# CITY OF EMERYVILLE

# MEMORANDUM

**DATE:** November 21, 2011

**TO**: Finance Committee

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

**SUBJECT**: Audited Financial Statements for the Year Ending June 30, 2011 and Transfer of Fund Balances

## Audited Financial Statements for the Year Ending June 30, 2011

Each year, the City of Emeryville (City) 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, 2011.

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

The Commission audit for the 2010-11 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 Commission as of June 30, 2011 and that the Agency is in compliance with generally accepted accounting principles.

Draft reports for both the City of Emeryville and its Commission 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 grant expenditures 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.

*GASB 54 implementation* – The City implemented GASB Statement 54 – Fund Balance Reporting and Governmental Fund Type Definitions – in the current CAFR. GASB 54 substantially alters the focus and terminology used for fund balance reporting.

**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 Compliance Audit report attached.

**Community Development Commission of Emeryville**

No findings of non-compliance were noted. However, the auditors recommend completing separate reports to more thoroughly document compliance. According to Health and Safety Code 33080.1, redevelopment agencies are required to prepare an annual report containing the following:

a. Independent financial audit report
b. Fiscal statement
c. Blight report
d. Loan report
e. Property report
f. List of the year the Agency expects various time limits to expire
g. Other information the Agency believes is useful, including, but not limited to, the number of jobs created and lost in the previous fiscal year
h. Housing and Community Development Report

The fiscal statement is the only report on the list that has not been separated prepared as the required information is available in the other reports submitted. Staff will prepare a separate fiscal statement beginning with fiscal year 2011 to more completely document compliance with H&S Code 33080.1.

**Governmental Accounting Standards Board (GASB) Statement 54 Implementation**

The City has implemented GASB Statement 54 "Fund Balance Reporting and Governmental Fund Type Definitions" for fiscal year 2010-11. This statement establishes new categories for reporting fund balance and revises the definitions for governmental fund types. As a result, the column referred to as General includes the City's General Fund along with the Economic Uncertainty Fund, PERS Liability Fund and Earthquake Insurance Fund. These funds no longer meet the definition of special revenue funds and therefore, cannot be discretely presented for financial reporting purposes. However, the City maintains these as separate funds for internal reporting and budgeting purposes.

**Fund Balance Designations**

***City***

The City has identified many unfunded liabilities, including a potential deficit in the Child

Development Center fund, 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 2011-12 fiscal year are $28,700,000. The unassigned fund balance, less amounts committed for encumbrances and the market value portfolio adjustment, of $11,400,000 represents approximately 40% of budgeted expenditures for the 2010-11 fiscal year. As of June 30, 2011, the Economic Uncertainty fund has an unassigned fund balance of $5,400,000 or 18.8 % of the fiscal year 2011-12 General Fund expenditure budget. Together with the Reserve for Economic Uncertainty, the unassigned fund balances total 58.5%.

Staff recommends assigning fund balance for unfunded liabilities of $4,225,000 leaving an unassigned fund balance (in the General Fund) of $7,174,000, equal to 25% of budgeted expenditures for fiscal year 2011-12**.** The funds available for designation are a result of the following:

| | |
|---|---|
| Revenues in excess of budget for FY10/11 | $ 1,622,000 |
| Expenditure savings in FY10/11 compared to budget | 1,793,000 |
| Change in portfolio valuation adjustment | 651,000 |
| Change in outstanding encumbrances | 159,000 |
| | $ 4,225,000 |

If the Committee supports the recommended assignment 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 |
|---|---|
| Reserve for SEIU/CAMP Contract Implementation – Fund 101 | $254,000 |
| Reserve for Tree Trimming – Fund 101 | 150,000 |
| Accrued Benefits Fund – Fund 700 | 600,000 |
| Child Development Center – Fund 230 | 300,000 |
| PERS Liability – Fund 710 | 1,000,000 |
| Transfer to General Fund Capital – Fund 475 | 1,155,000 |
| Transfer balance to Major Maintenance – Fund 650 | 766,000 |
| | |
| Total Transfers | $ 4,225,000 |

*Fund Balance Reserve*
Since the beginning of the 2011-12 fiscal year, additional General Fund funding requirements have been identified including $254,000 for the implementation of the SEIU and CAMP contracts and $150,000 for citywide tree trimming services. These items have or will be appropriated from the General Fund reserve, thus reducing the balance below the 25% minimum. Staff recommends maintaining this amount, $404,000, in the General Fund.

*Accrued Benefits Fund*
In the City's Accrued Benefits fund, expenditures have outpaced transfers in for several years. This fund is used to pay out vacation and sick leave banks upon service separation for those employees that leave in good standing. As a result, the liability at June 30, 2011 exceeded available cash by $523,000. Staff is recommending transferring $600,000 to ensure sufficient resources are available to meet future demands.

*PERS Liability Fund*
Staff recommends transferring $1,000,000 to the PERS Liability Fund towards future pension liabilities in the City's/MESA's plans but does not recommend transferring additional funds to PERS at this time.

Earlier this year, the City Council approved a transfer and subsequent payment to PERS to pay off the side funds in the safety plans and an additional $1,000,000 to pay down unfunded liability of the miscellaneous plan. After revised actuarial assumptions were implemented by PERS and the $1,000,000 pay down, the unfunded liability decreased from $2,483,000 to $1,995,000 or $488,000.

Over the last few years, PERS has made substantial changes to their actuarial assumptions and smoothing techniques. While smoothing investment losses over a longer period of time decreases rates in the short term, overall, the City will pay higher rates. PERS has also updated certain lifestyle, actuarial assumptions as they have found participants are living longer than previously projected. This has also increased employer rates. While transferring additional funds to PERS could decrease future employer rates, PERS investment returns in excess of 7.75% will also have the same impact. Transferring additional funds to PERS transfers control of how those assets are used and/or invested to PERS. Maintaining the funds in the PERS Liability fund provides a cushion for future rate spikes and gives the Council the flexibility to determine how best to fund pension costs. Historically, this fund has been used to subsidize the General Fund when actual rates charged by PERS exceed the "normal" cost rates. The PERS Liability Fund ended the year with a fund balance of $1,945,000; the balance would increase to $2,945,000 including the proposed transfer.

*General Fund Capital Fund*
Staff is recommending a $1,155,000 transfer to the General Fund Capital fund. Establishing an Emergency Operations Center (EOC) in the Corporation Yard was identified as a priority and staff has tried to seek grant funds for the upgrades. Staff applied for grant funds more than 18 months ago and no longer expects these funds to be awarded; therefore, staff is recommending $1,000,000 be set aside for this project. In addition, replace of the Fire Department's SCUBA gear is needed. The project will phase in the replacement over two years and is expected to cost $155,000.

*Major Maintenance Fund*
Furthermore, staff is recommending the balance, or approximately $766,000, be transferred 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. Additional projects have been

identified and prioritized including improvements to the Garden Level conference space ($250,000), Temescal Creek Park improvements ($725,000) and various smaller projects ($200,000). The Major Maintenance fund ended the fiscal year with an unallocated fund balance of $7,056,000. After completing the high priority items identified in the February 16 study session as well as the newly identified projects, the remaining fund balance would be less than $1,000,000. Staff is recommending a transfer of $766,000 to strengthen the reserves of the Major Maintenance fund.

***Community Development Commission of Emeryville***

Staff is not recommending any transfers within the Commission funds at this time. Due to the pending litigation regarding continued redevelopment operations, most activities of the Commission are suspended and the Commission is precluded from committing the funds until the Supreme Court has delivered its ruling.

**Recommendations**

The following are staff recommendations relating to the financial statements for the City and Commission for the year ended June 30, 2011:

- Review the draft financial statements attached and Finance Committee Letter,
- Recommend acceptance of the audits for the fiscal year ending June 30, 2011 by the full City Council and by the Commission Board,
- Endorse the designation of fund balance and recommend allocation for the General Fund,

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: | 1996-2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | Total | Recommended |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | | | | | | | | |
| **Fund:** | | | | | | | | | | | | | | |
| Child Development Fund | | | | | | | | | | | | | - | 300,000 |
| General Capital Improvement | 4,700,000 | 2,000,000 | | 1,000,000 | | | 500,000 | | | | | | 8,200,000 | 1,155,000 |
| Major Maintenance | 1,000,000 | 2,000,000 | | | | | | | | | 335,000 | | 3,335,000 | 766,000 |
| 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 | | | | | | | | | | 400,000 | | 600,000 | |
| Accrued Benefit Internal Service | 480,000 | | | | | 200,000 | | | | | | | 680,000 | 600,000 |
| Dental Self Insurance | | | | | | | | | | | 200,000 | | | |
| Unemployment Self Insurance | | | | | | | | | | | 100,000 | | | |
| 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 | 1,900,000 | | 14,946,000 | 1,000,000 |
| | | | | | | | | | | | | | | |
| Subtotal | 7,500,000 | 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 | 2,935,000 | | 37,135,000 | 3,821,000 |

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 | 1,651,500 | 150,000 | 150,000 | 150,000 | 150,000 | 150,000 | 150,000 | 200,000 | 332,000 | 350,000 | 350,000 | 300,000 | 4,083,500 |
| 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 | 1,651,500 | 2,150,000 | 1,650,000 | 1,650,000 | 1,150,000 | 150,000 | 1,150,000 | 1,300,000 | 832,000 | 768,000 | 350,000 | 300,000 | 13,101,500 |
| | | | | | | | | | | | | | |
| Total transfers | 9,151,500 | 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 | 3,285,000 | 300,000 | 50,236,500 |