



City of Emeryville

CALIFORNIA

MEMORANDUM

DATE: December 18, 2018
TO: Christine Daniel, City Manager
FROM: Susan Hsieh, Finance Director
SUBJECT: **Resolution Of The City Council Of The City Of Emeryville Accepting The Annual Audit Report, Which Includes The Audited Basic Financial Statements And Auditors' Opinion, For The City Of Emeryville For The Fiscal Year Ending June 30, 2018**

RECOMMENDATION

It is recommended that the City Council adopt the above-entitled resolution accepting the Audited Financial Statements for the City of Emeryville for the fiscal year ended June 30, 2018, including:

1. Comprehensive Annual Financial Report for City of Emeryville
2. Appropriations Limit Calculation
3. Child Development Program Compliance Audit
4. Measure B Compliance Audit
5. Measure BB Compliance Audit
6. Vehicle License Fee Compliance Audit
7. Housing Compliance Audit
8. Letter regarding Auditors' Communications with Audit Committee
9. Letter regarding Auditors' Report on Internal Control

BACKGROUND

Each year, the City of Emeryville (City) prepares a Comprehensive Annual Financial Report (CAFR) to provide the City Council and the public with information about the City's fiscal year financial activities and its end of year financial position. In addition, the City prepares compliance reports such as Measure B/BB reports to meet certain local/state/federal requirements. To provide independent assurance, the Certified Public Accounting firm of Lance, Soll & Lunghard (LSL) has been engaged to conduct financial and compliance audits for the year ended June 30, 2018. LSL has completed its audits and issued "clean" unmodified audit reports. The audited financial statements are attached for your reference.

The CAFR includes the following major sections and information:

Introductory Section

- Letter of Transmittal – provides information about the City's profile, economic conditions and outlook, and major initiatives and accomplishments.

Financial Section (key section of the CAFR)

- Independent Auditors' Report – report card on the truth and fairness of the City's financial statements.
- Management's Discussion and Analysis – provides an overview of the City's activities and financial performance.
- Basic Financial Statements – present the City's financial results and conditions. The key reports include balance sheet, income statement, and cash flow statement.
 - Government-Wide Financial Statements – provide a broad overview of the City's finances, in a manner like private-sector businesses.
 - Fund Financial Statements – focus on near-term inflows and outflows of spendable resources. Useful information in determining what financial resources are available in the near future to finance the City's programs.
 - Notes to Financial Statements – an integral part of the financial statements that provides additional information pertaining to City operations.
- Required Supplementary Information and Individual Fund Statements and Schedules
 - Pension funding information.
 - OPEB (other post-employment benefits) funding information.
 - Individual fund statements and budgetary comparison schedules.

Statistical Section (current and historical information – up to ten years)

- Financial Trends
- Revenue Capacity Information
- Debt Capacity Information
- Demographic and Economic Information
- Operating Information

DISCUSSION

Implementation of Governmental Accounting Standards Board (GASB) Pronouncement No. 75 – Accounting and Financial Reporting for Post-Employment Benefits Other Than Pensions

GASB 75 was effective beginning in fiscal year 2017-18. This new standard requires agencies to report unfunded OPEB (other post-employment benefits) liabilities on the face of their financial statements, similar to the net pension liabilities discussed below. The City's OPEB includes medical, dental and vision benefits. As of June 30, 2018, the City recorded \$4.4 million in net OPEB liability. This amount is equal to the City's OPEB liability minus assets held in a trust. Please refer to Note 12 in the CAFR for details. In addition to the investments in a trust, the City has set aside \$7.0 million in a reserve fund. The City contracts fire services with the Alameda County Fire Department (ACFD), and the fire OPEB liability is estimated at \$3.5 million. When accounting for all the assets and liabilities, the unfunded balance is about \$0.9 million. Please note that the OPEB liability may increase/decrease from time to time depending on the expected investment returns used for actuarial valuations.

Financial Highlights

City Pension Obligations and Funding Strategies

GASB Statement 68, Accounting and Financial Reporting for Pensions, requires agencies to report unfunded pension liabilities on the Statement of Net Position, similar to bonds and other debt obligations. This standard provides greater transparency in reporting the City's pension obligations.

As of June 30, 2018, the City has recorded a \$44.1 million net pension liability for its aggregate unfunded pension costs, including all Miscellaneous and Safety pension plans of the City. Of this amount, 73% is attributable to the City's Police and Fire pension plans. This amount does not reflect the \$4.0 million transferred to CalPERS in October 2017 to pay down the City's unfunded pension liability. This contribution is reported as deferred outflows/assets on the Statement of Net Position at June 30, 2018, and this amount will reduce the fiscal year 2018-19 net pension liability. Note that liabilities are reported one year in arrears, as data becomes available from CalPERS. Please refer to Note 10 in the CAFR for details.

The City's Statement of Net Position reflects a liability, with related deferred inflow and outflow accounts, that recognize and generally accelerate the accounting recognition of both good news and bad news as actual investment earnings, costs, and contributions vary from actuarial funding assumptions.

In December 2016, CalPERS announced a plan to reduce its discount rate assumptions from 7.5% to 7.0%. The reduction will be phased in over a three-year period beginning fiscal year 2018-19. As reported in the CAFR pension footnote, the sensitivity to the City's net pension liability of a 1% change in the investment earnings assumptions is estimated at about \$24.7 million for aggregated Miscellaneous and Safety Plans, which has the impact of increasing the City's net unfunded pension liability from \$44.1 million to \$68.8 million, as measured in today's dollars.

The City has taken proactive steps to fund its pension obligations. In addition to the \$4.0 million contribution to CalPERS, the City established a Section 115 Pension Trust in fiscal year 2017-18 and adopted a policy using a portion of the excess commercial property transfer tax to fund pension costs if surplus funds become available. To date, \$10.7 million has been set aside in the reserve and trust accounts. These prudent strategies will help the City to achieve savings and ensure sufficient funding for pension commitments.

General Fund Operating Results and Fund Balance

The City consolidates the General Fund and six related reserve funds for CAFR reporting, including the Economic Uncertainty Reserve, Pension Reserve/Section 115 Pension Trust, Pension Plan (the Old Plan), Economic Development, Community Programs and Disaster Funds. This meets a GASB objective of consolidating the reporting of unrestricted funds available to support City programs.

Fiscal year 2017-18 consolidated General Fund revenues exceeded budget by \$2.5 million mainly due to higher than expected revenues from licenses and permits, property taxes, and investment earnings. General Fund expenditures were under budget by \$11.7 million primarily due to lower than expected expenditures and a \$9.6 million contribution budgeted for the Section 115 Pension Trust. For budget purposes, cash outflows are reflected as expenditures in the budget and approved by the City Council. Of the \$9.6 million, \$2.4 million was transferred to a pension trust in fiscal year 2017-18, and the remaining balance was transferred in fiscal year 2018-19. Funds transferred to the trust account are reported as investments (not expenditures) in the CAFR, partly contributing to the budget to actual variance.

The following chart shows the General Fund revenue and expenditure trend versus the prior year and versus budget. Fiscal year 2017-18 revenues were higher than prior year revenues primarily due to increases in transient occupancy tax of \$0.9 million, residual tax increment of \$1.4 million, real property transfer tax of \$1.2 million, and other revenues of \$1.5 million (e.g., grants and charges for services). A new hotel was opened in November 2016, and fiscal year 2017-18 recognized the first full-year of revenue. Twenty-five percent of tax increment revenue is allocated to the General Fund starting in fiscal year 2017-18.

Fiscal year 2017-18 expenditures were higher than prior year expenditures mainly due to a \$4.0 million lump sum payment to CalPERS to pay down the City's unfunded pension liability. According to CalPERS, the City is expected to save \$11 million over a 30-year period, a proactive funding strategy to reduce pension liability and stabilize future costs.

FY 2017-18 General Fund Activity (a)	Audited 6/30/17	Budgeted 6/30/18	Audited 6/30/18	Budget vs. Actual
Revenues and Transfers In	\$ 40,314,845	\$ 42,842,395	\$ 45,327,434	\$ 2,485,039
Expenditures and Transfers Out	(36,680,513)	(54,267,289)	(42,563,326)	11,703,963
Net Results, before supplemental transfers	3,634,332	(11,424,894)	2,764,108	14,189,002
Transfers Out - Technology Projects	(1,000,000)	(725,000)	(725,000)	-
Transfers Out - Legal Services	(500,000)	-	-	-
Transfers Out - Worker's Compensation Program	-	(1,150,000)	(1,150,000)	-
Transfers Out - Code Enforcement Program	(250,000)	-	-	-
Transfers Out - Facility Condition Assessment Study	-	(110,000)	(110,000)	-
Transfers Out - Maintenance Program	-	(430,000)	(430,000)	-
Transfers Out - ECCL Capital Reserve	(400,000)	-	-	-
Net Results	\$ 1,484,332	\$ (13,839,894)	\$ 349,108	\$ 14,189,002

(a) For purpose of CAFR reporting, the City consolidates the General Fund and six related reserve funds, including the Economic Uncertainty Reserve, Pension Reserve/Section 115 Pension Trust, Pension Plan (the Old Plan), Economic Development, Community Programs and Disaster Funds.

The consolidated General Fund's fund balance increased by \$0.35 million to \$ 41.3 million at June 2018. Of this amount, \$3.8 million is undesignated funds and \$37.5 million is committed for specific purposes. As presented in the table below, City Council has

historically established various strategic fund balance reserves to improve security and sustainability for the General Fund. In particular, targets have been established for the Economic Contingency Reserve and Unassigned Reserve, using their ratio to the following year's 2018-19 operating expenditures as a benchmark. In fiscal year 2017-18, the City Council authorized a \$1.0 million contribution to the Pension Reserve. In addition, the City Council increased the Community Programs and Disaster Reserves by \$0.29 million and \$1.0 million.

General Fund (a) - Fund Balance Reserves	Audited Balance at 6/30/17	Audited Balance at 6/30/18
Nonspendable		
Prepaid Costs	270,534	38,877
Notes and loans	48,561	-
	319,095	38,877
Reserves		
Community Development Projects	-	80,000
Small Business Incentives	100,000	100,000
Pension Reserve	13,613,913	10,734,245
Pension Plan (the Old Plan)	283,451	263,008
Economic Development	1,355,522	1,647,919
Community Programs	389,250	572,100
Disasters	2,354,457	3,382,403
Economic Uncertainty	20,170,565	20,677,300
Unassigned	2,404,324	3,843,833
Total	40,990,577	41,339,685

Benchmark

2018-19 Budgeted Operating Expenditures 41,354,599

Reserves As % of 2018-19 Budgeted Operating Expenditures

Economic Uncertainty Reserve 50%
Council Goal: 50%

Combined Economic Uncertainty and Unassigned Reserves 59%

Notes

(a) For purpose of CAFR reporting, the City consolidates the General Fund and six related reserve funds, including the Economic Uncertainty Reserve, Pension Reserve/Section 115 Pension Trust, Pension Plan (the Old Plan), Economic Development, Community Programs and Disaster Funds. Please note that the old pension plan is a single-employer defined benefit plan. The membership as of June 30, 2018 included one retiree. The plan is closed to new entrants.

As of June 2018, the Community Development Project, Small Business Incentive, Economic Development, Community Programs, and Disaster reserves were \$0.1 million, \$0.1 million, \$1.6 million, \$0.6 million, and \$3.4 million respectively. These funds have been set aside to support various vital City services and projects, such as labor compliance standards, business tax rebate programs, shuttle service, and community grant programs. The Disaster Reserve will be used to respond to disasters such as fire, earthquakes, floods, and terrorist attacks. The two Pension Reserves totaled \$11.0 million at June 30, 2018.

The Economic Uncertainty Reserve in combination with the Unassigned Reserve totaled \$24.5 million at June 30, 2018. The reserve goal for the Economic Uncertainty Reserve is 50% of annual operating expenditures. As presented in the table above, the ratios for the Economic Uncertainty Reserve and combined reserves met/exceeded the 50% target as of June 30, 2018.

This analysis of the past fiscal year's actual operating results and assessment of the ending fund balance reserves will help guide the development of the 2019-21 budget. Over the next few months, staff will return to discuss City Council goals and priorities, reserve policies, and strategies for the upcoming budget. The goal is to develop a structurally balanced budget to ensure long-term sustainability.

Auditors' Communication with Those Charged with Governance

Professional auditing standards require the auditors to communicate in writing to management and those charged with governance. LSL has issued its *Auditors' Communications with those Charged with Governance* and its *Report on Internal Control over Financial Reporting and Compliance and Other Matters*. These letters are attached to this report for your review.

Findings and Recommendations –

The auditors recommended implementing a more formalized process for review of development agreements and submitting grant reimbursement requests in a timely manner to ensure proper recording of accounting transactions and a smooth grant reconciliation process. Staff will work with program departments to establish a more formal process for review of agreements and grant billing. For the Emeryville Child Development Center (ECDC), the auditors recommended routine review of participant files to ensure proper records are maintained, and communicating with system administrators to ensure accurate information is generated for state reporting. The Center will implement the recommendations.

Budget Advisory Committee Review

On December 13, 2018, the Budget Advisory Committee will review the reports issued by the City's independent auditors, Lance, Soll & Lunghard. A representative from the audit firm will attend the meeting to present audit reports and answer questions.

FISCAL IMPACT

None.

STAFF COMMUNICATION WITH THE PUBLIC

None.

PREPARED BY: Susan Hsieh, Finance Director

**APPROVED AND FORWARDED TO THE
City Council of the City of Emeryville:**



Christine Daniel, City Manager

ATTACHMENTS:

- Draft Resolution
- Comprehensive Annual Financial Report for City of Emeryville
- Appropriations Limit Calculation
- Child Development Program Compliance Audit
- Measure B Compliance Audit
- Measure BB Compliance Audit
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