

To: James L. App, City Manager
From: Mike Compton, Director of Administrative Services
Subject: Comprehensive Annual Financial Report
DATE: February 17, 2004

Need:

Present the Comprehensive Annual Financial Report for the fiscal year ending June 30, 2003 for City Council consideration.

Facts:

1. A Comprehensive Annual Financial Report (CAFR) is prepared to provide detailed information regarding the financial results of City operations.
2. The CAFR is prepared in accordance with generally accepted accounting procedures, including compliance with pronouncements issued by the Governmental Accounting Standards Board (GASB)
3. The CAFR and all supporting accounting and financial records are audited by the outside certified public accounting firm, Moss, Levy & Hartzheim in accordance with generally accepted auditing standards and the *Government Auditing Standards* as issued by the Comptroller General of the United States.
4. The opinion letter issued by Moss, Levy & Hartzheim is unqualified (clean) and indicates that the financial statements and other information reported in the CAFR fairly represent, in all material respects, the financial position of the City as of June 30, 2003.
5. Moss, Levy & Hartzheim has also issued a management letter citing two recommended improvements to the City's financial operations (copy attached):
 - All time sheets should be signed by a supervisor confirming time worked and leave taken.
 - Expenditures should not be "netted" against revenues.

Analysis and
Conclusions:

The City auditor recommended that a supervisor review and sign approval of all employee time sheets. This is a standard operating procedure that has been re-

communicated to City personnel and department heads. The auditor also recommended discontinuing the practice of netting expenditures against revenues. This recommendation will be implemented beginning with fiscal year 2005 budget.

The CAFR includes the newly modified government-wide financial statements, i.e. the management discussion and analysis (MD&A), statement of net assets and the statement of activities, all of which represent an entirely new financial reporting format.

Additional changes include major revisions to the governmental fund statements. In prior years, there was a separate statement for the General Fund, a separate statement for each individual special revenue, capital project and debt service fund. The current reporting format eliminates separate statements except for “major” governmental funds. The General Fund is always a “major” fund. Otherwise, major funds are limited to funds whose revenues, expenditures, assets, or liabilities (excluding extraordinary items) are at least ten percent (10%) of the totals for all governmental funds.

Statement of Net Assets

The statement of net assets is rather straightforward as it simply sub-totals all assets separately from liabilities and then subtracts one from the other to determine the total net assets. It categorizes all funds, except fiduciary (trust funds), as either governmental activity funds or business activity funds. All governmental funds are included in the “government activities” column and all enterprise/proprietary funds are included in the “business activities” column.

- Governmental Activity Funds – *Without identifying each and every line item*, the major components of the asset section include cash resources, the City’s investment in capital/fixed assets (land, buildings & improvements, equipment, construction in progress, infrastructure and respective accumulated depreciation) including accumulated depreciation. These major components included over \$40 million in cash and investments and \$113 million in net capital assets. These assets and others were offset by \$55.8 million in total liabilities; mainly \$53.5 million in long-term debt. Debt was previously reported separately in a separate category called “General Long-term Debt”. City’s total net assets (assets minus liabilities) for governmental activities totaled nearly \$101 million. These net assets are then categorized as to how much is invested in capital assets net of related debt, unrestricted or restricted.
- Business Activity Funds - Included herein are the City’s airport, sewer, transit and water enterprise funds. As with the governmental activity funds noted above, it simply lists all asset categories, all liability categories and deducts one from the other to arrive at “net assets”. Net assets are then categorized

as to how much is invested in capital assets net of related debt or is either unrestricted or restricted.

Statement of Activities

The statement of activities presents expenses and revenues by function. A key goal of the statement of activities is to highlight the *net* (expenses)/revenue of each functional activity. Accordingly, program revenues are subtracted from functional expenses to arrive at the “net cost” for each functional activity. This format is designed to emphasize that in the public sector, revenues are generated for the express purpose of providing services rather than as an end in themselves.

However, certain revenues are not “program” or functionally specific. These “general” revenues are presented separately but on the same schedule. The purpose of including the general revenues is to present the source of revenues to cover any revenue shortfalls for the functional activities.

As with the statement of net assets, the statement of activities is also divided into separate components for governmental activities and business activities.

- Governmental Activity Funds – In the case of governmental activity funds, there is no distinction made between fund-type. However, governmental fund expenditures and revenues are categorized by function as follow:

- General Government
- Public Safety
- Public Works
- Library and Recreation Services
- Community Development
- Interest on long-term debt

It includes expenditures for all purposes not just operating expenditures. As previously noted, the goal of the statement is to highlight the net result (expenditures/revenues) of each functional activity. Since non-functional revenues; i.e. property taxes, sales taxes and motor vehicle license fees, etc. are not included, it is not surprising that all functional categories except Community Development had a net deficit.

Business Activity Funds – In the case of business activity funds, since they are by definition “functional”, the activities listed will be the same as enterprise funds. However, a major distinction in presentation here, as opposed to operating statements (profit/loss statements), is that this statement include expenses for all purposes and revenues from all sources without regard to whether they are operating or not. Thus, this presentation may confuse the reader into believing that the enterprise funds are rather healthy. For example; for water operations the statement indicates a positive “net activity” (total resources exceeded total expenses) of \$2,259,281. However, this amount includes \$2,728,108 in

developer contributed (donated) fixed assets and impact fees. While not exact, the difference between the two amounts approximates the operating deficit of water operations.

Governmental Fund Financial Statements

Under the new reporting reformat, governmental funds are separated and reported as “major” or “non-major”. There is no distinction as to fund type; i.e. special revenue, capital project or debt service (refer to page 27). The General Fund is always a “major” fund. Otherwise, major funds are limited to funds whose revenues, expenditures, assets, or liabilities (excluding extraordinary items) are at least ten percent (10%) of the totals for all governmental funds. The City only had four (4) other major funds; Measure D Capital Projects Fund, Measure D GO Bond Fund, Bridge Development Impact Fee Fund and Redevelopment Agency Debt Service Fund. All other governmental funds (non-major) are consolidated and reported in the single column labeled “Other Governmental Funds”. However, details concerning each non- major governmental fund are provided in the Supplemental Information section starting on page 72.

- General Fund – From an operational perspective, the General Fund experienced an increase in fund balance (reserves) by \$859,685. However, due to a year-end adjustment to reallocate certain restricted fund balances to other individual funds, the CAFR will actually indicate a reduction in fund balance at 6/30/03. The year-end adjustment reverses an adjustment in fiscal year 2002 that consolidated certain funds into the General Fund (reallocation of certain restricted fund balances). General Fund balance at year-end was \$7,448,276.

By way of explanation for the restricted fund balances, certain funds were established from resources transferred from the General Fund. For reporting purposes only, in fiscal year 2002, certain funds were reported (consolidated) with the General Fund and shown as “restricted fund balance”. Upon further reflection, it was determined that this was not the best manner to report these funds. In order to report them separately, financial reporting required a fund balance transfer “out” of the General Fund in order to neutralize the prior year’s fund balance transfer “in”.

Proprietary Fund Financial Statements

- Water Operations - Net assets rose from \$25,402,516 to \$28,002,415. *Without identifying each and every line item*, the main contributors to the increase in net assets was the increase in capital assets, developer contributed capital, interest earnings, and impact fees. Developer contributed fixed assets and impact fees contributed \$2,728,108.

Water operations experienced an operating loss of \$(475,091). Last year the operating loss was \$(356,403). The Council adopted increased user fees

effective 3/1/02. However, operating cost increases have exceeded the user fee increase adopted by the Council.

The term “operating loss or profit” as used below refers to the result whereas operating revenues exceed or don’t exceed operating expenses. Operating revenues exclude such items as interest income, taxes, grant proceeds, proceeds from debt issuance, impact fees, developer contributed fixed assets and sale of surplus property. Operating expenses exclude interest expense, contributions to other agencies, bond issuance costs, and the acquisition of fixed assets.

The Water Operations Fund has no outstanding debt.

With regard to cash resources, the balance at 6/30/03 was \$13,902,037 as compared to last year’s balance of \$11,986,912.

Note that cash resources include development impact fee revenues that have been collected for projects currently underway and projects identified in the CIP budget that have not yet started. While the City expects to collect \$5.4 million dollars in impact fees over the next three years, the CIP budget contains over \$20 million in projects over the same time frame.

- **Sewer Operations** - Sewer Operations experienced a significant increase in net assets; increasing from \$19,077,362 to \$22,224,167. As with Water Operations and *without identifying each and every line item*, the increase is mainly attributable to interest income, development impact fees, and the inclusion of developer contributed fixed assets as revenues. The developer contributed (donated) fixed assets and impact fees totaled \$3,235,937. The impact fees increase total reported cash and developer contributed fixed assets increase total fixed assets. Thus, they have a significant impact on changes in net assets.

Cash resources at 6/30/03 totaled \$8,538,505, up from last year’s total of \$7,764,965. The increase is due primarily from sewer connection fee revenues generated from development activity.

Note that cash resources include development impact fee revenues that have been collected for projects currently underway and projects identified in the CIP budget that have not yet started. While the City expects to collect \$6.5 million dollars in impact fees over the next three years, the CIP budget contains nearly \$19 million in projects over the same time frame.

The Council adopted increased user fees effective 3/1/02 and provide for cost of living increases every January 1st through 2005. For the first time since fiscal year 1994, the Sewer Operations Fund has experienced an operating gain of \$41,121.

- Airport Operations - Similarly as with Water and Sewer, net assets in this fund increased due to the inclusion of capital contributions (federal grants) for the purchase of fixed assets that also contribute to the increase in net assets. Net assets were \$13,955,538 this year versus \$11,629,076 last year.

Although cash resources increased significantly from \$239,967 to \$548,757 this year, the Airport Operations Fund finished with an operating loss of \$(232,092). Depreciation and receipt of federal grant funds accounted for most of the increase in cash resources.

- Transit Operations - Transit operations saw an increase in net assets from \$442,808 last year to \$524,735 this year. The Fund's cash balance ended the year at \$94,763 as compared to \$84,695 last year.

Fiscal
Impact:

None.

Options:

- a. That the City Council receive and file the Comprehensive Annual Financial Report for the fiscal year ending June 30, 2003 or
- b. Amend, modify or reject any of the options above.

COMPREHENSIVE ANNUAL FINANCIAL REPORT

A Copy is available in the library for public review.

Additional copies are available in the City Clerk's Office and Administrative Services