

TESTIMONY TO THE PLANNING AND DEVELOPMENT COMMITTEE
March 3, 2008

Robert S. Dakers
Director of Municipal Finance Services
Office of Policy and Management

IN SUPPORT OF SENATE BILL 377
AN ACT CONCERNING MUNICIPAL AUDITS AND FINANCIAL PRACTICES

Senator Coleman, Representative Feltman, and distinguished members of the Planning and Development Committee: I am Robert Dakers of the Office of Policy and Management. I thank you for this opportunity to testify in support of Senate Bill 377, "An Act Concerning Municipal Audits and Financial Practices".

This legislative proposal was developed in conjunction with and has the support of the Municipal Finance Advisory Commission (MFAC). The commission's rationale for supporting for this legislation is outlined in the letter attached to this testimony.

Municipal Finance Advisory Commission

The Municipal Finance Advisory Commission (MFAC) was established by §7-394b of the General Statutes and is staffed by OPM. The MFAC and OPM have responsibility for ensuring that municipal audits are done in accordance with professional standards and state laws and to help detect and prevent instances of municipal fiscal distress. In regard to fiscally distressed municipalities referred to the MFAC by the Secretary of OPM, the MFAC's powers involve seeking information and making recommendations aimed at improving the fiscal condition of the city or town.

The membership of the MFAC includes the municipal finance directors from Norwalk, Mansfield and Manchester, a municipal bond attorney, a certified public accountant, an insurance professional, and David LeVasseur, the Undersecretary of Intergovernmental Policy at OPM.

My own background has included serving as staff to the oversight boards in Bridgeport, West Haven and, most recently, in Waterbury. The future need for such boards is something that I, the MFAC and OPM are dedicated to preventing. This goal was an important motivation for this proposal.

Background and Purpose of Proposal

In undertaking its work, the MFAC has found that the systems in place to ensure high quality audits and fiscal transparency in terms of local financial reporting are generally working well. In addition, most municipalities, while experiencing fiscal strains like all entities, are financially sound.

However, the MFAC and OPM have encountered instances of fiscal distress related to unsound financial management and budgeting practices. Waterbury was an extreme example in this

regard, while West Haven and some other municipalities have more recently experienced fiscal problems that have raised questions for the MFAC. These questions include: How did it happen? Why weren't these problems detected earlier through audits or other means? What is the appropriate State response to help prevent and address these situations?

Another concern for the MFAC is that current state statutes are not as clear as they could be in a number of areas. One of these areas involves the statutory language requiring the elimination of cumulative fund deficits. This is of particular concern since need for state bailouts and oversight boards in the past has resulted from cash flow crises, the cause of which were cumulative deficits that were left unaddressed, or which were allowed to grow worse.

The MFAC and OPM sought to develop a proposal that address these questions and concerns, while remaining cognizant of the fact that the current statutes and systems are generally working well. The result is the proposal incorporated in Senate Bill 377. It is worth noting that state laws in Massachusetts, Rhode Island, New Jersey, and other states related to municipal finance and audit issues are more prescriptive and involve more state involvement than Connecticut's current laws and the relatively modest adjustments being proposed in Senate Bill 377.

Details of Proposal

The provisions in Senate Bill 377 include:

- 1. Adoption of a Balanced Budget.** Current state statutes include provisions that require the adoption of a balanced budget. Senate Bill 377 would clarify that this provision applies to all of Connecticut's cities and towns. This clarification, as well as some of the existing provisions in state law, reflects the fact that cities and towns may occasionally appropriate a portion of their fund balance as part of their annual budgets.
- 2. Cumulative Fund Balance Deficit.** Current state statutes contain several provisions that clearly require municipalities to absorb a cumulative deficit in their upcoming budgets. These requirements do not involve a one-year operating deficit, but rather situations in which a city or town has depleted all of its general fund reserve. Senate Bill 377 seeks to clarify the statutory provisions related to the absorption of a cumulative deficit as well as provide a process to be followed in the relatively rare occurrence of such a deficit.

Under Senate Bill 377, a municipality would be required to inform the Secretary of OPM if it has a cumulative fund deficit and begin taking such actions in its current year budget as are reasonable and prudent to begin addressing the deficit. The municipality, as under current state law, would need to absorb the deficit in its upcoming budget. An option, which is already allowed under state law, would be to issue deficit funding bonds.

After the adoption of its budget, Senate Bill 377 would require the municipality's chief executive officer to inform the Secretary of OPM of the actions taken to eliminate the cumulative deficit. The Secretary would refer the municipality to the MFAC if the Secretary were to deem that the actions taken were insufficient to eliminate the deficit.

Municipalities referred to the MFAC under this proposal would then need to submit a deficit elimination and three-year financial plan to the MFAC, with the MFAC having the ability, if an acceptable plan is not submitted, to develop such plans for the municipality. The MFAC, whose powers would remain largely advisory in nature, would

not be able to impose the implementation of these plans. The only additional authority the MFAC would have, in cases where it has developed the required plans, would be to approve the property tax and state aid assumptions in the municipality's annual budget. Once again, the MFAC believes that resolute action to eliminate a cumulative deficit is critical in order to avoid the type of cash flow crises that has and can lead to the need for higher levels of State intervention.

3. **Timely Submittal of Annual Financial Audits.** Municipalities have six months following the end of the fiscal year, or until December 31st, to submit their independent audits to OPM, unless the Secretary of OPM grants one or more 30 day extensions. When a municipality needs to seek multiple extensions of time to complete its audit, it is often symptomatic of deeper financial management issues. What we are proposing would now require audit extensions totaling over 90 days be approved by the MFAC instead of the Secretary. This would enable more proactive involvement by the MFAC with a municipality in a more timely fashion.
4. **Findings of Serious Financial Management Weaknesses.** When significant deficiencies related to a municipality's financial practices are cited by its independent auditor, the municipality's chief executive officer (CEO) is required to submit a corrective action plan to OPM. When a significant deficiency appears for the third year in a row, under Senate Bill 377 the corrective action plan would then also have to be approved by the town's board of finance or town council. The intent of this provision is to add more accountability and transparency with respect to efforts to address these underlying weaknesses with the municipality's financial management systems.
5. **Best Practice Guidelines and Technical Assistance.** The proposal would authorize the MFAC and OPM to issue, in consultation with professional and municipal associations, best practice guidelines in regard to municipal finance, as well as to provide technical assistance to municipalities as needed and requested.
6. **Independent Auditor.** Limited to those municipalities that have been referred to the MFAC, the MFAC would be able, if it deems necessary to obtain a better and clearer view of the municipality's finances, to select the municipality's independent auditor. It is anticipated that it would be extremely rare that the MFAC would need to exercise this authority. In some other states, the state has to approve the auditors for all cities and towns. Senate Bill 377 would limit this to an "as needed" basis here in Connecticut.
7. **Peer Review.** The proposal would require that audit firms doing municipal audits submit their most recent peer reviews to OPM. This will help OPM staff in reviewing audits and potentially give these peer reviews a higher profile.

Conclusion

We believe that these are measured proposals that will help improve financial reporting and help to "nip" fiscal crises in the bud by assuring that the relatively rare occurrence of a cumulative general fund balance deficit will be addressed expeditiously. As has been described, these proposals rely mostly on enhancing transparency and the advisory powers of the MFAC, whose mission is to promote sound financial and budgetary management, as opposed to higher levels of intervention.

**STATE OF CONNECTICUT
MUNICIPAL FINANCE ADVISORY COMMISSION**

March 3, 2008

Planning and Development Committee
Connecticut General Assembly
Legislative Office Building
Hartford, CT 06106

Dear Senator Coleman, Representative Feltman, Senator Fasano, Representative Bacchiochi, and Honorable Members of the Planning and Development Committee:

As members of the Municipal Finance Advisory Commission (MFAC), we appreciate the opportunity to submit this letter in support of Senate Bill 377, "An Act Concerning Municipal Audits and Financial Practices". The MFAC worked closely with the Office of Policy and Management (OPM) in the development of this proposal.

As you may be aware, the MFAC operates under Section 7-394b of the Connecticut General Statutes. The duties of the MFAC include working with OPM and others on issues and policies associated with municipal finance and auditing and with fiscally distressed municipalities referred to us by the Secretary of OPM. By statute, the membership of the MFAC includes four local government chief executive or financial officers and four other members having experience and expertise in the field of municipal finance.

Based on our experience in the municipal finance arena and our work on the MFAC, we believe that Senate Bill 377 builds and improves upon the systems in place to ensure high quality financial reporting and to detect and avoid instances of severe municipal fiscal distress. As you will see in Senate Bill 377, while making some needed adjustments in these areas, the role of the MFAC and OPM would continue to involve providing appropriate oversight of municipal audits conducted by private accounting firms and promoting sound proactive planning and action by municipalities facing cumulative deficits or having serious financial management weaknesses. The goal of these plans and actions would be to ensure compliance with statutory requirements and to avoid the potential need for higher levels of State intervention as had occurred in the past. Senate Bill 377 also enables the MFAC to provide technical assistance to municipalities as needed and requested and to work with professional and municipal associations to issue best practice guidelines with respect to financial and budgetary management issues.

Once again, we appreciate the opportunity to offer our support for Senate Bill 377, and we would be pleased to provide any additional information or answer any questions you may have in this regard.

Sincerely,

The Members of the Municipal Finance Advisory Commission:

Jeffrey H. Smith, Chairman

W. David LeVasseur, Undersecretary, OPM

Alan J. Demarais

Thomas S. Hamilton

Douglas W. Gillette

John Schuyler

James B. Mullen, Jr.