SUBJECT: Annual Financial Statements and Annual Audit for FY 2018-19

REPORT BY: Heather Rowden, Finance Director

SUMMARY

Annually the City prepares financial statements which are audited by independent auditors. The Auditors have reviewed the City’s Basic Financial Statements and relayed their findings in the attached Annual Financial Report for fiscal year ending June 30, 2019.

STAFF RECOMMENDATION

That the Council:

1. Receive presentation of the results from the City’s independent auditor’s examination of the City’s financial reports for fiscal year ending June 30, 2019; and

2. Accept and file the reports.

BACKGROUND

The City Council has engaged the Certified Public Accounting firm of Chavan & Associates LLP, to serve as independent auditors of the City’s financial reports. This is the first year of a 3-year contract with this firm. The scope of work performed by the auditors encompassed examinations of the City’s:

- Basic Financial Statements;
- Albany Police and Fire Relief or Pension Fund;
- Alameda County Transportation Commission (ACTC) Measure B Fund, Measure BB Fund, and Vehicle Registration Fee Fund Compliance Reports;
- Transportation Development Act Reports; and
- A review of the calculation used for the annual adjustment to the City of Albany Appropriations Limit.

In addition, as part of their assignment, the auditors report their findings and recommendations regarding the City’s internal control structure.
DISCUSSION/ANALYSIS

The complete Basic Financial Statements for fiscal year ending June 30, 2019 are included as Attachment 1 to this report.

Financial Overview
The change in net assets is a snapshot of the financial results at the highest level. For the purpose of this staff report, the information is presented separately for Governmental Activities (Table 1) and Business Type Activities (Table 2).

<table>
<thead>
<tr>
<th>Governmental Activities Net Position (Table 1)</th>
<th>2018</th>
<th>2019</th>
<th>$ Change</th>
<th>% Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current and other assets</td>
<td>31,953,572</td>
<td>30,686,034</td>
<td>(1,267,538)</td>
<td>-3.97%</td>
</tr>
<tr>
<td>Capital assets</td>
<td>43,572,337</td>
<td>54,333,701</td>
<td>10,761,364</td>
<td>24.7%</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td>75,525,909</td>
<td>85,019,735</td>
<td>9,493,826</td>
<td>12.57%</td>
</tr>
<tr>
<td>Current liabilities</td>
<td>10,049,699</td>
<td>7,284,037</td>
<td>(2,765,662)</td>
<td>-27.52%</td>
</tr>
<tr>
<td>Noncurrent liabilities</td>
<td>55,134,486</td>
<td>60,229,707</td>
<td>5,095,221</td>
<td>9.24%</td>
</tr>
<tr>
<td><strong>Total liabilities</strong></td>
<td>65,184,185</td>
<td>67,513,744</td>
<td>2,329,559</td>
<td>3.57%</td>
</tr>
</tbody>
</table>

Net position:
- Invested in capital assets, net of related debt: 27,004,173 - 35,218,740 = 8,214,567 (24.4% increase)
- Restricted: 13,167,541 - 16,380,526 = 3,212,985 (18.14% increase)
- Unrestricted: 24,125,660 - 27,310,655 = 3,184,995 (13.2% increase)
- **Total net position**: 16,046,054 - 24,288,611 = 8,242,557 (51.37% increase)

As seen in Table 1, the Net Position for Governmental Activities the City’s net position has increased. Several adjustments contributed to this change. First, a review was done of the City’s cash and investment allocation. As a result of this review, adjustments were made to ensure funds are being reported in the correct place. This adjustment is outlined on page 62 of the Basic Financial Statements.

Second, the City’s capital assets were increased as it was revealed that several assets were missing from the previous year’s audit. To ensure the City’s records are complete, a physical asset inventory was completed by a third party in February 2020. Finance staff will be loading the results into the City’s financial system with the assistance of the software vendor as soon as the results are finalized. Utilizing the asset management software will ensure assets are not missed in the future. In conjunction with the asset inventory, City staff will present Council with an asset replacement plan as well as a funding strategy and policy in May.

Finally, the City’s pension liabilities have increased 13% since 2016. This number is included in the Noncurrent Liabilities line above. City staff retained Bartel & Associates to complete an analysis of the City’s pension obligations. A presentation on the findings and potential funding strategies will be on the Council agenda in May.
### Business Type Activities Net Position (Table 2)

<table>
<thead>
<tr>
<th></th>
<th>2018</th>
<th>2019</th>
<th>$ Change</th>
<th>% Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current and other assets</td>
<td>9,295,475</td>
<td>10,229,268</td>
<td>933,793</td>
<td>10.05%</td>
</tr>
<tr>
<td>Capital assets</td>
<td>15,554,817</td>
<td>24,071,422</td>
<td>8,516,605</td>
<td>54.75%</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td><strong>24,850,292</strong></td>
<td><strong>34,300,690</strong></td>
<td><strong>9,450,398</strong></td>
<td><strong>38.03%</strong></td>
</tr>
<tr>
<td>Current liabilities</td>
<td>716,947</td>
<td>2,560,608</td>
<td>1,843,661</td>
<td>257.15%</td>
</tr>
<tr>
<td>Noncurrent liabilities</td>
<td>3,090,000</td>
<td>4,485,249</td>
<td>1,395,249</td>
<td>45.15%</td>
</tr>
<tr>
<td><strong>Total liabilities</strong></td>
<td><strong>3,806,947</strong></td>
<td><strong>7,045,857</strong></td>
<td><strong>3,238,910</strong></td>
<td><strong>85.08%</strong></td>
</tr>
<tr>
<td>Net position:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Invested in capital assets, net of related debt</td>
<td>12,022,251</td>
<td>18,976,739</td>
<td>6,954,488</td>
<td>57.85%</td>
</tr>
<tr>
<td>Restricted</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>0.00%</td>
</tr>
<tr>
<td>Unrestricted</td>
<td>9,093,528</td>
<td>8,278,094</td>
<td>(815,434)</td>
<td>-8.96%</td>
</tr>
<tr>
<td><strong>Total net position</strong></td>
<td><strong>21,115,779</strong></td>
<td><strong>27,254,833</strong></td>
<td><strong>6,139,054</strong></td>
<td><strong>29.07%</strong></td>
</tr>
</tbody>
</table>

Table 2 represents the Business Type Activity which consists solely of the Sewer Enterprise Fund. The City collects user fees and provides for the maintenance and operation of the sanitary sewer collection system.

It is important to note that for both the Governmental Activities and Business Type Activities tables, assets overwhelmingly consist of capital assets (e.g. land, infrastructure, buildings, and equipment). These assets are not available for future spending. It should also be noted that the current asset balances include amounts that may be subject to restrictions on how they are used. Available general fund balances are discussed later in this report.

**Major Funds**

In order to be designated a “Major Fund,” certain minimum criteria must be met. Those criteria generally include comparison of revenues, expenditures, and assets compared to all funds. The format of the Fund Financial Statements presents individual information for each of the Major Funds and then all other Governmental Funds are reported in a single column. Table 3 provides a summary of the Governmental Fund revenue, expenditures and changes in fund balance for the year ending June 30, 2019.
### General Fund

<table>
<thead>
<tr>
<th></th>
<th>General Fund</th>
<th>Street &amp; Storm Funds</th>
<th>Non-Major Governmental Funds</th>
<th>Total Governmental Funds</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenues</strong></td>
<td>20,481,005</td>
<td>1,134,980</td>
<td>10,927,145</td>
<td>32,543,130</td>
</tr>
<tr>
<td><strong>Current expenditures</strong></td>
<td>19,803,926</td>
<td>291,406</td>
<td>4,906,046</td>
<td>25,001,378</td>
</tr>
<tr>
<td><strong>Capital outlay</strong></td>
<td>84,235</td>
<td>498,359</td>
<td>1,840,669</td>
<td>2,423,263</td>
</tr>
<tr>
<td><strong>Debt service</strong></td>
<td>163,116</td>
<td>-</td>
<td>1,513,580</td>
<td>1,676,696</td>
</tr>
<tr>
<td><strong>Total expenditures</strong></td>
<td>20,051,277</td>
<td>789,765</td>
<td>8,260,295</td>
<td>29,101,337</td>
</tr>
<tr>
<td><strong>Net transfers</strong></td>
<td>474,676</td>
<td>(391,834)</td>
<td>(82,842)</td>
<td>-</td>
</tr>
<tr>
<td><strong>Net change in fund balances</strong></td>
<td>904,404</td>
<td>(46,619)</td>
<td>2,584,008</td>
<td>3,441,793</td>
</tr>
<tr>
<td><strong>Fund balances, beginning of year (as adjusted)</strong></td>
<td>2,351,457</td>
<td>4,120,871</td>
<td>11,648,218</td>
<td>18,120,546</td>
</tr>
<tr>
<td><strong>Fund balances, end of year</strong></td>
<td>3,255,861</td>
<td>4,074,252</td>
<td>14,232,226</td>
<td>21,562,339</td>
</tr>
</tbody>
</table>

### Inter-Fund Transfers

The City Council previously approved a schedule of inter-fund transfers as part of the fiscal year 2018-19 budget. As part of the normal process of closing the books and preparing financial statements for the fiscal year, the actual amounts transferred may vary to reflect actual revenue and expenditures.

### General Fund Balance

The City’s overall general fund balance, as shown in Table 3, is $3,255,861. The Council approved the use of $894,233 to cover the excess of expenses over revenue in the FY2020 budget, leaving $2,361,628 undesignated fund balance. Based on the Fund Balance Policy passed by Council in June 2019, 25% of current year expenditures, or $5,409,345 must be held in reserve.

Due to the numerous prior year adjustments made during the FY19 audit, the City’s General Fund fund balance has fallen below the 25% level, while other fund balances shown on the audited financial statements have increased. As mentioned previously, City staff plan to bring Council an asset replacement and pension funding plan in May. The plan includes adjusting non-mandated reserve funds to bring the City’s General Fund fund balance back to 25% while establishing capital reserve funds for the replacement of City assets and reducing the City’s unfunded pension obligations over time.

An example of an intended adjustment of non-mandated reserves includes moving the balance of the City’s Internal Service Funds, referenced on page 108 of the audit, to the General Fund. These funds were established to hold money in reserve for workers’ compensation and insurance purposes, as well as to hold reserves for compensated absences.
(sick leave, vacation, and administrative leave accrual balances). After reviewing the City’s financial position, including outstanding liabilities and future obligations, and discussing the funds with the Auditor, staff will be recommending that these funds be closed and the balances, a total of $3.78m in cash and investments, be moved to the General Fund as part of an overall reserve fund and fiscal planning strategy.

Auditors’ Report to City Council
Each year, the independent auditors report any material findings regarding internal accounting controls, management’s compliance with generally accepted accounting principles, management’s judgement in applying accounting estimates, disagreements between the auditors and management, and difficulties performing the audit. The auditors reported several findings for fiscal year ending June 30, 2019. The report, titled Independent Auditors’ Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards and Schedule of Findings and Responses, is attached. Additional detail on staff response is discussed in the Next Steps section of this report.

SUSTAINABILITY CONSIDERATIONS

Not applicable.

SOCIAL EQUITY AND INCLUSIVITY CONSIDERATIONS

Not applicable.

CITY COUNCIL STRATEGIC PLAN INITIATIVES

Goal 5, Objective 1: Sound and Transparent Management of City Financial Resources

FINANCIAL IMPACT

Not applicable.

NEXT STEPS

Since the fiscal years 2016-17 and 2017-18 audit reports were presented to Council in February of 2019, an ongoing priority within the Finance Department has been to correct issues and refine policies and procedures. While some of the auditor’s findings had been corrected, many took longer to address than anticipated and were not fully resolved prior to the close of fiscal year 2018-19 in June of 2019. Working with Chavan and Associates, staff have addressed many of the findings and implemented additional policies and procedures.

Improvement Overview
The overall operations and organization of the Finance Department has been thoroughly reviewed including analysis conducted by Matrix consulting in 2018. The staffing roles and assignments are reviewed on an ongoing basis to ensure overall effective administration of
the department. At this time the City has issued a recruitment for the position of Finance Supervisor to add an additional level of oversight to the day to day functions with regard to the major work areas of budget and grants analysis, and oversight of payroll functions.

Further, the department continues to utilize and refine its master deliverables calendar. This document lists all duties and deadlines by position, including monthly, quarterly, and annual tasks. The calendar is monitored by management to ensure that tasks are completed on time. This document is an essential tool that helps further ensure accountability.

In addition, staff continues to work on policies and procedures for each function within finance to ensure efficiency and accountability in addition to planning for continuity in the event of an employee departure. The City contracted with a third party to assist in drafting administrative policies and procedures such as:

- *Accounting for Cash and Investments* This policy addresses how the City pools cash and investments, allocates interest among funds, and borrows between funds. It identifies the staff member responsible for specific tasks and provides specific deliverable dates for items such as reconciliations and reports to Council.

- *Debt Service Payments and Compliance Procedures* This policy lists the City’s outstanding debt and associated paying agent. It states that debt statements should be reconciled to the general ledger and debt schedules monthly, identifies the correct journal entries for these payments, and addresses continuing disclosure compliance. In addition, the policy addresses what should be done with any investment earnings left in an account after the debt has been paid off.

- *Payroll Procedures* The purpose of this policy is to ensure accurate and timely processing and recording of payroll with appropriate checks and balances. The policy clearly indicates when changes should be made by HR and when they should be made by Finance. The policy also addresses the reconciliation of benefit bills and payments to ensure the Accounting Supervisor can complete reconciliation of the bank account in a timely manner.

In conjunction with these policies, staff has been working to document step by step procedures using both prepared how-to documents provided by Munis and screen shots for Albany specific operations. Payroll processing and approval procedures have been completed and staff are working on formal accounts receivable and payable procedures as time allows.

**Capital Assets and Related Debt (2019-001)**

As mentioned previously, a complete physical asset inventory was completed in February of this year. The results of this inventory will be used to implement the Munis Fixed Assets module so the City can track asset purchasing and valuation as invoices are processed. The fixed assets module also tracks depreciation so that the calculations are not done manually, leaving less room for error and a breakdown in process with staff turnover.

In addition to the implementation of the fixed assets module, staff have contacted the Munis team and will be scheduling a training on the Work Orders module in last summer, early fall.
The work order module will allow staff to track maintenance done on each asset which will help refine budgeting for repair and replacement of City assets.

**Financial Reporting and Closing (2019-002)**
The Finance Department has put in place several measures to ensure a smooth close to FY2020. First, staff have been reconciling all bank and investment accounts in a timely manner consistent with the recently implemented administrative Accounting for Cash and Investments policy. Previously, these entries were not made until the end of the fiscal year. In addition, Finance staff are closing each month by utilizing Munis’ Month End Manager. This involves reviewing all journal entries that have been made and resolving any open entries (for example, reviewing work to post investment entries and following up on unposted contract and purchase order entries).

For FY2020 close, staff have spoken with both Chavan & Associates and Munis representatives to schedule time to work through the process of closing the year. Chavan & Associates will assist the City with procedures around what journal entries are needed to adjust accruals and interfund transfers for the purposes of drafting the City’s financial statements. Once all entries and year-end adjustments have been made, Munis staff will come on site to assist with closing the year in the financial system.

While working with both Chavan and Munis, Finance Department staff will draft detailed procedures to ensure a smooth fiscal closing going forward.

**Cash Reconciliations (2019-003)**
As mentioned previously the Finance Department has implemented an administrative Accounting for Cash and Investments policy. This policy, as well as the Department Calendar, outline when all bank reconciliations should be completed. Staff reconcile the zero balance AP and Payroll checking accounts monthly, marking checks as cleared in the system to ensure proper outstanding check values.

In addition to bank account reconciliations, investment entries, such as recording interest earnings and market gain/loss, are being made monthly. Investment statement balances will soon be added to the quarterly budget update to keep Council apprised of changes in City assets.

**Long-term Debt (2019-004)**
Finance and Treasury have been working together since the close of fiscal year 2018-19 to ensure the City’s financial statements accurately reflect all outstanding debt, as well as principle and interest payments associated with City issued debt. Debt payments are authorized by the City Treasurer and entered by the Finance Department. Investment accounts associated with debt holdings are monitored by Finance staff and entered into the financial system monthly along with other investment account entries.

**Grant Tracking (2019-005)**
Finance is working with other City departments to ensure proper tracking and accounting for grant revenue and expenditures. While the process is currently manual, the City plans
on bringing Munis staff out in the fall or winter for training on the grants and project tracking modules. This will help centralize grant tracking and monitoring.

In addition, Finance is doing many things to ensure grants are not overlooked. Staff closely monitor Council agendas to ensure Finance is aware of new grants, and potential matching requirements, as soon as possible. Invoices are also monitored for any mention of grants, and then reviewed to ensure proper coding and use of funds.

**Disbursements (2019-006)**
During fiscal year 2018-19, Finance staff tightened review and increased questioning around certain purchases, including purchase card statements. Where backup and signatures were previously overlooked in certain cases, all purchases, no matter the value, now require backup. If receipts are missing, or don’t align with standard department purchases, Finance reaches out to the purchaser and Department Head review and sign off is required. In addition, purchase card audits are being conducted on a regular basis with the Finance Director questioning Department Heads on unusual purchases.

Regarding the purchases that were not paid within the standard 30 days, most of these purchases were related to Public Works projects. In most cases, Public Works was disputing work or charges covered by the invoices. This has been discussed with Public Works and notes will be added to invoices that are being paid later than anticipated going forward.

**Cash Receipt (2019-007)**
Cash handling procedures have been reviewed and were updated based on auditor feedback.

**Internal Service Funds and Related Liabilities (2019-008)**
Staff were unable to locate policies relating to the use and funding of the City’s two internal service funds. Reviewing fund history, the funds have not been used consistently for several years. As mentioned in the Discussion/Analysis portion of this report, after reviewing the City’s financial position, including outstanding liabilities and future obligations, and discussing the funds with the Auditor, staff will be recommending that these funds be closed and the balances be moved to the General Fund as part of an overall reserve fund and fiscal planning strategy.

**Attachments**