

December 8, 2017

Staff Discovers Error in Fiscal Year 2017/18 Projected Fund Balance for the Sewer Fund

Public confidence and trust in its government is fundamental for a thriving democracy. For the City, and for me as the City Manager, it is key that we earn and maintain the public's faith in our management of tax dollars and City finances. We must demonstrate that we are acting in good stead with the community's resources and spending tax payer money wisely. In addition, the community should expect that we will provide them with accurate and timely data so they can review our work.

With that in mind, our community and City Council have asked for timely reporting on City finances, in particular, around the WRF project. The reporting is intended to keep the community and City Council informed on how those funds are being spent.

City Council requested at its November 14, 2017 meeting that staff be prepared to provide them and the public with an update on the WRF finances in December. There had been a pause on reporting for a portion of 2017 as the City transitioned to a new City Manager and Finance Director, understanding that it would take some time to get up to speed on the financial system.

City staff responded by reviewing financial reporting related to the sewer fund and the proposed WRF project. Through a comprehensive review of the related financial documents and the City's financial system, staff noted the following:

- Reports provided to Council and the public in July 2017 regarding cash balance for the sewer fund were overstated. In July 2017, the reported balance of the projected FY 2016/17 year-end cash balance was estimated to be \$8.3 million, a cumulative overstated amount of \$2.68 million. This amount is balanced against other reporting errors and a double counting of large capital expense, equating to an \$800,000 overestimation of available funds for the sewer fund.

How did this happen?

- The overstatement is traced to the Fiscal Year (FY) 2017/18 adopted budget. In that budget document, the overstatement originated in reported balances for FY 2015/16, and that overstatement carried forward into FY 2016/17 projections and the FY 2017/18 budgeted balances.
- The overstatement of funds resulted from human error, as cash balances were derived from the City's budget document, which is independent of the City's finance software system. Typically, cash balances would be derived from the finance system and not from a projected budget amount, in order to provide a more precise picture of the available funds. It was an unfortunate, but unintentional reporting error in the budget.

It is important to note that all actual sewer and WRF project funds are accounted for and all expenditures incurred during the years in question were related to the sewer fund. The most recent independent financial audit completed confirms the balances in our financial system are accurate and the independent auditor rendered a “clean” opinion on the City of Morro Bay’s financial statements for the year end for FY 2016/17.

A detailed report on this issue is attached and will be reviewed and discussed by City Council at their December 12, 2017 meeting.

As noted above, the City is committed to transparency and sound financial management of community tax dollars. City staff is verifying all other City funds at this time, to ensure there are no other over or understatements of available funds in the FY 2017/18 budget. Staff will review the budget process and other financial procedures and policies to ensure you can have faith in your City’s financial practices.

In addition, the community’s request for monthly financial reporting will be discussed by City Council in January. Beginning in January staff will be prepared to provide both monthly cash balance and expenditure reports, via the City’s website, for Council and Community review. Accessibility of these reports, coupled with improvements to the City’s internal controls and review process will serve to avoid future reporting errors in the budget and other reports.

Scott Collins,
City Manager

ATTACHMENT:

Report to City Council, for the December 12, 2017 meeting



AGENDA NO: C-2 ADDENDUM
MEETING DATE: December 12, 2017

ADDENDUM

TO: Honorable Mayor and City Council **DATE:** December 8, 2017
FROM: Rob Livick, Public Works Director
Jennifer Callaway, Finance Director
SUBJECT: Receive Water Reclamation Facility Fiscal Year 2016-17 4th Quarter Program Budget Update and Provide Comments and Direction as Deemed Appropriate

BACKGROUND

Prior to the WRFCAC meeting on December 5, 2017 a series of 6 questions were received related to the committee report. Staff verbally responded to those questions during the discussion of this item. Attachment 1 is a listing of the questions and summary of staff's response.

In addition, at the City Council meeting on November 14, 2017, the Morro Bay City Council directed staff to review the 4th quarter program expenditures and budget for the Water Reclamation Facility (WRF) project and report back to Council at the December 12, 2017 Council meeting. The direction was to provide the updated quarterly financials in the traditional format to Council, and the WRFCAC if time permitted.

Staff completed the review of the 4th quarter WRF expenditures and budget and provided a program budget update to the WRFCAC at the regularly scheduled meeting on Tuesday, December 5, 2017. During the presentation, staff indicated that the 4th quarter expenditures and budget were being provided, however cash balances for the Sewer Fund were not provided as City staff was in the process of verifying those balances and had outstanding questions to discuss with prior City staff. The updated cash balance for the Sewer Fund would be provided for the Council discussion on Tuesday, December 12, 2017.

FISCAL IMPACT

The reported cash balances in the City's adopted budget, beginning in FY 2015/16, were overstated, resulting in a cumulative difference through FY 2017/18 of \$813,471 less than originally projected. However, it is important to clarify that no actual funds are unaccounted for, rather they were reported inaccurately through the budget documents and previous WRF financial reports.

DISCUSSION

In July 2017, the City Council and community were presented with financial information from the

Prepared By: RL, JC Dept Review: _____
City Manager Review: SJC City Attorney Review: _____

budget document regarding the WRF project, including cash balances for the Sewer and Water Accumulation Funds. The cash balances that were provided for the Sewer Accumulation Fund were as follows:

Sewer Accumulation Fund

	2013/14 Actual	2014/15 Actual	2015/16* Actual	2016/17 Projected	2017/18 Budgeted
Beginning Cash Balance	\$3,714,093	\$3,964,766	\$4,209,495	\$6,334,741	\$8,330,242
Ending Cash Balance	\$3,964,766	\$4,209,495	\$6,334,741	\$8,330,242	\$5,113,924
Source/(use of) Fund Balance	\$250,673	\$244,729	\$2,125,246	\$1,995,501	(\$3,216,318)

*First Year of Sewer Rate increases went into effect

These balances were provided as part of the adopted FY 2017/18 budget (page 94 of the budget document is provided as Attachment 2 for reference).

In preparing the requested financial update for Council, staff began to verify the prior reported cash balances and determined that effective in FY 2015/16, forward into FY 2017/18, the reported cash balances in those budgets were not in agreement with the cash balances in the City's finance system (New World). The chart below shows the previously reported cash balances compared to the actual cash balances that staff have verified in the City's financial system, and notes the difference:

Sewer Accumulation Fund

	2015/16 Per Adopted Budget	2015/16 Actual - Per City's Finance System	Difference
Beginning Cash Balance	\$4,209,495	\$4,209,495	
Ending Cash Balance	\$6,334,741	\$4,337,164	(\$1,997,577)
Source/(use of) Fund Balance	\$2,125,246	\$127,669	

	2016/17 Per Adopted Budget	2016/17 Actual - Per City's Finance System	Difference
Beginning Cash Balance	\$6,334,741	\$4,337,164	
Ending Cash Balance	\$8,330,242	\$5,646,241	(\$2,684,001)
Source/(use of) Fund Balance	\$1,995,501	\$1,309,077	

	2017/18 Per Adopted Budget	2017/18 Corrected Budgeted Amounts	Difference
Beginning Cash Balance	\$8,330,242	\$5,646,241	
Ending Cash Balance	\$5,113,924	\$4,300,453 *	(\$813,471)
Source/(use of) Fund Balance	(\$3,216,318)	(\$1,345,788)	

* The Ending projected cash balance at June 30, 2018 includes an adjustment of a double counting of the MB/CSD Wastewater Treatment Plant in the amount of \$1.87 million. Effectively, this helps to mitigate the prior year variances.

The overstatements that were presented to Council in July 2017 were drawn from budget documents. Therefore, staff reviewed all related cash transactions, beginning with FY 2015/16, that affected the Sewer Revenue and Accumulation funds. In addition, staff reviewed the budget spreadsheets to determine where the discrepancy occurred and to reconcile to the financial system to ensure all funds are accounted for. Based on this review, staff determined that the overstatement occurred only in the budget document, which was separate and independent of the City's financial system. The city's financial system is accurate and reflective of true program revenues and expenditures.

The primary causes of the overstatement in the budget of cash balances versus actual cash balance in FY 2015/16 was twofold:

First, the adopted budget sheets for the FY 2017/18 budget reported actual figures for FY 2015/16. Those actual figures reported were, in some cases, not updated to the true actuals; instead they were budgeted figures for the year. As a result, the Morro Bay/Cayucos Sanitation District (MB/CSD) Wastewater Treatment Plant expenditure of \$1.67 million was not captured in the actual number reported for FY 2015/16. The chart below is a snapshot of the relevant budget page. Highlighted in yellow is the missing expenditure (see next page for chart).

CITY OF MORRO BAY
2017/18 ADOPTED BUDGET

SEWER REVENUE FUND

	2013/14 Actual	2014/15 Actual	2015/16 Actual	2016/17 Amended Budget	2017/18 Adopted Budget
Beginning cash balance	\$ -	\$ -	\$ -	\$ -	\$ -
Revenues from:					
Sewer user fees	4,070,514	4,221,780	4,921,000	5,561,000	6,198,000
Intergovernmental	-	-	-	-	-
Rental income	18,704	23,370	20,000	20,000	20,000
Other revenues (Penalties)	33,330	34,675	25,000	27,000	48,000
Subtotal	4,122,548	4,279,825	4,966,000	5,608,000	6,266,000
Transfers in from:					
Accumulation fund	-	-	-	-	-
Other	-	-	-	-	-
Subtotal	-	-	-	-	-
Total revenues and transfers in	4,122,548	4,279,825	4,966,000	5,608,000	6,266,000
Expenses for:					
Personnel	(535,091)	(543,849)	(653,618)	(649,167)	(591,989)
Supplies	(127,031)	(116,221)	(156,250)	(223,750)	(199,760)
Services	(236,783)	(341,322)	(424,984)	(582,768)	(487,693)
Other (no depreciation)	(71,690)	(61,396)	-	-	(14,075)
MB/CSD Wastewater Treatment Plant	(2,624,352)	(2,700,186)	-	(1,796,417)	(1,680,199)
Subtotal	(3,594,947)	(3,762,974)	(1,234,852)	(3,252,102)	(2,973,716)
Transfers out to:					
General fund for cost allocation	(164,701)	(166,348)	(167,512)	(170,862)	(174,228)
Utility discount program	-	(28,409)	(25,000)	(27,000)	(48,000)
IT replacement fund	-	-	(4,000)	(5,164)	(18,384)
to Waste Water Treatment Fund	-	-	-	-	(1,870,530) *
Accumulation fund	(362,900)	(322,094)	(3,534,636)	(2,152,872)	(1,181,142)
Subtotal	(527,601)	(516,851)	(3,731,148)	(2,355,898)	(3,292,284)
Total expenses and transfers out	(4,122,548)	(4,279,825)	(4,966,000)	(5,608,000)	(6,266,000)
Revenues over(under) expenses	-	-	-	-	-
and transfers out	-	-	-	-	-
Ending cash balance	\$ -	\$ -	\$ -	\$ -	\$ -

* This is a double counting of the MB/CSD Wastewater Treatment Plant and should be removed from the expenditures. This is further discussed later in the report.

Staff has confirmed that the annual \$1.67 million expense for the city's share of the existing system did occur, was accurately recorded in the New World system and accounted for in the FY 2015/16 annual audit. The error only affected reported cash balances on the budget versus actual report in the July 2017 update.

Second, the FY 2015/16 actual numbers reported in the FY 2017/18 adopted budget did not capture the Capital project costs, or CIP costs, related to the current WRF project. In FY 2015/16 the capital projects totaled \$1.8 million dollars. These projects impact cash and should have been accounted for in the reported cash balances in the budget document. Staff has confirmed the capital projects expenses were incurred and were correctly recorded on the City's books.

The offsetting difference for FY 2015/16 is a combination of other adopted figures being reported as actuals, pre-paid, accrual and receivable items.

Ending cash balances carryforward into the following fiscal year as beginning cash balances. Therefore, with the initial overstatement being reported in FY 2015/16, this resulted in the following years cash balances being impacted.

Fiscal Year 2017/18 Adopted Sewer Accumulation Fund Budget

In the adopted budget, the June 30, 2018 cash balance in the sewer accumulation fund was projected to be \$5.1 million. With the corrected cash balances brought forward, the new projected June 30, 2018 cash balance would be \$2.4 million. However, it has been noted that there was a double counting within the adopted budget for FY 2017/18 of the MB/CSD Wastewater Treatment Plant costs, totaling \$1.87 million. Based on staff's review, the FY 2017/18 adopted budget for the sewer fund does appear to have double counted the expense. Therefore, with the removal of the \$1.87 million dollars from the expenditure budget, the new projected June 30, 2018 cash balance in the Sewer Accumulation fund is \$4.3 million, a difference of \$813,000 from the previously reported estimates.

It is important to note, that the new projected cash balance amount of \$4.3 million is inclusive of the WRF project budget of \$4.2 million for FY 2017/18, meaning that the Council and community have sufficient cash on hand to continue with the budgeted project expenditures.

CONCLUSION

In honoring the commitment to transparency and professional due diligence, staff felt it was incumbent to daylight these overstatements as soon as they were confirmed. As such, staff is continuing to work on verifying all funds reported cash balances in the budget document, will work to reconcile any differences from the actual cash balances that may be discovered, and report back to Council in January 2018 with a comprehensive summary of our findings.

ATTACHMENTS

1. Questions and Staff's Response for WRFCAC Meeting on November 14, 2017
2. Sewer Accumulation Fund Adopted FY 2017/18 Budget

Questions Received Prior to the WRFCAC meeting at 1300 on December 4, 2017 (Staff responses are in **Bold**)

1. Minutes of 7/5/17 meeting (bottom of first paragraph): EPA's website address is incorrect. Please change this address to read: epa.gov/waterfinancecenter.

Minutes corrected

2. Staff Report dated 11/29/17 (B-1)
Page 5, Economic Outreach: Lobbying support expenditures year-to-date are \$18,017. What services has the Ferguson Group provided other than lobbying for the dredging of Morro Bay's harbor?

The Ferguson Group does not provide any assistance for the dredging of the Morro Bay Harbor. The Ferguson Group provides advocacy services at the federal level focused on project funding and favorable legislative and regulatory action. In that effort, TFG has assisted with outreach to the USEPA, USDA, USBR, and Congressman Carbajal's office and has facilitated meeting with the same.

Page 6, Printing Advertising: Year-to-date expenditures by outside vendors for copies, printing, and postage to develop and distribute WRF program materials are \$25,592. One way to reduce this cost (especially postage) is to develop (in-house) Qs & As (one page) on different WRF topics and include these with the City's monthly water/sewer bills.

Yes, the Staff can incorporate FAQs or Q and As and incorporate into the water/sewer bills. Since not all citizens of Morro Bay receive a printed water/sewer bill, staff would also keep these FAQs updated on the website and have printed material available at the public counter.

Page 7, second paragraph: The report states that the City was awarded a \$10.3 million SRF planning and design loan from the SWRCB. Is this loan still viable? (In other words, is there a requirement to start spending the award by a certain date or the award is withdrawn?)

The State Revolving Fund (SRF) Planning and Design loan is still active. The City has not needed to access those loan funds, as there has been sufficient funds available within the Sewer Enterprise Accumulation Fund. Once the Design-Build contract notice to proceed is issued, the City will need to access the SRF Planning and Design funds to fund the first steps into the design for the design build process prior.

Page 7, third paragraph: Has the City actually started to write the application for the WIFIA loan from EPA? And if so, has the City encountered any stumbling blocks? (The report only mentions an initial conference call with EPA staff.)

The City has not started filling out the actual EPA WIFIA application forms. Staff has been working with our EPA WIFIA program manager to develop the technical and environmental packages needed to support the application. Additionally we are coordinating between the two subsidized loans WIFIA and SRF to minimize the duplication of effort.

3. Quarterly Budget Summary for 4Q2016/17

Page 2, Property Acquisition: What does the \$30,500 expenditure reflect?

\$5,500 in appraisal fees and \$25,000 payment to the property owner for an option on the Righetti property. The option expired and is no longer in effect.

Page 2, SRF Loan: Has the City been awarded \$59,937,500 for a SRF construction loan or is this just an estimate? (I was led to believe that SRF loans for future projects were uncertain. Has this situation changed?)

The City does not have a SRF construction loan in hand. \$59,937,500 is an estimate of potential revenue available given the existing rate structure.

4. Staff Report dated 11/29/17 (B-2)

- Program Schedule Update: Suggest moving up the deliverable date for the rate study to April since the final analysis will be completed in February. Also suggest holding the Prop 218 hearing in May instead of June. These changes would allow the City more time to make last minute edits to the WIFIA loan application.

The rate analysis and Prop 218 process will rely upon the costs prepared by the Design Build firms responding to the RFP. Those proposals will not be due until the end of April 2018.

5. Morro Bay WRF Project Schedule

- Line item 167: Task 106 – Grant and Loan Pursuit and Management. How does this task relate to Ferguson’s lobbying work? (In other words, are the City’s consultants and lobbyists coordinating their efforts to obtain funding for the WRF?)

Both Kestrel and the Ferguson Group are coordinating their efforts through City staff and the Program Management Team. The Ferguson Group provides advocacy at the federal level while Kestrel coordinates with local and regional agency staff and prepares funding applications.

6. Staff Report dated 11/29/17 (B-3 rev 1)

Discussion, bullet 1: With regard to the WRFCAC members who are chosen to assist in the review of the SOQs, I suggest that they ask the interviewees to provide examples of creative solutions they have implemented in the past to reduce project costs.

Comment noted and is one of the existing evaluation criteria for the SOQ

ATTACHMENT 2

CITY OF MORRO BAY
2017/18 ADOPTED BUDGET

SEWER ACCUMULATION FUND

	<u>2013/14</u> <u>Actual</u>	<u>2014/15</u> <u>Actual</u>	<u>2015/16</u> <u>Actual</u>	<u>2016/17</u> <u>Amended</u> <u>Budget</u>	<u>2017/18</u> <u>Adopted</u> <u>Budget</u>
Beginning cash balance	\$ 3,714,093	\$ 3,964,766	\$ 4,209,495	\$ 6,334,741	\$ 8,330,242
Revenues from:					
Impact fees	54,256	82,103	50,000	60,000	41,115
Interest income	24,209	-	-	-	-
Subtotal	<u>78,465</u>	<u>82,103</u>	<u>50,000</u>	<u>60,000</u>	<u>41,115</u>
Transfers in from:					
Revenue fund	<u>362,900</u>	<u>322,094</u>	<u>3,534,636</u>	<u>2,152,872</u>	<u>1,181,142</u>
Subtotal	<u>362,900</u>	<u>322,094</u>	<u>3,534,636</u>	<u>2,152,872</u>	<u>1,181,142</u>
Total revenues and transfers in	<u>441,365</u>	<u>404,197</u>	<u>3,584,636</u>	<u>2,212,872</u>	<u>1,222,257</u>
Capital improvements	<u>-</u>	<u>(44,468)</u>	<u>(1,319,390)</u>	<u>(40,000)</u>	<u>(4,261,204)</u>
Transfer out to:					
Sewer Equipment Replacement Fund	(115,000)	(115,000)	(140,000)	(177,371)	(177,371)
Sewer Revenue Fund	(75,692)	-	-	-	-
Subtotal	<u>(190,692)</u>	<u>(115,000)</u>	<u>(140,000)</u>	<u>(177,371)</u>	<u>(177,371)</u>
Total capital and transfers out	<u>(190,692)</u>	<u>(159,468)</u>	<u>(1,459,390)</u>	<u>(217,371)</u>	<u>(4,438,575)</u>
Revenues and transfers over(under) capital improvements and transfers out	<u>250,673</u>	<u>244,729</u>	<u>2,125,246</u>	<u>1,995,501</u>	<u>(3,216,318)</u>
Ending cash balance	\$ <u>3,964,766</u>	\$ <u>4,209,495</u>	\$ <u>6,334,741</u>	\$ <u>8,330,242</u>	\$ <u>5,113,924</u>

The FY 17/18 expenditure is \$4,261,204 for the WWTP Relocation and Replacement project (WRF).

1 Represents anticipated spending through June 30 2017. The majority of appropriations for Capital Projects will go unexpended for FY 2016/17