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## **OLR Bill Analysis**

### **sHB 5472**

#### ***AN ACT CONCERNING MUNICIPAL FINANCE AND AUDITS.***

#### **SUMMARY**

This bill makes various changes to the Municipal Accountability Review Board (MARB) law, including:

1. changing the procedure for designating municipalities referred by the Office of Policy and Management (OPM) to the Municipal Finance Advisory Commission (MFAC) as tier I municipalities,
2. modifying the criteria and procedure used for determining whether a municipality retains its tier designation,
3. authorizing Municipal Restructuring Fund distributions to be used to pay an arbitrator selected under MARB's existing binding arbitration requirements, and
4. expanding the criteria MARB must use in determining whether to designate a tier III municipality as a tier IV municipality.

The bill also amends the law on municipal audits to, among other things, (1) increase the maximum civil penalty the OPM secretary can assess a municipality, regional school district, audited agency, or auditor that misses the audit filing deadline and (2) allow him to assess the penalty by reducing state grants awarded to the entity.

EFFECTIVE DATE: July 1, 2024

#### **§ 1 — DESIGNATION AS TIER I MUNICIPALITY**

The bill gives MFAC discretion to designate a municipality referred to it by OPM as a tier I municipality, rather than automatically designating these referred municipalities as tier I. Under the bill, MFAC

must base its decision on an evaluation of the municipality's financial condition and practices. As under existing law, designated tier I municipalities must prepare and present a five-year financial plan to MFAC for its review and approval.

By law, OPM must refer a municipality to MFAC if it (1) was not referred previously (e.g., because of evidence of unsound or irregular financial practices or specified deficiencies in its audit report) and (2) meets one of several fiscal distress criteria (e.g., if it has a negative fund balance, reported a fund balance percentage of less than 5% in the three immediately preceding fiscal years, or received a bond rating below A).

## **§ 2 — CONDITIONS FOR RETAINING TIER DESIGNATION**

The bill changes the criteria for determining whether a municipality retains its tier designation. Under current law, a municipality in any tier retains its designation (regardless of any positive changes in the factors that led to its designation) until it meets the following four criteria in the fiscal years after its designation:

1. it had no audited general fund operating deficits for two consecutive fiscal years;
2. its bond rating either improved or remained unchanged since its most current designation;
3. it presented, and either MFAC or MARB approved, a financial plan that projects a positive fund balance for the next three fiscal years, with a positive fund balance of at least 5% projected for the third fiscal year; and
4. its audits for these three years have been completed and have no general fund deficit.

The bill eliminates these requirements for tier I municipalities and instead requires that they retain their designation until MFAC unanimously votes to end it based on its evaluation of the municipality's financial condition and practices.

For tier II, III, and IV municipalities, the bill authorizes MARB to determine whether a municipality must retain its designation, but allows it to do so at its own discretion or at a municipality's request. MARB must do so using the current criteria described above, with the following changes:

1. additionally requires that the municipality have a long-term bond rating from one or more rating agencies that is investment grade or higher,
2. additionally requires (a) each fiscal year of the municipality's approved financial plan be based on recurring revenue and expenses and (b) the plan exclude funding received as contract assistance or from the Municipal Restructuring Fund,
3. requires the audits to report an audited fund balance for the municipality's general fund of at least 5%, and
4. additionally requires that there be no evidence that the municipality has engaged in unsound or irregular financial practices related to commonly accepted municipal finance standards.

Under the bill, if MARB determines that a municipality meets these criteria, the OPM secretary must end the municipality's designation or redesignate it to a lower tier, but not tier I. (This effectively allows MARB to redesignate only tier III and IV municipalities to a lower tier.) The secretary must do this at his discretion and considering the municipality's fiscal condition and state's best interests. Within 60 days after MARB's determination, the OPM secretary must notify the municipality of his decision to redesignate or end the municipality's designation. A municipality must keep its existing designation until it receives this notice. If the secretary does not provide it within the 60-day period, the municipality's tier designation terminates on the next day.

Any tier III or IV municipality redesignated to a lower tier (1) must meet the statutory requirements for that tier and (2) may only ask MARB

to determine whether it should be ended after a year has passed.

### **§ 3 — MUNICIPAL RESTRUCTURING FUND**

By law, the Municipal Restructuring Fund provides financial assistance to designated tier II, III, and IV municipalities. To receive assistance, an eligible municipality must submit a plan for approval to the OPM secretary that details the municipality's overall restructuring plan, including the local actions it will take and how it will use the funds.

The bill authorizes (1) the OPM secretary to distribute money from the Municipal Restructuring Fund to a third party on behalf of a designated tier II, III, or IV municipality and (2) these funds to be used to pay an arbitrator selected under MARB's existing binding arbitration requirements.

### **§ 4 — TIER IV DESIGNATION**

The bill expands the criteria MARB must use in determining whether to designate a tier III municipality as a tier IV municipality to include whether there is evidence of unsound or irregular financial practices related to commonly accepted municipal finance standards that MARB believes may materially affect the municipality's financial condition.

As under existing law, MARB may designate a tier III municipality as a tier IV municipality based on its finding that the municipality's fiscal condition warrants it, based on its evaluation of specified criteria (e.g., the municipality's reserve fund balance, liabilities, economic outlook, access to capital, and budget projections for the next five years).

### **§ 5 — MUNICIPAL AUDITING ACT**

By law, municipalities, regional school districts, and other local and regional entities (i.e., audited entities) must have their financial statements and accounts audited by an independent auditor at least once every year and submit the audit reports to various local officials and the OPM secretary. (These audited entities include special taxing districts, municipal utilities, the Metropolitan District Commission, regional councils of government, and other local entities with more than

\$1 million in annual revenues.)

The bill makes the following changes to these auditing requirements:

1. limits the amount of additional time the OPM secretary may grant an audited entity to file its required audit report to six months from the date it was due;
2. increases, from three to five years after the filing date, the length of time auditors must preserve the working papers they used to prepare the audit and make them available to OPM for inspection;
3. increases, from \$10,000 to \$50,000, the maximum civil penalty the OPM secretary can assess an entity or auditor that misses the filing deadline; and
4. allows the secretary to assess the penalty as a reduction in one or more grants he awards to the entity, including a payment in lieu of taxes (PILOT) grant.

Under current law, this civil penalty must be between \$1,000 and \$10,000. By law, unchanged by the bill, the secretary can waive the penalty for reasonable cause if the auditor or an official of the audited entity request it in writing.

## **BACKGROUND**

### ***MARB***

MARB is an 11-member board charged with providing technical, financial, and other assistance and oversight to municipalities experiencing fiscal distress. It is composed of state officials and members with business, labor, and municipal government expertise appointed by the governor or legislative leaders. Under the MARB law, distressed municipalities are designated as tier I, II, III, or IV, based on specified factors, including their fund balance, bond rating, equalized mill rate, and levels of state aid. The higher numbered tiers indicate higher levels of fiscal distress and MARB oversight.

**MFAC**

MFAC is an eight-member commission that advises the OPM secretary about standards and practices for preparing and submitting audits and that works with any municipality referred to it by OPM to improve its fiscal condition. Its members include the secretary and finance experts, including four municipal executive or fiscal officers.

**COMMITTEE ACTION**

Planning and Development Committee

Joint Favorable Substitute

Yea 21 Nay 0 (03/22/2024)