CITY OF EMERYVILLE

MEMORANDUM

DATE: November 30, 2010

TO: Finance Committee

FROM: Karan Reid, Chief Financial Officer
Finance Division, Administrative Services Division

SUBJECT: Audited Financial Statements for the Year Ending June 30, 2010 and Transfer of Fund Balances

Audited Financial Statements for the Year Ending June 30, 2010

Each year, the City of Emeryville completes a financial audit, in which independent outside auditors provide an opinion on the City's financial statements. Emeryville has engaged the firm of Lance, Soll & Lunghard as the City's outside auditor. The auditor's opinion is unqualified and indicates that the City's financial statements represent fairly and in all material respects the financial position of the City of Emeryville as of June 30, 2010.

In addition, each year, the Redevelopment Agency is required to complete a separate financial audit in which the outside auditor provides an opinion on the Agency financial statements and on the Agency's compliance with provisions of the Health and Safety Code of the State of California.

The Agency audit for the 2009-10 fiscal year has been completed. The auditor's opinion is unqualified and indicates that the Agency's financial statements represent fairly the position of the Emeryville Redevelopment Agency as of June 30, 2010 and that the Agency is in compliance with generally accepted accounting principles.

Draft reports for both the City of Emeryville and its Redevelopment Agency are attached.

Auditors' Communication with those Charged with Governance

Professional auditing standards require the auditor to communicate, in writing, to management and those charged with governance, certain communications including a Finance Committee Report and a Report on Internal Control over Financial Reporting and Compliance and Other Matters. The Finance Committee letter covers all reported issues in both reports as well as the description of the auditor's responsibilities under Generally Accepted Accounting Standards and Government Auditing Standards. Areas noted in the report with regards to Internal Control Over Financial Reporting are summarized below by reporting entity.

City of Emeryville

Federal Grant Reporting – The auditors identified numerous grants that were not included on the Schedule of Expenditure of Federal Awards (SEFA). Staff will develop administrative guidelines and procedures to ensure the Finance division is able to properly identify all Federal grants on a timely basis.

Timeliness of Grant Reporting – During the audit, the auditors noted grant expenditures for prior years which had not been submitted for reimbursement. Staff will incorporate reimbursement guidelines into the grant administrative instruction discussed above in order to ensure timely reporting and reimbursements of grant expenditures.

Audit Difference – The Auditors noted a difference in the fair market valuation calculation (GASB 31 adjustment) of $27,565. The difference is a result of a revised LAIF market valuation that occurred between the date staff completed their calculation and the date of the audit fieldwork. The adjustment is not material to the presentation of the City financial position.

Child Development Center

The auditors noted instances of non-compliance with certain laws, regulations, contracts and grant agreements. The detailed findings and staff responses are included in the Auditors' Letter to the City Council.

Emeryville Redevelopment Agency

No findings or instances of other matters were required to be reported.

Fund Balance Designations

City

The City has identified many unfunded liabilities, including retirement costs, major maintenance of City facilities and general capital projects. The City Council has established a policy priority to identify and fund unfunded liabilities, and during the past several years, the City Council has taken action to fund unfunded liabilities when funds are available. Since fiscal year 1995-96 designated General Fund balance has been transferred to the following funds: General Capital Improvement Fund, Major Maintenance Fund, Vehicle Replacement Fund, Economic Uncertainty Fund, Technology Fund, Pension Trust Fund, Accrued Benefit Internal Service Fund, Litigation Fund, PERS Liability Fund, and Earthquake Insurance Fund. A chart detailing the approved transfers since 1996 is attached.

The City's policy, as restated by Council in June 2010, is to maintain undesignated fund balance in an amount of at least 25% of operating expenditures with a goal of bringing the level of fund balance up to 50% including the Economic Uncertainty Fund. Once an acceptable level is achieved, any current year excess revenues should continue to be set aside into long term reserves for unfunded liabilities and economic uncertainties. Budgeted expenditures for the 2010-11 fiscal year are $28,500,000. The undesignated fund balance of $10,500,000 represents approximately 37% of budgeted expenditures for the 2010-11 fiscal year. As of June 30, 2010, the Economic Uncertainty fund has an undesignated fund balance of $5,283,809 or 18.5 % of the fiscal year 2010-11 General Fund expenditure budget. Together with the Reserve for Economic Uncertainty, the undesignated fund balances total 55.5%.

ON December 16, 1997, as part of the acceptance of the FY 96/97 audit, the City Council designated $325,000 of fund balance in the General Fund for contingencies. This amount was set aside to cover refunds of transient occupancy and sales taxes for possible claims. As the claims relating to sales tax have been resolved and no claim for a refund of transient occupancy tax was received, staff is recommending rescinding the designation of $325,000 for contingencies.

Staff recommends the designation for unfunded liabilities of $3,700,000 leaving an undesignated fund balance (in the General Fund) of $7,175,824, equal to 25% of budgeted expenditures for fiscal year 2010-11**.** The funds available for designation are a result of the following:

Expenditure savings in FY09/10 compared to budget	$ 2,226,000
Reduction in outstanding encumbrances at June 30, 2010	815,000
General Fund budget was reduced $1.66 million in FY 10/11 thus lowering the 25% threshold from the prior year	414,000
Change in portfolio valuation adjustment	164,000
Rescission of $325,000 designation	81,000
	$ 3,700,000

If the Committee supports the recommended designation for unfunded liabilities, staff seeks an additional recommendation for the allocation of these funds. Staff recommends making the following transfers (in order of priority):

Fund	Amount
Pension Trust Fund – Fund 712	$ 400,000
Dental Self Insurance – Fund 610	200,000
Unemployment Self Insurance – Fund 612	100,000
PERS Liability for Safety plans – Fund 710	900,000
PERS Liability for Misc plans – Fund 710	1,000,000
Transfer balance to Major Maintenance – Fund 650	1,100,000
Total Transfers	$ 3,700,000

The unfunded retirement liability, as of the last actuarial valuation of June 30, 2009, for the City's closed pension plan was approximately $356,000. However, due to the low interest rate environment, staff anticipates the unfunded liability will increase when the next valuation is performed in June 2012. Therefore, staff recommends a transfer of $400,000 to fund this liability.

In two of the City's self insurance funds, Dental and Unemployment, expenditures have outpaced transfers in for several years. As a result, fund balance is eroding. Staff is recommending transferring $200,000 to the Dental and $100,000 to the Unemployment self insurance funds to strengthen the fund balances to ensure sufficient resources to meet future demands.

The unfunded PERS liability, as of the most recent communication from PERS, totals $3,575,000; $490,000 for Police, $425,000 for Fire and $2,660,000 for Miscellaneous. Staff is recommending transferring $1,900,000 to the PERS Liability Fund and further recommending an advance payment to PERS for $1,915,000 towards the unfunded liabilities in the City's/MESA's plans.

The PERS Liability Fund ended the year with a fund balance of $4,149,700; however, employer rates are expected to increase substantially in future years to offset the investment losses PERS

has experienced over the last few years. For Safety personnel, rates are expected to rise from approximately 25% to 30% by fiscal year 2013/14. For Miscellaneous, the employer rate is anticipated to rise from 10.4% to 13.2% over the same time frame. Reducing the liability will help mitigate the future rate increases. The associated rate reductions for Police and Fire are approximately 2.47% and 2.78%, respectfully. The rate associated with the unfunded liability for the Miscellaneous plan is about 1.2%; however, the miscellaneous rate will not drop the full 1.2% as the recommendation is to pay down $1,000,000 of the $2,660,000 unfunded liability.

Furthermore, staff is recommending $1,100,000 transfer to the Major Maintenance fund to strengthen the reserves for facility maintenance. On February 16, 2010, staff presented the results of the facilities study. The total recommended project costs are approximately $21,000,000; however, the Public Works committee made recommendations as to the highest priority projects at a cost of approximately $5,500,000. The Major Maintenance fund ended the fiscal year with an unallocated fund balance of $7,400,000. After completing the high priority items identified in the February 16 study session, the remaining fund balance would be less than $2,000,000. Staff is recommending a transfer of $1,100,000 to strengthen the reserves of the Major Maintenance fund.

Redevelopment Agency

Staff is not recommending any transfers within the Redevelopment Agency. Due to the Supplemental Educational Revenue Augmentation Fund (SERAF) payment of $11.3 million made in fiscal year 2010, there are not sufficient funds to make any transfers.

Recommendations

The following are staff recommendations relating to the financial statements for the City and Agency for the year ended June 30, 2010:

- Review the draft financial statements attached and Finance Committee Letter,
- Recommend acceptance of the audits for the fiscal year ending June 30, 2010 by the full City Council and by the Redevelopment Agency Board,
- Recommend rescinding the $325,000 designation for contingencies of fund balance in the General Fund,
- Endorse the designation of fund balance and recommend allocation for the General Fund,
- Recommend a payment to CalPERS of $1,915,000 towards the unfunded liability of the City/MESA plans.

Attachments:

Financial Statements
Auditors' Communications with those Charged with Governance
Historical Chart of Fund Balance Transfers

City of Emeryville
Summary of General Fund Transfers
For Unfunded Liabilities and Projects:

Fiscal Year Ending:	1996-1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Total	Recommended
Fund:														
General Capital Improvement	1,700,000	3,000,000	2,000,000		1,000,000			500,000					8,200,000	
Major Maintenance	1,000,000		2,000,000										3,000,000	
Vehicle Replacement	600,000		1,500,000										2,100,000	
Economic Uncertainty			1,500,000	800,000	1,000,000				554,000				3,854,000	
Technology	300,000												300,000	
Pension Trust	200,000												200,000	
Accrued Benefit Internal Service	480,000						200,000						680,000	
Litigation	220,000								1,900,000				2,120,000	
Earthquake Insurance				1,000,000									1,000,000	
PERS Liability						1,700,000	2,500,000	3,300,000	1,246,000	3,300,000	1,000,000		13,046,000	
Subtotal	4,500,000	3,000,000	7,000,000	1,800,000	2,000,000	1,700,000	2,700,000	3,800,000	3,700,000	3,300,000	1,000,000		34,500,000	3,700,000

In addition, the following transfers were made during the then current fiscal year:

General Capital Improvement			2,000,000	1,500,000	1,500,000	1,000,000		1,000,000					7,000,000
Litigation Fund	1,501,500	150,000	150,000	150,000	150,000	150,000	150,000	150,000	200,000	332,000	350,000		3,433,500
Economic Uncertainty											408,000		408,000
Accrued Benefit Internal Service									100,000				100,000
PERS Liability									1,000,000	500,000	10,000		1,510,000
Subtotal	1,501,500	150,000	2,150,000	1,650,000	1,650,000	1,150,000	150,000	1,150,000	1,300,000	832,000	768,000		12,451,500
Total transfers	6,001,500	3,150,000	9,150,000	3,450,000	3,650,000	2,850,000	2,850,000	4,950,000	5,000,000	4,132,000	1,768,000		46,951,500