



## Legislation Text

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### Report to Mayor and City Council

Tuesday, March 07, 2017

Discussion

#### **SUBJECT:**

**COMPREHENSIVE ANNUAL FINANCIAL REPORT DATED JUNE 30, 2016**

#### **I. SUMMARY**

The City's independent financial statement auditor, White Nelson Diehl Evans, has completed the audit for FY15-16. The purpose of this report is to provide an overview of the audit and financial results.

#### **II. RECOMMENDATION**

RECEIVE and FILE this staff report.

#### **III. ALTERNATIVES**

TAKE another action deemed appropriate by City Council.

#### **IV. BACKGROUND**

The City retained White Nelson Diehl Evans (WNDE), an independent firm of Certified Public Accountants to perform the financial statement audit for the fiscal year ended June 30, 2016. The auditor has issued a clean opinion. This means the auditor has found the financial statements to be presented fairly, in all material respects, the financial position and activities of the City and its component units.

The Comprehensive Annual Financial Report (CAFR) is available on the City's website and at City Hall for viewing. Each City Council Member has received a separate bound copy of the report with the distribution of this agenda.

The General Fund is the primary operating fund of the City. The following is a summary of FY15-16 estimates vs. FY15-16 actual numbers.

	FY15-16	FY15-16	FY15-16
	Estimate	Actual	Variance
Beginning Fund Balance, Actual June 30, 2015	27,567,192	27,567,192	-
Revenues	74,248,741	74,176,750	(71,991)
Expenditures	(75,856,102)	(82,927,513)	(7,071,411)
Net Transfer to Other Funds	(1,559,917)	(105,989)	1,453,928
Fund Balance, June 30, 2016	<u>24,399,914</u>	<u>18,710,435</u>	<u>(5,689,479)</u>

Actual revenue was \$71,991 less than estimated (0.1%).

Operating expenditures were approximately \$0.9 million less than estimated. However, an additional \$8 million of expenditures were accrued for various litigation settlements (\$0.5 million) and the Colony Cove mobile home park rent control case (\$7.5 million), which the City is aggressively defending in appellate court. The \$0.9 million favorable operating variance offset the additional \$8 million of expenditures, resulting in a net unfavorable expenditure variance of \$7.1 million.

The FY15-16 estimates included an assumption that the restricted monies accounted for in the General Fund would be transferred to the new special revenue funds with the close of the FY15-16 books. However, those transfers are being made during FY16-17, now that we have final FY15-16 numbers. Examples include the 1% PEG fee and utility undergrounding fees. Therefore, transfers out to other funds during FY15-16 were approximately \$1.4 million less than originally estimated.

Because the June 30, 2016 fund balance is less than expected, primarily due to the Colony Cove judgment, the FY16-17 estimates must be revised to reflect the actual fund balance at July 1, 2016.

	FY16-17	FY16-17
	Estimate	Revised
Beginning Fund Balance, July 1, 2016	<b>24,399,914</b>	<b>18,710,435</b>
FY15-16 Amendments after FY16-17 Budget	(1,364,750)	-
FY15-16 Continued Appropriations	787,858	-
Revenues & Transfers to Other Funds	75,949,484	75,949,484
Expenditures	(78,403,250)	(78,403,250)
Estimated Ending Fund Balance, June 30, 2017	<u>21,369,256</u>	<u>16,256,669</u>

The ending fund balance includes set-asides based on City Council policy. When we subtract those set-asides from ending fund balance, we arrive at the “spendable” fund balance referred to as Unassigned Fund Balance. That number has been reported recently in City Council agendas as \$1,991,834. The following is the calculation of Unassigned Fund Balance updated with the new information. The calculation indicates that Unassigned General Fund Balance has decreased to a *deficit* of \$6,115,474, an approximate \$8.1 million swing, primarily due to the Colony Cove judgment.

	FY16-17	FY16-17
	Estimate	Revised
Estimated Ending Fund Balance, June 30, 2017	<b>21,369,256</b>	<b>16,256,669</b>
Less Set-Asides:		
Nonspendable Items (e.g. Inventory)	(375,759)	(342,432)
Transfers to be made in FY16-17:		
Restricted Load Shed		(247,421)
Restricted Utility Undergrounding		(1,116,110)
Restricted 1% PEG		(431,403)
Restricted Raised Median		(233,114)
Capital Asset Replacement		(1,000,000)
Alameda Corridor	(1,000,000)	(1,000,000)
Economic Uncertainty (20% of Expenditures)	(15,326,663)	(15,326,663)
Reward Funds	(125,000)	(125,000)
50th Anniversary Event	(50,000)	(50,000)
Self-Insurance	(1,500,000)	(1,500,000)
Capital Projects	(1,000,000)	(1,000,000)
Estimated Unassigned General Fund Balance, June 30, 2017	<b>1,991,834</b>	<b>(6,115,474)</b>

During the FY17-18 budget process, the City Council will be asked to reconsider the “Set-Asides” to help correct the deficiency.

If the City prevails in the Colony Cove case appeal, the \$7,464,718 million judgment will be removed from the City’s books, and the estimated Unassigned General Fund Balance will be updated accordingly.

#### Auditor’s Communication to City Council

The WNDE Audit Partner, Bob Callanan, met with the Audit Subcommittee of the City Council on March 1, 2017 to discuss the results of the audit. Mr. Callanan will attend the City Council meeting on March 7<sup>th</sup> to answer questions from the entire City Council.

The Auditor is required to issue a letter to the City Council outlining significant audit findings, estimates, and corrections (Exhibit A). The letter indicates that the Auditor encountered no significant difficulties in dealing with management in performing and completing the audit; and that all material misstatements detected during the audit were corrected by management before the financial statements were issued.

#### Auditor’s Report on Internal Control

The Auditor also issued a report on internal control, which identified material weaknesses and significant deficiencies (Attachment B). In all cases, Management agreed with the findings and comments. The report includes Management’s responses, and the steps that have been and will be taken to prevent recurrences in the future. Topics included the following.

- Proper accounting for Successor Agency, Housing Authority and Reclamation

Authority notes receivable and land assets.

- Investment policy.
- Lack of clear employee authorization for disbursements of funds.
- Timely filing of annual housing report to the state.
- Late budget adoption.
- Segregation of duties in the Treasurer's Office.

#### Management Letter Comments

The Auditor also issued a letter to the City Council offering suggestions for improvement of internal controls (Exhibit C). The comments were not considered to be material weaknesses or significant findings.

- Manual tracking of refundable security deposits, and stale deposits.
- Stale dated checks, with no policy to address them.

Finance Department management will work with the City Treasurer's Office to improve these internal controls over the next several months.

#### Timing of the Audit

Normally, the audit is completed and financial statements are issued by December 31<sup>st</sup> following the fiscal year end. The financial statements were issued on February 28, 2017. This was the first year of the engagement for WNDE, and there was a significant amount of work to establish a baseline understanding of the City's controls, processes, and policies. Other examples contributing to the delay follow.

- The City had not recorded a value for the 157-acres on the Reclamation Authority books during FY14-15; and it took some time to determine the value before a prior-period adjustment could be made.
- There were no City Council meeting minutes to review for a significant portion of the year being audited; and the auditor had to use other means to validate City Council actions that impacted the financial statements.
- The Reclamation Authority should have previously been reported as a component unit of the City; and the City's financial statements had to be reorganized to include the Reclamation Authority.

#### • **V. FISCAL IMPACT**

There is no direct fiscal impact associated with the recommendation. However, the General Fund Budget Summary has been updated to reflect the actual beginning balance

for FY16-17 (Exhibit D).

**VI. EXHIBITS**

A - Auditor letter to City Council (pages 6-9)

B - Auditor's Report on Internal Control (pages 10-18)

C - Auditor's Management Letter Comments (pages 19-20)

D - Updated FY16-17 General Fund Budget Summary (page 21)

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