



STAFF REPORT TO THE CITY COUNCIL

DATE: Regular Meeting of January 12, 2021

TO: Members of the City Council

SUBMITTED BY: David Biggs, City Manager
Edwin Gato, Director of Finance

SUBJECT: FY 2019-20 Comprehensive Annual Financial Report

RECOMMENDED ACTION

Receive the Fiscal Year (FY) 2019-20 Comprehensive Annual Financial Report (CAFR) and Accept the Audited Financial Statements.

COMMISSION/SUBCOMMITTEE ACTION AND RECOMMENDATION

This report will be presented to the Finance Commission regular meeting on January 20, 2021.

FISCAL IMPACT OF RECOMMENDATION

There is no financial impact associated with accepting this report. The audited results of the FY 2019-20 fiscal year are utilized as a starting point in the development of the FY 2021-22 budget, especially in regard to the one-time funding.

BACKGROUND

The CAFR communicates the City's financial condition and activity in a transparent and organized manner and in compliance with accounting and financial reporting standards established by the Governmental Accounting Standards Board (GASB). The report presents historical and comparative information that can be useful to City staff, elected officials, and external users such as debt rating agencies, businesses, other public agencies, and the City's residents. The most recent CAFR and prior years reports are available at the City's libraries, the City's Finance Department, and on the City's Finance website at: <https://www.ci.hercules.ca.us/government/finance/comprehensive-annual-financial-reports>

The City of Hercules prepares audited financial statements for each fiscal year as required by various financing covenants and rules associated with restricted funding. To ensure compliance with these requirements and bond indentures, the City contracts with an independent audit firm. The City's external audit firm, The Pun Group, completed the independent audit and issued the audit report for the fiscal year ended June 30, 2020. The City selects its independent auditor through a competitive procurement process that includes member of the Finance Committee as proposal reviewers. The City's current independent auditor is in its first year auditing the City.

The quality of the City's financial reporting and the CAFR are measured in two ways: (1) an unmodified audit report by the independent auditors; and (2) the Certificate of Achievement for Excellence in Financial Reporting, awarded by GFOA. The attainment of the latter is the highest form of recognition in governmental accounting and financial reporting.

Auditors follow audit industry standards established by the American Institute of Certified Public Accountants (AICPA). These standards require auditors to provide an opinion on specific areas of the City's financial statements based on observations, inquiries, testing of transactions, and analysis.

The City's CAFR includes the following major sections and information:

Introductory Section

- Letter of Transmittal – prepared by management and used to communicate information on areas that may have an impact on the City's finances now and in the future. This includes economic factors as well as budget and management factors.

Financial Section (the main body of the CAFR for current year information)

- Independent Auditors' Report – the City's report card on the content of the CAFR.
- Management's Discussion and Analysis (MD&A) – provides an analytical overview of the City's financial status and results for the year.
- Basic Financial Statements – reports finances at a point in time (assets - liabilities) and throughout the year (revenues - expenditures), and cash flows.
 - City-Wide Statements – overview of financial information including all of the City's operations by financial activity.
 - Fund Financial Statements – a detailed look at funds, reporting the Balance Sheet and Statement of Revenues, Expenditures and Changes in Fund Balance.
 - Notes to the Financial Statements (Notes) – a narrative explanation that accompanies the Basic Financial Statements.

Required Supplementary and Supplementary Information Sections

- Budget to Actual Comparisons – for all governmental funds with a legally adopted budget.
- Notes to Required Supplementary Information.
- Pension Information – schedule of changes in the net pension liability and related ratios; schedule of contributions by plan.
- OPEB Information – schedule of changes in the net Other Post-Employment Benefits (OPEB) liability and related ratios; schedule of contributions.
- A breakout of individual non-major funds – for funds that were presented in a cumulative manner in the Financial Section

Statistical Section (current and historical information – up to 10 years)

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

DISCUSSION

This fiscal year ended June 30, 2020, the City converted its financial statement from Basic financial statement report to CAFR. The Basic financial statement typically presents only the basic financial report about the government. A CAFR, in contrast, presents a wider variety of important information intended to help the reader properly understand the basic statements, as illustrated above. The basic financial statements only show the financial section that consists of the MD&A, the basic financial statements, and the independent auditor's report, without the individual non-governmental fund financial statements and schedules.

The City's external independent audit firm, The Pun Group, completed its audit of the annual Financial Statements and has issued an unmodified (or "clean") audit opinion validating the fair presentation of the City's financial position as of June 30, 2020. The City's CAFR shows that the City continued to hold a sound financial position.

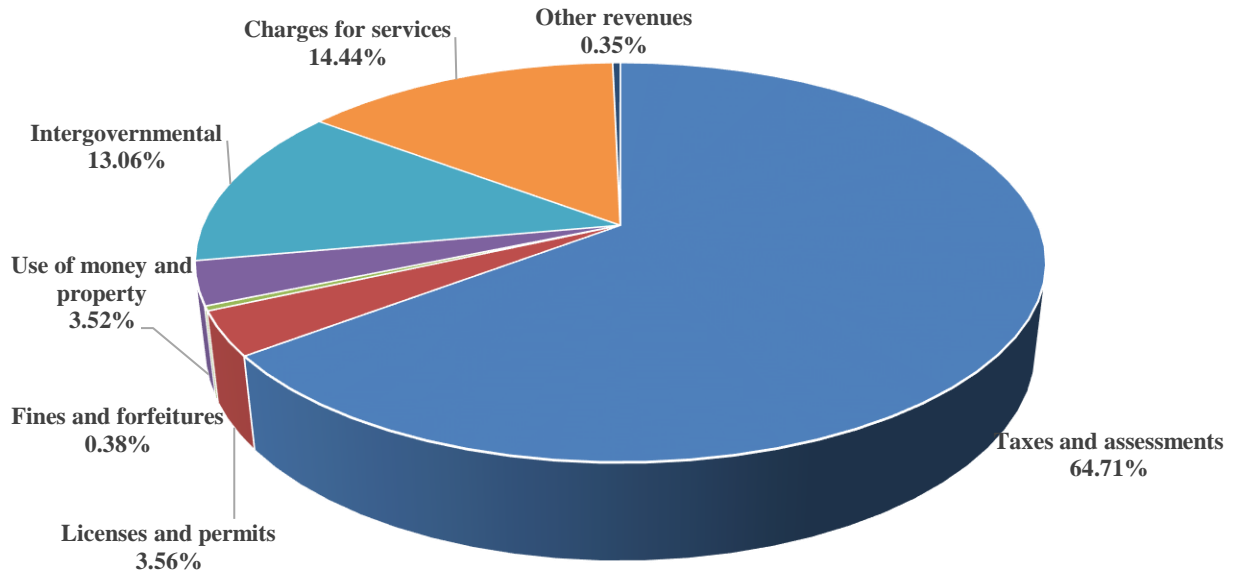
GENERAL FUND

The General fund is the chief unrestricted operating fund of the City. The General Fund reflects the City's sound management practices and prudent financial decisions as steady growth and improved financial results are evident in the audit report for FY 2019-20. On June 30, 2020, the City's General Fund had a fund balance of over \$44 million, of which \$8.4 million is unassigned, and \$1.8 million is available for expenditures. There were no changes on the amounts reported compared to the preliminary FY 19-20, as discussed at the regular meeting last November 10, 2020. Moreover, the amounts presented in the preliminary FY 19-20 were on a budgetary basis of accounting.

The basis of accounting used for financial reporting purposes in accordance with Generally Accepted Accounting Principles (GAAP) is not necessarily the same basis used in preparing the budget document. For example, governmental funds are required to use the modified accrual basis of accounting in GAAP financial statements. In contrast, the cash basis of accounting or the "cash plus encumbrances" basis of accounting may be used in those same funds for budgetary purposes. Disparities between GAAP and the budgetary basis of accounting often occur because regulations governing budgeting (e.g., laws or ordinances of the state, county, City, or other jurisdiction) differ from GAAP. Thus, the City adopts its budgets each fiscal year on a cash plus encumbrances basis of accounting, which results in some items which are budgeted as expenditures, like, for example, transfers to reserves, being reflected in the audit as balance sheet adjustments/designation of fund balance. See attachment 7 for the reconciliation of differences between budgetary basis (cash plus encumbrances) and the GAAP basis of accounting.

Revenue Analysis

FY 19-20 Audited General Fund Revenues



The majority of General Fund revenues comes from the following categories, about 70% of total revenues:

- Utility Users Tax
- Sales Tax
- Property Taxes
- Intergovernmental: Vehicle License Fee (VLF)

The Utility User's Tax (UUT) is imposed by the City on the consumption of utility services, including (but not limited to) electricity, gas, water, sewer, telephone, and cable television. The City determines the rate of the tax and the use of its revenues. As of June 30, 2020, the City has collected about \$3.5 million, or 3% better than what was projected in the forecast (See attachment 8). This tax fluctuates with consumer consumption and is assessed based on a percentage of gross receipts. The following are the history of revenues collected from UUT:

	FY 15-16	FY 16-17	FY 17-18	FY 18-19	FY 19-20
Gas	301,190	411,681	515,824	399,849	393,007
Electricity	1,158,823	1,223,928	1,251,069	1,207,098	1,249,697
Telephone	1,069,750	959,670	883,172	737,161	600,549
Water	435,569	480,197	571,586	615,518	691,261
Cable	550,233	500,577	562,081	542,638	549,329
	<u>3,515,565</u>	<u>3,576,053</u>	<u>3,783,732</u>	<u>3,502,264</u>	<u>3,483,843</u>

Sales Taxes, the largest revenue source for the City's General Fund, is remitted to the City from the State on an on-going basis. This tax is also exceeded the revenue projections by \$500K (See attachment 8). Total Sales Tax revenue is highly concentrated within a few major operators. A few top producers generate over 30% of the City's sales tax. The following depicts the summary history of the City's sales tax revenues by the type of sales and use tax:

	FY 15-16	FY 16-17	FY 17-18	FY 18-19	FY 19-20
1% Bradley Burns	2,021,233	2,234,898	1,933,140	2,602,420	2,726,712
Prop 172	155,271	125,912	145,876	150,480	149,045
Measure B	1,034,605	963,996	1,127,079	1,235,801	1,336,528
	<u>3,211,109</u>	<u>3,324,806</u>	<u>3,206,096</u>	<u>3,988,701</u>	<u>4,212,285</u>

Property Tax and related taxes collected through June 30, 2020, which are the current year secured and unsecured, were slightly higher by 1% compared to the budget.

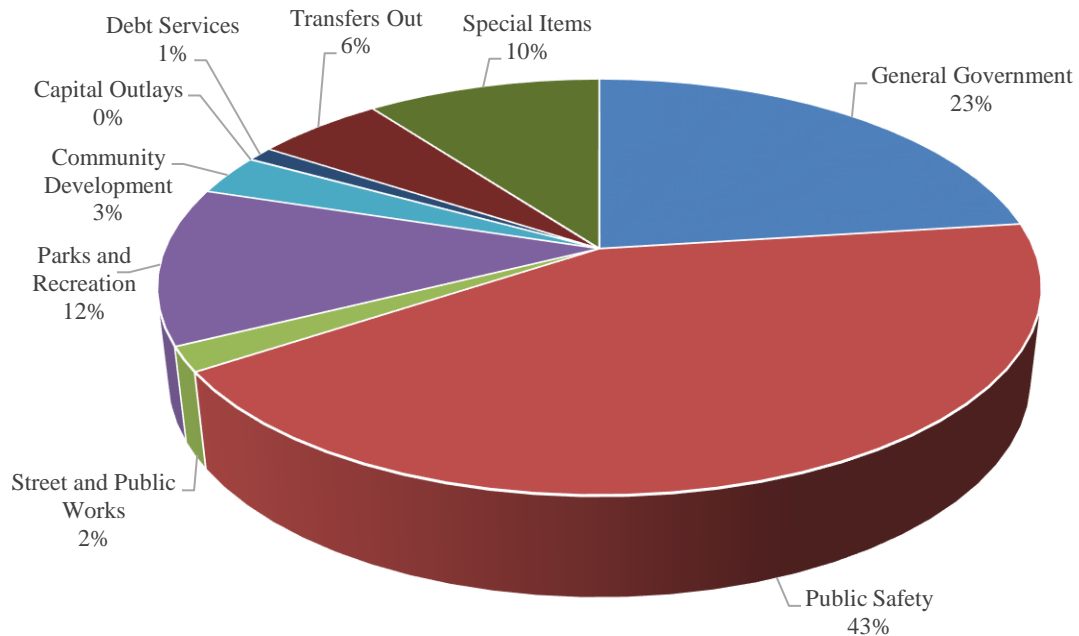
Also, the County anticipates the final deferred subordinated pass-thru payment of will be made in the next RPTTF distribution on January 2, 2021. The estimated City share of pass thru and residual RPTTF is approximately \$150K. This will be treated as one-time use of funding in future budget recommendations, as those payments will diminish as a fixed amount is of subordinated pass-throughs is fully repaid.

Due to COVID-19 closure, the Parks & Recreation program was closed for the last 3.5 months of the fiscal year or the last quarter. As a result, the staff revised the revenue projection downward during the adoption of the FY 20-21 Budget. The actual program receipts were 3% higher than the revised forecast, which was more than \$700,000 lower than what was included in the original budget.

Overall, the General Fund year-end revenues totals came in \$1 million, or 6% higher than the FY 19-20 revised budget figure.

Expenditure Analysis

FY 19-20 Audited General Fund Expenditures



This section discusses the General Fund expenditures. It includes encumbrances, which are obligations in the form of purchase orders or contracts chargeable to the budget for which a part of the budget is reserved. The FY 19-20 budget, as revised, was \$18.9 million. Operating expenses in total are all tracking 2% below the revised budget figure. The total operating costs were \$374K, better than projections (See attachment 8).

The Parks & Recreation revised projections show \$2.2 million of expenditures. The revised year-end estimates presented to the Council during the adoption of the FY 20-21 budget included the adjustments related to the impact of COVID-19. The actual expenditures were lower by 2% compared to the estimate.

Net Annual Results

The General Fund operation resulted in higher revenues than anticipated, and expenditures came below the revised appropriation. Because the General Fund ended with positive results better than the projected FY 2020-21 Budget, there was no withdrawal needed to use reserves to bridge the gap as previously anticipated from the fund, and the City ended the FY 2019-20 with three months of expenditures or 25% as opposed to the 17% as projected.

Staff will revisit the FY 2020-21 Budget at mid-year and report to Council with recommendations to adjust the budget. As previously discussed in November when the preliminary results were presented, the budget adjustments will include the return of unused

money drawn from the reserve and other factors that will enhance the City's financial standings in FY 20-21. This includes subsequent events such as the allocation from CARES Act funding of \$315,000 and cash flow savings of \$458,000 from the library bonds' refinancing.

OTHER GOVERNMENTAL FUNDS

Fund balances in the City's other restricted governmental funds (including Debt Service, Gas Tax, Measure C Street Fund, City Capital Projects, and other governmental funds) totaled approximately \$20 million as of June 30, 2020. These funds are governed by many covenants and restrictions and may only be used on specific purpose.

INTERNAL SERVICE FUNDS

The available net position in the City's Internal Service Funds totaled approximately \$2.8 million as of June 30, 2020. This was higher by \$842K compared to the ending balance in the prior fiscal year due to an accumulation of reserves to meet future fleet, equipment, and information technology replacements, and facility maintenance needs.

SEWER ENTERPRISE FUND

The net position in the City's Sewer Fund totaled approximately \$42.5 million as of June 30, 2020, which was \$1.6 million greater than the ending balance in the prior fiscal year. Of the \$42.5 million in net position, \$11.5 million is invested in capital assets, \$7.6 million is restricted for debt service, and \$23.2 million is unrestricted for sewer system replacement.

FILINGS WITH THE STATE CONTROLLER'S OFFICE AND ISSUANCE OF SUPPLEMENTAL REPORTS

In addition, the City prepares the City Financial Transactions and Annual Street Reports to be submitted to the California State Controller's Office by February 1, 2021, and December 1, 2020, respectively. Also, the City is required to issue the following supplemental reports: the FY 19-20 Public Financing Authority Financial Report, Wastewater Financial Report, and Agreed Upon Procedures (AUP) for Measure B and C, and GANN Appropriation Limit Calculation by December 31, 2020. These reports were issued before the due dates.

ATTACHMENTS:

FY 19-20 Comprehensive Annual Financial Report (CAFR):

<https://www.ci.hercules.ca.us/government/finance/comprehensive-annual-financial-reports>

1. FY 19-20 SAS Letter or Required Communication Letter in an Audit
2. FY 19-20 Hercules Public Financing Authority (PFA) Financial Statements
3. FY 19-20 Hercules Wastewater Fund Financial Statements
4. FY 19-20 Agreed Upon Procedures (AUP) Report on Measure B
5. FY 19-20 Agreed Upon Procedures (AUP) Report on Measure C
6. FY 19-20 Agreed Upon Procedures (AUP) Report on GANN Appropriation Limit Calculation
7. FY 19-20 General Fund – Reconciliation Between Budgetary and GAAP Basis of Accounting
8. FY 19-20 General Fund – Audited Year-End Results (Budgetary Basis)

Financial Impact

Description:

Funding Source:

Budget Recap:

Total Estimated cost:	\$	New Revenue:	\$
Amount Budgeted:	\$	Lost Revenue:	\$
New funding required:	\$	New Personnel:	\$
Council Policy Change:	Yes <input type="checkbox"/> No <input type="checkbox"/>		