



Legislation Text

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TO:

Honorable Mayor and Members of the City Council

THROUGH:

Bruce Moe, Interim City Manager

FROM:

Steve S. Charelian, Acting Finance Director
Henry Mitzner, Controller
Libby Bretthauer, Financial Analyst
Julie Bondarchuk, Senior Accountant

SUBJECT:

Fiscal Year 2016-2017 Comprehensive Annual Financial Report (Acting Finance Director Charelian).

RECEIVE AND FILE

RECOMMENDATION:

Staff recommends that the City Council receive this report.

EXECUTIVE SUMMARY:

The attached Comprehensive Annual Financial Report (CAFR) presents the City's financial results for Fiscal Year (FY) 2016-2017. The FY 16-17 CAFR was first delivered to the City Council as part of the January 16, 2018 agenda packet. This evening, Richard Kikuchi, Managing Partner at Lance, Soll and Lunghard, the City's auditor, will be present to discuss the process and results.

We are pleased to report that once again, the City has received the best possible opinion, an unmodified (formerly unqualified) audit opinion, meaning that the auditor believes that the City's financial statements are fairly presented in all material respects in conformity with Generally Accepted Accounting Principles (GAAP). Further, the auditor reported no material deficiencies (Attachment 3).

FISCAL IMPLICATIONS:

There is no fiscal implication associated with the recommended action. The results of fiscal year 2016-2017 are summarized below and are included in the CAFR (Attachment 2).

DISCUSSION:

Attached to this report is the City's CAFR for the fiscal year ended June 30, 2017. This independent audit report is prepared with the assistance of the City's auditor, Lance, Soll and Lunghard, the certified public accountancy firm selected by the City Council. Staff would like to take this opportunity to acknowledge the auditor's professionalism and diligence in the completion of the audit.

The attached report contains detailed information about the City's financial results for FY 2016-2017. The document, which is in industry-standard format, is organized as follows:

Introductory Section

The Introductory Section includes the City's transmittal letter providing an executive summary of the financial and economic events characterizing FY 2016-2017. A review of the transmittal letter will help the reader understand the City's organizational structure and provide performance highlights of the City's most significant funds and operations.

Financial Section

The Financial Section presents the independent auditor's report. The auditor's report contains two main sections: the Audit Opinion and the Management Discussion & Analysis (MD&A).

Audit Opinion

The Audit Opinion, worded in an industry standard format, provides a statement by the auditor attesting to the fair presentation of financial data in conformity with generally accepted accounting principles and government accounting standards.

Management Discussion & Analysis (MD&A)

The required MD&A is intended to serve as an introduction to the City's basic financial statements, which comprise three components: 1) Government-wide Financial Statements, 2) Fund Financial Statements, and 3) Notes to the Financial Statements, providing an overview and analysis of the financial activities of the City of Manhattan Beach for the fiscal year that ended June 30, 2017.

The Government-wide Financial Statements are designed to provide readers with a broad overview of the City's finances, in a manner similar to a private-sector business. These statements utilize full accrual accounting, which recognizes revenue in the period it is earned and expenses in the period it occurs, as is done in private industry. The statements included in this section are the statement of net position and the statement of activities. Both government-wide statements are designed to show the annual increase or decrease in net assets and, in doing so, distinguish functions of the City that are principally supported by taxes and intergovernmental revenues (governmental activities) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (business-type activities). The governmental activities of the City include general government, public safety, public works, planning, building and safety, and recreation. The City's business-type activities include water, wastewater, stormwater, refuse and parking.

The Fund Financial Statements include governmental funds reported on a budgetary modified accrual basis (which recognizes revenues when they become available and measurable and, with a few exceptions, recognizes expenditures when liabilities are incurred), and proprietary funds reported on a full accrual basis. Major governmental funds (General Fund, Capital Improvement Fund) and major enterprise funds (Water, Waste Water, Parking) are shown individually, while non-major funds are aggregated into a single column (full details are listed later in the document). Internal service funds are considered minor proprietary funds and are aggregated following enterprise funds.

The Notes to the Financial Statements section provides disclosures about the City's financial statements. That section is followed by the Combining Financial Statements & Schedules and the Statistical section. The combining statements are presented in the traditional fund manner and report on the details of all non-major funds, which appear on a combined basis in the front of the document.

The Statistical Section, not subject to audit review and testing, provides general trend information presenting financial and economic data over time.

Staff recommends that the reader, at a minimum, review the Letter of Transmittal and MD&A portions of the report. These will provide an overview of the audit results and financial highlights.

The audit results were discussed with the Finance Subcommittee at their December 11, 2017 meeting.

Net Pension Liability Reporting

A significant change in the reporting model occurred with the FY 2014-2015 financial statements in accordance with Governmental Accounting Standards Board (GASB) Statement 68. Prior to FY 2014-2015, pension liabilities were discussed only in the footnotes; no pension liabilities were presented in the statements. Statement 68 now requires governments providing defined benefit pensions to recognize their long-term obligation for pension benefits as a liability and to more comprehensively and comparably measure the annual costs of those benefits. As a result, net pension liabilities for the defined benefit plans are presented in the Statements of Net Position under Noncurrent Liabilities (liabilities due in more than one year). As of June 30, 2017, the City's CalPERS Net Pension Liability is \$65,629,933, an increase of \$15,884,649 from FY 2015-2016. This increase is mainly attributable to CalPERS' investment returns not meeting projections.

As City Council had requested during last year's CAFR discussion, staff has created a one page summary sheet of the City's pension assets and liabilities (Attachment 5).

Summary of Results

General Fund

Overall, General Fund results were better than budgeted projections. Revenues exceeded expenditures by \$2,929,920. Including net transfers, other sources and uses (Marine Avenue Park bond refunding) and proceeds from the sale of capital assets, the General Fund balance increased by \$1,297,354 from the prior year. Transfers Out, which totaled \$2,364,678, included General Fund transfers to the Insurance Fund (\$667,000) to support long term liabilities, Stormwater Fund (\$967,382) to fund operations and continuing capital projects, and Street Lighting & Landscaping District Fund (\$230,296) to cover excess expenditures over revenues.

By category, revenues exceeded the final (amended) budget by \$1,980,847, and expenditures came in under final (amended) budget by \$1,712,558 (Attachment 1).

The total fund balance in the General Fund as of June 30, 2017 was \$25,047,635. Utilizing governmental accounting standards classifications for governmental type funds (GASB 54), the fund balance is as follows:

Unassigned:	\$23,367,583
Non-Spendable:	<u>1,680,052</u>
Total	\$25,047,635

The Unassigned category includes the City Council financial policy reserve of \$13.5 million (20% of expenditures) and the Economic Uncertainty Reserve of \$4.0 million. Once all City Council established internal reserves and designations were accounted for, the General Fund had an available balance of \$5.9 million, as of June 30, 2017 (please note that this amount does not reflect subsequent appropriations from the available fund balance, including those in the fiscal year 2017-2018 budget).

General Fund Revenue Highlights

Total revenues exceeded budget by \$1,580,847, or 2.3% (Attachment 1). Property Tax exceeded the budget by \$393,649 (1.4%) and surpassed the prior year by \$1.9 million (7.1%). As a category, Other Taxes (Sales, TOT, Franchise, etc.) was under FY 15-16 by \$377,176 (1.9%) and under budget by \$624,741 (3.1%). Sales Tax totaled \$8,962,617 in FY 16-17, falling behind the prior year by \$385,988 (4.1%) and under budget by \$337,383 (3.6%). Transient Occupancy Tax (TOT) exceeded the prior year by \$91,928 (2.1%) but was under the budget projection by \$71,130 (1.6%).

Licenses and permits came in \$93,211 (3.3%) more than the prior year but \$330,764 (10.9%) below budget. The budget variance is primarily due to building permits, which came in \$317,638 (16.4%) under budget due to the timing of permits for the Manhattan Village Mall project. (The FY 2017-18 Adopted Budget was adjusted to reflect the permits occurring after June 2017.)

Fines and Forfeitures performed below budget by \$301,910 or 10.8%. Within this group, Parking Citations were \$254,819 under budget (9.9%) but in line with the prior year (under \$4,865).

Current Service Charges came in over budget by \$1,541,596 (23.8%). This group includes Plan Check Fees, Parks and Recreation revenues, and Police and Fire service fees among others. Plan Check fees came in over budget by \$626,390 (49.4%) due to the receipt of plan check fee charges for the Manhattan Village Mall project.

Miscellaneous revenues totaled \$1,709,522, ahead of budget by \$796,622, primarily due to the one-time transfer fee of \$730,000 for the 1334 Tennis Club Ground Lease.

General Fund Expenditure Highlights

FY 2016-2017 General Fund expenditures as a group came in below budget by \$1,700,795 or 2.5% (Attachment 1). Within General Fund categories, Salary and Wages came in over budget by \$912,221 (2.9%), but this variance was more than offset by savings in other categories. This overage occurred primarily through sworn salaries, which exceeded budget by \$727,016 (5.6%), and sworn overtime, which was under budget by \$11,723 (0.3%). The salary overrun is due to staffing levels above the presumed 4.0% vacancy factor budgeted in FY 2016-2017 and the permitted cash-out of vacation time by sworn personnel. Additionally, there were periods of the year when the Police Department was staffed at full strength, and even temporarily over-staffed in anticipation of upcoming vacancies due to retirements. By over-staffing in advance of these vacancies, the Police Department's fully-trained force is sustained without interruption to service.

The category of Employee Benefits realized budgetary savings from two non-recurring items in FY 2016-2017. A \$500,000 initial contribution was budgeted for a Pension Stabilization Trust Fund in FY 2016-2017. However, no funds were transferred for this purpose until FY 2017-18 (the Pension

Stabilization Fund is now in effect with an initial contribution of \$750,000). Additional budgetary savings of \$238,512 were realized when the budgeted contributions for Other Post-Employment Benefits plan were unnecessary due to the plan's "super-funded" status.

Attachment 1 lists the expenditures across all departments by object class. Highlights include:

1. Capital Outlay came in under budget by \$446,230.
2. Operating Expenditures (contract services, materials, utilities, etc.) were below budget by \$1,229,508.
3. Debt Service was under budget by \$239,161.
4. Personnel Services exceeded budget (as described above) by \$200,853.

Operating Expenditures also includes the City Council Contingency of \$100,000. Although \$10,000 was used during the year for FPPC Filing Software costs, \$90,000 remained unspent in FY 2016-17. Utility costs for Electricity, Natural Gas and Water ended the year under budget by \$103,038 (8.3%). Projected cost increases assumed during the development of the utility budgets did not materialize over the year.

Capital Outlay expenditures included critical property, equipment and software purchases in FY 2016-17. This included Community Cameras (\$265,000), the City Clerk's document imaging project (\$34,000), and a large-format scanner/printer for Community Development plans (\$26,000).

Other Funds of Note

While most funds performed as expected, several are worth mentioning.

Insurance Fund

The Insurance Reserve Fund ended the year with a negative net position of \$1,801,739, an increase of \$566,497 from the prior year. The negative fund balance was first reported in FY 2014-2015, which had a year-end net position of negative \$2,083,430. This was primarily caused by prior years' unusually high levels of liability and workers compensation activity, as well as recognition of long-term pension liabilities. In order to rectify the situation, the City Council implemented a recapitalization plan, which included phased General Fund transfers to the Insurance Fund over three fiscal years (FY 15-16, FY 16-17, and FY 17-18), totaling \$2 million.

Expenses for General Liability claims over the last three fiscal years have averaged \$2.3 million with internal billings to recoup the costs averaging \$2.2 million. On the other hand, expenses for Workers' Compensation claims have averaged \$4.8 million over the last three fiscal years, while internal billings to departments averaged only \$3.8 million in recouped costs. To a small extent, recoveries of payments in excess of self-insured levels help mitigate these losses. While the phased recapitalization plan has helped stabilize the fund, further transfers, as well as increased departmental charge-outs, will be necessary to address this funding issue.

Water Fund

The Water Fund continues to build resources for planned capital improvements needed to sustain the utility's operation and infrastructure. Net position increased \$4,014,282 from the prior year. Revenue from sales increased by \$158,447 (1.0%), while operating expenses (labor, materials, services, etc.) rose by \$883,134 (9.0%). The cause of the increase was mainly due to the substitution of imported water for pumped well water during a time when the City-owned well was out of commission for

repairs.

During FY 2010, the City Council approved increased water and waste water rates to support system infrastructure needs, as well as bolster the fiscal integrity of those funds. The new rate structure became effective in January 2010 and provided for annual increases through 2014. Accumulated fund balances provide resources for planned capital improvements to the utility's infrastructure, estimated at \$42.2 million over the next five years.

Waste Water Fund

The Waste Water fund change in Net Position for FY 2016-2017 was \$1,891,434. Operating revenue increased \$12,033 (0.3%) while operating expenses increased \$48,704 (3.6%). Waste water rates were implemented with the water rates in January 2010. Similar to the water utility, the new rates are being utilized to fund needed capital improvements to the waste water system, estimated at \$18.8 million over the next five years.

It is important to note that because waste water revenues are based on water consumption, water conservation efforts cause them to fluctuate without the benefit of lower costs, as seen in the Water fund, where conservation efforts result in less pumping and less Water being purchased.

Storm Water Fund

The Storm Water Fund net operating income in FY 2016-2017 totaled \$656,955. This loss represents an ongoing pattern of losses in FY 2015-2016 (\$771,508), FY 2014-2015 (\$424,468), FY 2013-2014 (\$420,831) and FY 2012-2013 (\$57,093). The combination of fixed fees and rising costs requires General Fund subsidies (in FY 16-17 the General Fund provided \$967,382). Additionally, capital improvements due to legislative mandates will also result in increased costs. A Proposition 218 assessment vote, or other revenue enhancement, will be necessary to properly fund operations going forward.

Building Maintenance and Operations Fund

Similar to the Insurance Fund, the Building Maintenance and Operations Fund indicates a Net Pension Liability (NPL) due to the inclusion of long-term pension liabilities of \$493,825. With the NPL, the fund has a net position of negative \$327,504; without this noncurrent (long-term) liability and deferrals, the fund balance would be positive \$82,786. Prior to the implementation of GASB 68, this internal service fund was always intended to be a pass-through with close to zero fund balance. However, with the NPL now causing this fund to be negative, a commensurate amount will need to be committed if a positive fund balance is to be maintained.

For all Internal Service Funds (Insurance Reserve, Information Technology, Building Maintenance, etc.), NPL is a noncurrent liability that does not affect liquidity/working capital; however, additional working capital to cover this liability will need to be generated via increased charge-outs to using departments.

In closing, the Interim City Manager and Acting Finance Director wish to recognize the dedication, hard work and attention to detail of all departments throughout the year that enables the City to achieve the unmodified opinion. Special recognition is in order for Finance staff, particularly Henry Mitzner, Libby Bretthauer and Julie Bondarchuk.

PUBLIC OUTREACH/INTEREST:

After analysis, staff determined that public outreach was not required for this issue.

ENVIRONMENTAL REVIEW

Not required.

LEGAL REVIEW

The City Attorney has reviewed this report and determined that no additional legal analysis is necessary.

Attachments:

1. FY 2016-2017 General and Enterprise Fund Summary Results
2. FY 2016-2017 Comprehensive Annual Financial Report (CAFR)
3. Report on Internal Control (Management Letter)
4. Audit Committee Letter
5. Summary of Pension Liabilities and Employer Contribution Expenditures
6. Auditor Power Point Presentation