ESSEX REGIONAL RETIREMENT SYSTEM

MANAGEMENT LETTER

DECEMBER 31, 2016

Powers & Sullivan, LLC
Certified Public Accountants

100 Quannapowitt Parkway
Suite 101
Wakefield, MA 01880
T. 781-914-1700
F. 781-914-1701
www.powersandsullivan.com

To the Honorable Essex Regional Retirement Board
Essex Regional Retirement System
Danvers, Massachusetts

In planning and performing our audit of the financial statements of the Essex Regional Retirement System (System), as of and for the year ended December 31, 2016, in accordance with auditing standards generally accepted in the United States of America, we considered the Essex Regional Retirement System'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 opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control. Accordingly, we do not express an opinion on the effectiveness of the System's internal control.

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 or significant deficiencies, and, therefore, material weaknesses or significant deficiencies may exist that were not identified.

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. We did not identify any deficiencies in internal control that we consider to be material weaknesses.

However, during our audit we became aware of several matters that represent opportunities for strengthening internal controls and operating efficiency. The memorandum that accompanies this letter summarizes our comments and suggestions concerning those matters.

The System's written responses to the comments identified in our audit have not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

We will review the status of these comments during our next audit engagement. We have already discussed these comments and suggestions with various System personnel, and 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.

This communication is intended solely for the information and use of management of the Essex Regional Retirement System, and is not intended to be and should not be used by anyone other than these specified parties.

Powers & Sullivan LLC

June 15, 2017

ESSEX REGIONAL RETIREMENT SYSTEM

MANAGEMENT LETTER

DECEMBER 31, 2016

TABLE OF CONTENTS

PAGE

Current Period Comments and Recommendations

Timing Consideration for Actuarial Valuations

Comment

Since the initial implementation of GASB statements 67 and 68, we have become aware of issues related to the timing of actuarial valuations as they relate to some of the System's municipal light departments and housing authorities. These issues, which are summarized below, should be addressed by the System when considering the timing of the next actuarial valuation, which is currently scheduled to be conducted as of January 1, 2018.

Background

GASB statements 67 and 68 require municipalities to report their proportionate share of the System's net pension liability in their respective financial statements. To make this possible, the System reports, to each member unit, their proportionate share of the net pension liability (NPL); which must be measured as of a "measurement date" no earlier than the employer's prior fiscal year. Accordingly, the net pension liability measured as of December 31, 2016 will be used for reporting by most member communities for their June 30, 2017 financial statements.

The net pension liability measured as of December 31, 2016 will be based on an actuarial valuation dated January 1, 2016, rolled forward to the December 31, 2016 measurement date. GASB 68 requires the actuarial valuation to be within 30 months and 1 day of the employer's most recent year end. This is within the requirements for any member unit with fiscal years ending prior to June 30, 2018. Consequently, we do not anticipate any issues with the use of the System's reports as of December 31, 2016.

Issue

The potential issue would arise if the System continues to use the January 1, 2016 actuarial valuation, rolled forward for a second year to the measurement date of December 31, 2017. This second roll-forward is allowed under the GASB requirements as long as the actuarial valuation date is still within 30 months and 1 day of the employer's year end. While there is not issue for those member units who report using a June 30 fiscal year end, it will be an issue for any member unit with a fiscal year end after June 30, 2018, which includes 4 of the 5 municipal light plants that are included within member communities and some of the housing authority member units. Since these member units would be recording a NPL measured using an actuarial valuation as of January 1, 2016, which is greater than the 30 months and 1 day, allowed under the GASB, they would likely receive qualified opinions on their financial statements for a departure from Generally Accepted Accounting Principles (GAAP).

Recommendation

We recommend the System review the options below and select a solution that best suits the System.

Option 1: continue with biennial valuations with a timelier issue date:

Time the actuarial valuations so that when the valuation is done (for example, January 1, 2018), a GASB 67/68 report is done at the same time (for example, use a measurement date of December 31, 2017). With this option, that same valuation report can be used for the December 31, 2017 and December 31, 2018 GASB 67 and 68 reports and any member unit with a year-end prior to June 30, 2020 could use this report.

Although this option allows a System to continue the practice of having a new valuation once every two years, it would require the new valuation to be completed and accepted by the board within the first few months of the year to have the information audited by June to be used by the member units for their June 30th financial statements.

This is a much more aggressive schedule for completing the actuarial valuation than has been used in the past. However, it would resolve any timing issues that would occur for Light Departments or Housing Authorities that would have resulted if the January 1, 2016 valuation were used for the December 31, 2017 GASB 67/68 reports.

Option 2: annual actuarial valuations:

Annual actuarial valuations would eliminate the requirement to speed up the process of completing the valuations since each year's valuation could be used with 1 rollover to that year end. For example, the January 1, 2017 valuation would be used for the December 31, 2017 GASB 67/68 report. This report could be used for all member units with fiscal years ending prior to June 30, 2019.

Option 3: make no changes:

The option with the least appeal is to makes no changes and continues to roll forward each actuarial valuation twice, where the actuarial valuation date is too old to be used for some of the member units on the second roll over. This is not in compliance with the GASB requirements and could result in a qualified audit opinion for each of these member units every other year.

<u>Management's Response</u>

Powers & Sullivan presented the three options listed in this report to the Board at their meeting on May 22, 2017. The Board endorsed the first option and a subsequent RFP for actuarial consulting services was issued containing a schedule consistent with this recommendation. Powers & Sullivan was provided a draft of the RFP for actuarial consulting services prior to its issuance.

Travel Authorization and Reimbursement

<u>Comment</u>

The System utilizes travel authorization forms, as stipulated in the System's travel regulations which were approved by the board in 2003. During our testing of travel reimbursements, we noted three travel reimbursement requests that were missing either the date of the approval, the signature of the individual requesting reimbursement, or supporting documentation for mileage reimbursement.

<u>Recommendation</u>

We recommend that all requests for reimbursement be signed by both the individual requesting and approving the reimbursement and that they be accompanied by supporting documentation.

<u>Management's Response</u>

The Board is aware of the three instances described in the Management Letter where the forms were not fully complete. The Board members and staff have been made aware of the need to fully complete the forms going forward.

Verification of Payroll Amounts Used for Appropriations

Comment

To determine the annual appropriation to be paid by each member unit, the System exports a salary report for each member unit through September 30th. The 4th quarter salary figures are estimated and the total is sent to each member unit in October for approval and verification. Five of the member communities did not return a signed copy of the payroll reports. If the member units are not verifying and approving this information, there is increased risk that the System is using inaccurate information to determine the annual appropriations for each member unit.

Recommendation

We recommend the System emphasize the importance of verifying the accuracy of pensionable earnings with each of the member units. This can be done as part of an annual training process or through instruction included with the request for verification of the pensionable earnings report. We also recommend the System require 100% compliance with the approval and verification process over pensionable earnings.

Management's Response

The Board shares the auditor's view that the failure to verify whether the withholdings from individual members are accurate increases the risk that the retirement system is using inaccurate information to determine the annual appropriations for each member unit. The Board further shares the auditor's view that 100% verification compliance is necessary to insure the accuracy of the annual salary survey.

However, there is no current mechanism to compel 100% compliance, other than to withhold the entire salary survey report to PERAC until such time as all units have verified and returned their individual survey. It should be noted that PERAC has an October 31st deadline for the submission of the annual salary survey.

The Board will have to determine as a matter of policy if the entire salary survey should be withheld until 100% compliance is achieved, even if this means that PERAC's October 31st annual reporting deadline will be missed and, consequently, the receipt by our member units of the annual appropriation letter may be delayed.