustments directly resulted from compliance with rather than a deviation from established policies of recording transactions on a modified accrual basis throughout the year and making year-end adjustments converting Enterprise Funds to accrual basis. It is therefore inaccurate to imply that the volume of entries resulted from Management's inactivity or a departure from GAAP.*

***4.) Student Activity Audits***

During the summer of 2017, we were contracted to perform the agreed-upon procedures as outlined by the guidance set forth by the Massachusetts Department of Elementary and Secondary Education entitled "Agreed Upon Procedures and Audit Guidelines: Student Activity Funds". We were contracted to perform these services for the fiscal year ending June 30, 2016. Through use of the guidance provided by the Massachusetts DESE we tested the policies, procedures, and controls over Student Activity funds at a selection of New Bedford Schools. We issued our report on February 9, 2018. This report included twelve findings and the School department's corrective action plan for each finding.

Per MGL Chapter 71, Section 47 there shall be an annual audit of the student activity funds for each school, which is enforceable by the School Committee only. It is the opinion of the Massachusetts Department of Elementary and Secondary Education ("DESE") that the audit may be performed internally by a responsible and qualified individual who is independent of student activity responsibilities, with the caveat that at least once every three years the procedures should be performed by an outside independent auditor if student activity balances exceed $25,000. It is also in the DESE's opinion that the schools may be rotated with respect to the outside audit component of this requirement on an annual basis.

Since we performed these agreed-upon procedures of the student activity funds at June 30, 2016, the School Department should have performed and documented the procedures at June 30, 2017. We were not provided with any such documentation of the procedures being performed at June 30, 2017 as of the date of this writing.

**Recommendation**

It is recommended that the School Committee internally perform and document the agreed-upon procedures as outlined by the guidance from the Massachusetts DESE or contract with an outside firm annually to perform such agreed-upon procedures. Either of these options will ensure that the School department is in adherence with the requirements of MGL Chapter 71, Section 47.

**Management's Response**

*As part of its system of internal controls, New Bedford Public Schools established new policies and procedures in order to comply with DESE regulations related to student activity accounts (SAA). Training on the new guidelines was held in January 2018; updates to SAA policies, procedures, and documentation requirements were communicated; and written instructions along with standard forms were issued. Balance limits for SAA will be set by the New Bedford School Committee in a July 2018 meeting, and future limits will be approved annually. The Business Office will also submit a request to close out all inactive accounts and transfer them into a miscellaneous account. The Business Manager will review all accounts annually in June to determine their need in the upcoming school year, and the Business Office will audit of each school's SAA annually. There will be an external audit every third year.*

***5.) Internal Controls over Cash Disbursements (Purchase Orders)***

Testing over cash disbursements was conducted during the 2017 audit and identified the following issues:

- During allowable cost testing in the Airport Improvement program single audit, 2 out of 20 selected transactions had purchase orders that were dated after the invoice date and 4 out of the 20 selected transactions had no purchase order at all.
- During cash disbursement testing across all City funds, we noted that in 4 out of 25 instances, purchase orders were dated after the invoice date.

Based on our review of the controls over cash disbursements it appears that the controls could be strengthened.

**Recommendation**
It is recommend that the City review internal control procedures over cash disbursements, specifically the controls over purchase orders, and take appropriate action to strengthen the controls where determined necessary.

**Management's Response**
*Management agrees with this finding and implemented a monitoring system in September 2017 designed to achieve greater compliance through an escalating series of notices to non-compliant departments that could eventually result in suspension of their authority to make purchases on behalf of the City.*

***6.) General Fund – Receivables Due from the Harbor Development Commission and the New Bedford Redevelopment Authority***

We noted that the City is carrying receivables due from the Harbor Development Commission ("HDC") and the New Bedford Redevelopment Authority ("NBRA") on its general fund balance sheet at June 30, 2017 in the amounts of $849,885 and $650,931 (respectively), for a combined total of $1,500,816. Further details of these balances can be seen in the respective component unit financial statements.

The HDC and NBRA qualify as "component units" of the City under GASB Statement No. 61 guidance and are required to be included within the City's financial reporting entity. Please refer to Note 1 of the City's June 30, 2017 Comprehensive Annual Financial Report (CAFR) for more information regarding GASB Statement No. 61 requirements.

The amount due from the HDC last had activity during fiscal year 2017 through a payment of $50,000 from the HDC. We did note that HDC has made regular payments against its obligation due to the City for a number of years now. During fiscal year 2015 (two periods ago) the HDC owed $1,124,885.

The amount due from the New Bedford Redevelopment Authority last had activity during fiscal year 2016, specifically on September 23, 2015. On this date, the NBRA voted to settle the claims of the NBRA and related City entities against AVX Corp. for the North Terminal Rail Yard. The City credited the amount due from the NBRA for $125,000, reducing the amount due from $775,931 to $650,931. It should be noted that the NBRA has difficulty generating steady cash flows and as a result has not been able to make regular payments to the City.

We inquired of City management with respect to any developments regarding a plan to collect the amounts due from the HDC and the NBRA. At this time, there appears to be no formal plan in place for repayment. If the City were to elect to write down, or off, either of these receivables, the City Council would need to appropriate the amount through the budget process (similar to an appropriation from free cash under MGL Chapter 59 Section 23).

**Recommendation**

We recommend that City management discuss the amounts due with the HDC and NBRA and develop a written agreement documenting the decision reached.

**Management's Response**

*The City has an informal agreement with the Harbor District Commission that provides for the repayment of its loan from the City in annual $50,000 installments with no interest charged or imputed. The first payment under this agreement was received on July 1, 2017. The New Bedford Redevelopment Authority currently lacks sufficient resources to enter into a repayment agreement. However, the possibility of future expansion of its role within the community may generate sufficient revenues to commence repayment, at which time the parties will enter into an appropriate agreement.*

***7.) City and School Grant Budgets in MUNIS***

We noted that many of the City and School grant budgets input to MUNIS did not have budgetary appropriations equal to budgetary sources of revenue, whether they be federal, state or local. In some cases, we also noted that budgetary revenue and/or appropriations input to MUNIS did not match the grant award. We also noted that in some cases amendments of the original budget did not match the support attached.

It should be noted that some of these grant awards are Federal awards, and therefore the City is subject to the provisions of Uniform Guidance, specifically Section 200.302 "Financial management". A "budget" as defined by Uniform Guidance means "the financial plan for the project or program that the Federal awarding agency or pass-through entity approves during the Federal award process or in subsequent amendments to the Federal award. It may include the Federal and non-Federal share or only the Federal share, as determined by the Federal awarding agency or pass-through entity." On Federal grants, the City is required per 200.302(b)(5) to have a financial management system that must be able to provide for a "comparison of expenditures with budget amounts for each Federal award."

**Recommendation**

We recommend that the City ensure that "balanced" budgets are input that have budgetary appropriations equal to budgetary sources of revenue. The City is responsible to ensure that grant funding is used correctly and for its intended purpose and that the information can be compared to the actual expenditures for each Federal, state and local award.

**Management's Response**

*Management acknowledges the occurrences of out-of-balance budgets that existed at year-end, most of which predated the implementation of MUNIS. During fiscal year 2017, an initiative was commenced to research each occurrence and take remedial action, which resulted in a decrease to 452 out-of-balance budgets at year-end. The remainder will be resolved over a two-year period, with a 50% reduction expected by June 30, 2018.*

***8.) Compensated Absence Testing – Exceptions Noted***

Through our testing of the City's compensated absence records we noted the following exceptions:

- We noted that for 3 individuals tested out of the police department, the longevity pay was calculated incorrectly. We tested a total of 20 transactions, city-wide.
- We also noted that 1 out of the 20 individuals tested had more sick time than could be accrued based on years of service. This individual was part of the EMS records.

**Recommendation**

We recommend that the City implement procedures to consistently perform internal audits over the compensated absence balances.

**Management's Response**

*Management acknowledges the findings. However, the findings were of non-systemic errors in an annual procedure to calculate accrued compensated balances and resulted in an immaterial overstatement of that accrual. None affected accrual balances in MUNIS, which are the basis for leave payments. We believe procedures are in place to calculate this annual accrual without material misstatement.*

### *9.) Set a Long-Term Goal to Meet the GFOA's Recommended Fund Balance Levels for the General Fund*

The Government Finance Officers Association (GFOA) recommended through their "Best Practices – Fund Balance Guidelines for the General Fund" publication that "at a minimum, general-purpose governments, regardless of size, maintain unrestricted budgetary fund balance in their general fund of no less than two months of regular general fund operating revenues or regular general fund operating expenditures." The GFOA continues to state that each government should apply this recommendation based on its own particular situation and should "apply these measures within the context of long-term forecasting, thereby avoiding the risk of placing too much emphasis upon the level of unrestricted fund balance in the general fund at any one time."

For the purposes of this analysis, we used overall GAAP fund balance as opposed to budgetary fund balance as (1) the City budgets on a basis consistent with generally accepted accounting principles, as applied to governmental units, and in compliance with State requirements (per "Basis of Budgeting" on page 27 of the FY2018 Adopted Budget), (2) many governments don't show budgetary fund balance in their RSI schedules and therefore we could not obtain this data for comparison, and (3) using the budgetary fund balance in the RSI would not count the size of the City's stabilization fund, which is required per GASB Statement No. 54 to be reported within the general fund, often as a "committed" fund balance, due to the definitions of fund balances in GASB Statement No. 54.

Our firm calculated the GFOA's recommended level of fund balance for the City of New Bedford's general fund as follows (data from the fiscal year 2017 CAFR):

| | |
|---|---|
| Operating Budget of the General Fund (Final Budget): | $ 314,749,177 |
| GAAP Fund Balance of the General Fund (includes Stabilization): | $ 27,978,085 |
| Two Months of Regular GF Operating Expenditures: | $ 52,458,196 |
| Excess (Deficiency) of GFOA Recommendation: | ($ 24,480,111) |

Our firm also collected data for all Massachusetts municipalities that have populations in excess of 75,000 at the 2010 US Census (the City of New Bedford had a population of approximately 95,000 at that time). Of the thirteen (13) communities above 75,000 in population, only five (5) of the thirteen met the GFOA's recommended level of fund balance for the City's general fund. Three (3) of those five had AAA/Aaa bond ratings based on the data we collected (i.e. the top bond rating that could be earned, "best quality" category). The other two (2) had AA or higher ratings (i.e. the upper tiers of the 2nd best category "high quality").

**Recommendation**
We recommend that the City consider amending its "Fund Balance Management" policy effective November 27, 2013 to include long-term goals (i.e. 5-10 years) for fund balance levels in the general fund as recommended by the GFOA. Currently, we noted that the City does have a policy over the desirable funding for the Stabilization fund of "between two (2%) and six (6%) of the General Fund operating budget. The City and School stabilization funds had fund balance totaling $9,671,585 at June 30, 2017. That level of funding equates to 3.07% of the General Fund final operating budget. We did note that the City did incorporate a "Long Range Financial Plan" in its 2018 budget document, however that plan is rather vague and does not aggressively set goals to increase the ending fund balance in the general fund (which includes the City stabilization funds) over the next five fiscal periods. In a separate comment within this letter, we recommended the City expand upon and further detail its "Long Range Financial Plan".

***9.) Set a Long-Term Goal to Meet the GFOA's Recommended Fund Balance Levels for the General Fund (continued)***

**Recommendation (continued)**
We would also recommend that the Stabilization fund be invested by the Treasurer in long-term investments such as a combination of equities and bonds that will yield an annual return above 5%. This will prevent older contributions in the stabilization fund from being eroded by inflation over time.

We noted that the "School" portion of the stabilization fund currently invested this way, however the "City" portion was not. As of June 30, 2017, the split of the $9.6M within stabilization was $8.3M in "City" stabilization and $1.3M in "School" stabilization. During fiscal year 2017, the School balance earned nearly as much investment income as the City stabilization balance, despite having $7.0M less of a balance.

We believe that if the City were to incorporate long-term planning for fund balance levels within the general fund and set goals to increase the fund balance reserves in the long-run, it is likely that the City will continue to maintain, or be upgraded from, its current "AA-" rating from Standard and Poor's (S&P).

**Management's Response**
*Although the City's Fund Balance Management Policy provides only the framework and target ranges for building General and Stabilization Funds fund balances, a long-range financial forecast always accompanies it as an exhibit, particularly within the Official Statements reviewed by rating agencies. This forecast includes specific fund balance targets over the next five years, stated in absolute dollars. Management believes the forecast is an effective augmentation of its policy, sufficient in both its detail and the period over which fund balances are projected.*

*Management will consider the recommendation of a longer-term investment strategy when it considers the trade-off between liquidity and yield as part of the execution of its long-range financial forecast.*

***10.) Implementation of GASB Statement No. 75 (Postemployment Benefits Other Than Pensions) During Fiscal Year 2018 and Long-Term Funding Schedule Recommendation for OPEB***

GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, replaces the requirements of Statement No. 45, and establishes new accounting and financial reporting requirements for OPEB plans. Among changes to required notes to the financial statements and required supplementary information, the statement will require the employer to recognize a liability equal to the net OPEB liability on its accrual based financial statements.

The Statement defines "net OPEB liability" as the portion of the present value of projected benefit payments to be provided to current active and inactive employees that is attributed to those employees' past periods of service (total OPEB liability), *less* the amount of the OPEB plan's fiduciary net position (i.e. the value of the OPEB investments).

Had this standard been in place at fiscal year ended June 30, 2017, the City would have an OPEB liability of $477,150,353 on its government-wide balance sheet (assumed 3.75% discount rate as a result of "pay-as-you-go" contributions), as opposed to the $181,417,827 accrued on its balance sheet at year end as a result of the current accounting rules (i.e. the definition of "net OPEB obligation" differs between GASB 45 & 75).

If the City were to commit to a funding schedule for its OPEB Trust Fund it is possible the City may benefit from the new "discount rate" assumptions stipulated in GASB Statement No. 75 paragraph 36 and could in turn reduce the OPEB liability presented on its balance sheet. The City should consult with its actuaries further for an analysis of the potential effects.

For more information on OPEB, please see Note 10 to the City's fiscal year 2017 Comprehensive Annual Financial Report (CAFR).

Credit rating agencies have stated that they will consider OPEB funding status in their evaluations of government financial condition. It is possible that bond ratings may suffer for those governments with large and/or mounting liabilities and no plan to pay for these future costs. This may be particularly true as certain governments move forward with OPEB strategies while others do not. The extent to which a local government's OPEB funded status affects its overall credit rating may depend on a number of factors, including the City's current rating and a comprehensive review of the City's finances.

Our firm noted that Standard and Poor's (S&P) recently affirmed the City's 'AA-' underlying rating to the City's general obligation bonds but said in its April 18, 2017 "Ratings Direct" report that *"In our [S&P's] opinion, a credit weakness is New Bedford's large pension and OPEB obligation, without a plan in place that we think will sufficiently address the obligation. However, we recognize the city has taken some steps toward reducing their long-term liabilities... We acknowledge the city recently completed an exhaustive review of its health care program, with the objective of reducing retiree health care costs. In December 2015, the city council voted to establish an OPEB trust fund, which currently has a balance of $1.1 million. New Bedford has adopted a policy to contribute at least 10% of surplus funds to the trust each year, which they estimate will be $300,000. The OPEB unfunded actuarial accrued liability is $485 million. We expect the city's retirement liabilities to remain significant in the short-to-medium term."*

The S&P report continued on to its "Outlook" section noting that *"All else being equal, we could raise the rating if the city demonstrates more comprehensive planning to mitigate its long-term liabilities, coupled with strengthening and sustaining available reserves through positive budgetary performance to levels we consider commensurate with its higher-rated peers."*

***10.) Implementation of GASB Statement No. 75 (Postemployment Benefits Other Than Pensions) During Fiscal Year 2018 and Long-Term Funding Schedule Recommendation for OPEB (continued)***

***Recommendation for GASB Statement No. 75 Implementation***

We recommend the City begin to review the changes in accounting requirements set forth in GASB Statement No. 75, and work with its actuaries to ensure these requirements will be ready to be fulfilled for the *fiscal year 2018 financial statements*. We would also be happy to assist the City with any questions it may have with respect to GASB Statement No. 75 implementation.

***Recommendation for Long-Term Funding Schedule for OPEB***

We also recommend that the City consider annually funding its OPEB trust fund through either a budgetary appropriation, a consistent contribution from certified free cash, or a combination of both. Pre-funding benefits will allow the government to grow assets for which it can use in future budget periods to offset rising healthcare costs and could reduce the total OPEB liability by up to 35%, assuming full-prefunding consistently each year. It will also prove to the rating agencies (ex. S&P, Moody's) that the City does have a plan in place to sufficiently address the obligation. We recommended pre-funding OPEB in the 2013, 2014, 2015 and 2016 management letters.

The Government Finance Officers Association (GFOA) recommends through their "Best Practices – Sustainable Funding Practices for Defined Benefit Pensions and Other Postemployment Benefits (OPEB)" publication that governments "adopt a funding policy with a targeted funded ratio of 100 percent or more (full funding). The funding policy should provide for a stable amortization period over time, with parameters provided for making changes based on specific circumstances". Other recommendations regarding frequency of actuarial studies, the frequency of employee and employer contributions into the trust, and recommendations for discussion of the funding and amortization methods with the government's actuary are made in this "Best Practices" publication. It is worth noting that neither GASB Statement No. 43/45 or 74/75 require pre-funding of OPEB benefits. Also, there is no MGL that requires a "target funded date" be set, unlike unfunded pension liabilities.

The cost to fully fund the OPEB liability during fiscal year 2017, would have equated to additional cash contributions into the OPEB Trust of $15,361,480 (the City did contribute $270,000 during fiscal year 2017). We do realize the City is consistently facing significant budgetary challenges and full pre-funding may not be possible, however, we do recommend the City contribute a lesser amount that it feels would begin to grow the assets in the OPEB trust to help offset rising healthcare costs that continue to outpace inflation. According to the City's 10-year data in its fiscal year 2017 financial statements (page 116-117), health costs rose from $31,753,513 in 2008 to $39,767,304 in 2017, a 25.24% increase over the 10 year period.

For example, a funding policy that contributes $1,000,000 (i.e. the amount the City "intends" to appropriate each fiscal year according to item #11 on the *Investment Agreement* with the State Retiree Benefits Trust dated December 21, 2015) at the *beginning* of each fiscal year into a trust fund with an appropriate asset allocation setup (i.e. a combination of equities and bonds) to achieve a target rate of 8% return, for a 30 year funding period (a total of $30,000,000 in contributions) would potentially be worth $122,345,868 at the end of 30 years, assuming the City is pre-funding benefits and does not withdraw from this fund (calculation based on the mathematical formula of the "future value of an annuity due"). Increase the target rate of return to 9% (a 1% increase) and the figure will rise to $148,757,217, decrease the target rate of return to 7% (a 1% decrease) and the figure will decrease to $101,073,042. It is worth noting, this method of funding would be considered a non-actuarially calculated method of funding (i.e. does not consider the liability side of the projections). An actuarially calculated method of funding would more closely resemble the cash contribution against the ARC mentioned above (the $15,361,480).

We would recommend that if the City were to adopt a basic funding schedule such as the $1,000,000 example above, that it increase its payment each year by the amount of inflation assumed in its actuarial valuation (3.5%).

We would also recommend that the City consider amending its policy titled "Other Post-Employment Benefits Trust Fund" effective November 30, 2016 to include a funding schedule that the City would commit to over a longer time horizon. We would like to recommend that the City consider setting a target date to be fully funded, even if this date is 30 years or more away.

***10.) Implementation of GASB Statement No. 75 (Postemployment Benefits Other Than Pensions) During Fiscal Year 2018 and Long-Term Funding Schedule Recommendation for OPEB (continued)***

**Management's Response**

*Management is aware of the requirements of GASB 75 and will consult with both its actuaries and independent auditors in preparation for its implementation. Related to the recommendation to annually fund its OPEB fund, the City has adopted a policy of designating the equivalent of 10% of its free cash as certified annually by DOR for funding into its OPEB Trust Fund. Additionally, its Fund Balance Management Policy establishes a policy of generating minimum free cash of 1% of its operating budget. We believe this is the current limit of resources that can be designated for OPEB Trust Fund funding and that a formal fixed schedule is not practical at this time.*

## CITY OF NEW BEDFORD, MASSACHUSETTS

*Status of Prior Year Comments and Recommendations*

For the Year Ended June 30, 2017

| Prior Year Comments and Recommendations: | Status: | Page Reference: |
|---|---|---|
| Cash Reconciliation with the General Ledger and Presentation of Cash Accounts on the General Ledger | Modified | 2 |
| Workers' Compensation Liability | Modified | 3 |
| Deadlines for Audits of the City's Component Units | Removed | N/A |
| New Bedford Redevelopment Authority Component Unit Audit | Removed | N/A |
| Implementation of GASB Statement No. 77 (Tax Abatement Disclosures) During Fiscal Year 2017 | Removed | N/A |
| Implementation of GASB Statement No. 75 (Postemployment Benefits Other Than Pensions) During Fiscal Year 2018 | Modified | 13 |
| Certificate of Achievement for Excellence in Financial Reporting Program (CAFR) Recommendation | Removed | N/A |
| Highlighted Changes to Non-Federal Entity Responsibilities as a Result of OMB's Uniform Guidance | Removed | N/A |