SUBJECT: ACCEPTANCE OF THE COMPREHENSIVE ANNUAL FINANCIAL REPORT, SINGLE AUDIT REPORT, AND ANNUAL AUDIT OF TRANSPORTATION DEVELOPMENT ACT FUNDS FOR 2018-19

RECOMMENDATION

Review and accept the Comprehensive Annual Financial Report for Fiscal Year 2018-19. (Attachment A)

DISCUSSION

The accompanying Comprehensive Annual Financial Report (CAFR) has been prepared as required by the City of San Luis Obispo’s (City) Charter and applicable State laws regarding financial reporting for municipalities. The CAFR provides an audited representation of the City’s financial condition across all funds for the fiscal year that ended June 30, 2019. The CAFR was published on the City’s website on March 10, 2020 and distributed to the City Council through the Council Agenda for the March 17, 2020, public meeting.

In accordance with the City Charter\(^1\), the City’s financial statements have been audited by independent certified public accountants from Badawi & Associates. The objective of the financial audit is to provide users of the financial reports with reasonable assurance from an independent source that the financial reports are reliable and represent a fair assessment of the City’s financial condition. The independent auditor concluded that the City’s financial statements present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City as of June 30, 2019, the respective changes in financial position, and, where applicable, cash flows therefore for the year then ended in accordance with accounting principles generally accepted in the

\(^1\) Section 810. Independent Audits.

The Council shall employ, at the beginning of each fiscal year, an independent certified public accountant who, at such time or times as may be specified by the Council, at least annually, shall examine the books, records, inventories, and reports of all officials, employees, departments, and agencies who receive, handle, or disburse public funds. As soon as practicable after the end of the fiscal year, a final audit and report shall be submitted by such accountant to the Council, one copy thereof to be distributed to each member, one each to the City Clerk, the City Treasurer, the City Manager, and City Attorney respectively, and three (3) additional copies to be placed on file in the office of the City Clerk where they shall be available for inspection by the general public for the period required by the laws of the State of California. Restricted and special assessment district funds shall be segregated in the audit report.
Historically, the City’s audited financial statements have been completed within 180 days of the end of the fiscal year and posted by December 31st. During FY2018-19, the City implemented a new Enterprise Resource Planning (ERP) system, which included accounting and financial reporting functions as well as the implementation of a Human Capital Management module including payroll. The implementation was complex and encountered substantial issues, which delayed staff’s ability to close the year and ensure all transactions were posted and reflected appropriately. The issues encountered during 2018-19 are not expected to recur and staff does not anticipate delayed financial statements in the future.

New Government Accounting Standard Board (GASB) Statements
Though the GASB issues new statements annually, there are two recent GASB statements that influence government financial statements. Pursuant to GASB Statement No. 68 (GASB 68 implemented in June 2015), Accounting and Financial Reporting for Pensions and GASB Statement No. 75 (GASB 75 implemented in June 2018), Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions (OPEB), the City reports on the unfunded pension and OPEB liabilities on the full accrual basis of accounting in the government-wide financial statements. Also included are note disclosures and supplementary schedules as required by GASB 68 and GASB 75. The measurement date for fiscal year 2018-19 pension and OPEB liabilities is as of the fiscal year ended June 30, 2018. This date reflects a one-year lag and was used so that the financial statements could be issued in an expedient manner. Activity (i.e. contributions made by the City) occurring during fiscal year 2018-19 are reported as deferred outflows of resources in accordance with GASB Statement No. 71.

For FY 2018-19, four new standards went into effect and the City’s audit was conducted in full compliance with those standards listed below:

GASB 83 Certain Asset Retirement Obligations
GASB 84 Fiduciary Activities
GASB 88 Certain Disclosures related to Debt incl. direct borrowings and direct placements
GASB 90 Majority Equity Interest

After discussions with the independent auditors, the financial statements for FY2018-19 include a prior period adjustment related to recognizing the pension and OPEB liabilities connected to the Whale Rock Fund. The key issue in determining whether these items are liabilities of the City or of the Whale Rock Commission centers around the contractual obligations of the Whale Rock Commission partners and the actuarially determined liability. Fundamentally, the Whale Rock reservoir is operated and maintained by employees of the City assigned to this function. These employees participate in the City’s CalPERS retirement program and are included in the actuarial valuation of the pension liability for all City employees. The Whale Rock Commission does not have its own contract with CalPERS, nor do the other two partners in the commission, California Polytechnic State University (Cal Poly) and the California Men’s Colony, directly pay into the City’s plan. As the Whale Rock Commission was formed in 1959 based on agreements between the partners, no other structure such as a JPA was formed that could hire the employees directly and be
a contributing CalPERS agency. The City has previously assigned pension costs and share of unfunded liability based on a reasonable allocation methodology; however, this methodology does not meet the requirements under GASB Statement Nos. 68 and 75 for recording these liabilities in the Whale Rock Fund. The financials were therefore restated, and the liability is now reflected in the City’s Water Fund. Staff intends on addressing this issue with the Commission and amend the agreement to reflect the liability for the two outside member agencies.

Financial Results Highlighted in the CAFR

Within the CAFR, the Transmittal Memorandum and Management’s Discussion and Analysis (MD&A) summarize the City’s fiscal performance and provide an analysis of the influencing factors. They also provide information on the City’s fiscal policies, practices and financial results. Key variances from projected ending balances for 2018-19 are highlighted in the Transmittal Memorandum. Both documents allow the reader to gain insight into the City’s audited financials and provide context to the following statements.

Financial results for fiscal year 2018-19 compare favorably with budget estimates in virtually all areas of the City’s operations. For the General Fund, financial results for the year exceed final estimates for revenues by $4 million or 5.6%. This is largely due to substantial increases in Development Review related fees as private development activity remained high through 2018-19. However, the City’s top three key revenue sources, Sales Tax including the City’s Half-Cent Sales Tax Measure, Property Tax, and Transient Occupancy Tax (TOT), all fared well in 2018-19 ending the fiscal year at above budgeted estimates. These revenue sources account for 50% of all funding sources in the General Fund and are closely monitored through the year.

Expenditures and other uses ended slightly above budget amounts by $343,000. The net result of the overall difference leads to the ending fund balance of $30.1 million. This compares to an ending balance of $29.6 million in 2017-18. As the chart below outlines, the majority of the ending balance is restricted or assigned and not available for spending in conformance with GASB 54.

<table>
<thead>
<tr>
<th>General Fund</th>
<th>2018-19 Final Budget</th>
<th>2018-19 Actual</th>
<th>Positive (Negative) Variance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenues</td>
<td>$71,332,510</td>
<td>$74,524,795</td>
<td>$3,192,285</td>
</tr>
<tr>
<td>Expenditures</td>
<td>74,031,470</td>
<td>72,462,957</td>
<td>1,568,513</td>
</tr>
<tr>
<td>Other sources (uses)</td>
<td>(2,319,511)</td>
<td>(1,542,736)</td>
<td>776,775</td>
</tr>
<tr>
<td>Beginning fund balance</td>
<td>29,576,440</td>
<td>29,576,440</td>
<td>-</td>
</tr>
<tr>
<td>Ending fund balance</td>
<td>$24,557,969</td>
<td>$30,095,542</td>
<td>$5,537,573</td>
</tr>
<tr>
<td>Ending fund balance Nonspendable</td>
<td>-</td>
<td>51,636</td>
<td>51,636</td>
</tr>
<tr>
<td>Restricted</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Committed</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Assigned</td>
<td>23,858,332</td>
<td>23,858,332</td>
<td>-</td>
</tr>
<tr>
<td>Unassigned</td>
<td>6,185,574</td>
<td>6,185,574</td>
<td>-</td>
</tr>
<tr>
<td>Total ending fund balance</td>
<td>$24,557,969</td>
<td>$30,095,542</td>
<td>$5,537,573</td>
</tr>
</tbody>
</table>
Included in the assigned fund balance are committed expenditures (encumbrances), balances related to the City’s Local Revenue Measures, as well as the required 20% operating reserve, the Revenue Stabilization reserve, and $1.4 million for the Section 115 Pension Trust Fund.

Previous Council action prioritized any unassigned fund balance above reserve levels to be used to pay down the City’s unfunded pension liability. This agenda item is followed by a report that outlines the recommended payment as well as the use of remaining funds to one-time expenditures in Fiscal Year 2019-20 and 2020-21.

Enterprise Funds
The City maintains four Enterprise Funds for its Water and Sewer utility, and the Parking and Transit enterprises. Enterprise Funds are business-type activities within government accounting and are reported on separately.

The primary sources of revenue for the Water, Sewer, and Parking Funds are fees for sales and services. All funds saw an increase in revenue in 2018-19 which was largely due to substantial increases in impact fees due to high development activities, as well as interest on investment revenues. The Transit fund increased its income from ridership by 13%, continuing a positive upward trend in bus use.

The Transit Fund receives revenue from fare collection but is mainly funded through federal and state grants to offset its operating cost for the City’s transit system. Therefore, the City’s single audit is mainly reporting on Transit as the largest source of Federal grant funding.

All four funds ended the fiscal year 2018-19 positively with all of them experiencing an increase in net position at year end. (CAFR page 33).

CAFR Organization
In accordance with generally accepted accounting principles for state and local governments, the City’s CAFR is organized into three major sections: Introduction, Financial Reports and Statistical Tables. The following is a brief summary of the contents of each of these sections.

Introduction. The Transmittal Memorandum and other information of general interest are presented in this section, including directory of officials, advisory bodies, and organization chart.

Financial Reports. This section includes the City’s primary financial statements in five major parts:
1. Auditors’ opinion regarding the financial statements.
2. Management’s Discussion and Analysis (MD&A) providing a narrative overview of City-wide finances.
3. The basic financial statements presenting the government-wide results combining the activities of the major funds (General, Capital Outlay and all Enterprise Funds) into governmental and business-type categories; the fund financial statements; and the notes to the financial statements.
4. Required supplementary information presenting the General Fund actual results with both the original and final adjusted budgets.
5. Other supplemental schedules and financial statements providing financial information for each of the City’s non-major governmental and agency funds. This includes a financial schedule presenting Half Percent Sales Tax Measure revenues and uses in 2018-19.
**Statistical Tables.** This section provides demographic and financial tables showing current and historical trend information for the City and is organized into six major parts:

1. **Statistical overview.** General information about the San Luis Obispo community.
2. **General financial trends.** Ten-year summary information on net assets, governmental revenues and expenditures and fund balances.
3. **Revenue capacity.** Ten-year summary information on property and sales tax trends.
4. **Debt capacity.** Ten-year summary information on debt service requirements.
5. **Economic and demographic trends.** Ten-year summaries of taxable sales, building permits and valuations, housing, population and other demographic trends.
6. **Operating information.** Ten-year trend information on operating indicators by function.

**Recognition for Excellence in Financial Reporting**
Beginning in fiscal year 1983-84, all of the City’s CAFRs have been awarded the certificate of achievement for excellence in financial reporting from the Government Finance Officers Association of the United States and Canada (GFOA). This is a prestigious national award recognizing the City’s use of the highest standards in preparing its annual financial report. The City received the award for its 2017-18 CAFR and has submitted the award application for the 2018-19 CAFR.

**Additional Reporting**
The Federal Single Audit Act requires agencies expending $500,000 or more of Federal assistance funding to undergo organization-wide audits of their internal controls. Accordingly, the Single Audit Report provides a Report on Internal Control Over Financial Reporting and on Compliance and Other Matters. In the findings section of this report, the auditors notes possible deficiencies or suggests improvements. In response to the finding, staff will respond with improvements and changes to address the findings.

The Transportation Development Act annual audit is also by the same independent certified public accounting firm and provides information on the City’s compliance with statutes, rules, and regulations of the Transportation Development Act (TDA), the California Code of Regulations, and instructions and resolutions of the San Luis Obispo Council of Government for the period ending on June 30, 2019.

Both report and accompanying findings will be submitted to the City Council via Council Correspondence prior to the Council meeting. The independent auditor will also present the findings during the public meeting on March 17, 2020.

**Policy Context**
The City’s Charter under Section 810 requires the employment of an independent certified public account to examine the City’s financials.

**Public Engagement**
The City’s annual audit and issuance of the comprehensive annual financial report fulfills a legal requirement and does not have a public engagement component. It will be presented to the City Council in open session on March 17, 2020, and the public can comment prior to or during the
meeting. The report will be made available on the City’s website and in the Council Reading File as part of this report.

ENVIRONMENTAL REVIEW

The California Environmental Quality Act does not apply to the recommended action in this report, because the action does not constitute a “Project” under CEQA Guidelines Sec. 15378.

FISCAL IMPACT

Budgeted: Yes
Funding Identified: Yes

Fiscal Analysis:

<table>
<thead>
<tr>
<th>Funding Sources</th>
<th>Total Budget Available</th>
<th>Current Funding Request</th>
<th>Remaining Balance</th>
<th>Annual Ongoing Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Fund</td>
<td>$75,000</td>
<td>$59,890</td>
<td>$15,110</td>
<td></td>
</tr>
<tr>
<td>State</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Federal</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fees</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The City budgets the cost for the auditing firm annually. The cost is appropriated with the annual budget approval. The current fiscal year contains the budget for the previous fiscal year audit. $75,000 were approved to cover the cost. With the change in auditors, the actual cost was reduced to $59,890 for this fiscal year.

ALTERNATIVES

The City Council could decide to revise or not accept the Comprehensive Annual Financial Report, Single Audit Report, and annual audit of the Transportation Development Act Funds for fiscal year 2018-19. This is not recommended as the reports have been prepared in conformance with a variety of accounting and other reporting requirements and represent the professional evaluation and analysis by the City’s independent auditors. They have rendered clean opinion which means that they are presented fairly and in conformity with generally accepted accounting principles.

Attachments:

a - Council Reading File - City of San Luis Obispo CAFR 2019 - 20200310-1125-Draft