SULTAN CITY COUNCIL
AGENDA ITEM COVER SHEET

ITEM NO: Pre-meeting Presentation

DATE: December 11, 2008

SUBJECT: State Audit Report

CONTACT PERSON: Laura Koenig, Clerk/Deputy Finance Director

ISSUE:

The issue before the City Council is to receive a presentation from the State Auditors Office on the City's 2007 financial audit. A copy of the Audit Report is available at https://www.sao.wa.gov

STAFF RECOMMENDATION:

Review available materials, listen to the audit report, ask questions and direct staff to areas of concern.

SUMMARY:

The State Auditor's Office has completed its review of the City's 2007 financial reports. The Auditor has identified several "exceptions" which are minor issues the City should address prior to the next financial audit. The City received one audit finding dealing with internal controls over the accounting and financial reporting.

The Auditor's Office has provided the final Audit Report and the Accountability Audit Report to the City. Staff will prepare an action plan for addressing any exceptions identified by the Auditor's Office.

Going Concerns Analysis

One of the tasks the State Auditor performs is an analysis of the City's overall fiscal health. The auditor looks at the City's fund balances at the end of each year over the past 3 years to see if the fund balances are increasing or decreasing.

Attachment A shows the fund balances are decreasing at a rate of 9% over the last three years. The Auditor requested a response from the City explaining how the Mayor, Council and management team will work together to address this issue.

Overall, as explained in the attached memo, the problem appears to be centered around the general fund, street fund, and enterprise funds. The Council and community

appears these efforts are not keeping pace with the rapid rate of decreasing revenues and increasing expenses.

The Mayor, Council and management team are discussing further rate increases in the enterprise funds in 2009 to offset operating expenses. The Auditor's going concerns analysis further emphasizes why the increases are necessary.

BACKGROUND:

The State Auditor's Office looks at financial information and compliance with state, federal and local laws on the part of all local governments, including schools, and all state agencies, including institutions of higher education.

Governments normally prepare financial statements for parties outside the government, such as taxpayers, oversight and legislative bodies, and investors and creditors. Such financial reporting plays an important role in assisting governments to be accountable to their customers.

The goal of the financial statement audit is to assure users of a government's financial statements that those statements are "fairly presented." The auditor provides users with an independent basis for relying upon management's assertions concerning the government's financial position, results of operations and cash flows. Auditors collect evidence needed to attest to the fairness of management's assertions. This can be done by inspection, observation, inquiry, and confirmation from third parties.

Financial audits are conducted according to "generally accepted auditing standards", often referred to by the acronym GAAS. These standards have been established by the Auditing Standards Board of the American Institute of Certified Public Accountants (AICPA). Under GAAS, the auditor prepares a report that expresses an opinion (or declines to express an opinion) on the fair presentation of the financial statements.

RECOMMENDED ACTION:

Review available materials, listen to the audit report, ask questions and direct staff to areas of concern.

ATTACHMENTS:

A – Going Concerns Memo
B - Audit Report and Accountability Audit Report

City of Sultan

Memo

To:	Blaine Fritts, State Auditor
From:	Deborah Knight, City Administrator
CC:	Mayor Carolyn Eslick
	City Council
	Management Team
Date:	12/5/2008
Re:	Fund Balance Trends

This memo is in response to a request from the state auditor to explain how the Mayor, Council and management team will address the City's declining fund balance.

Background:

In brief, part of the state auditor's going concerns testing includes an analysis of the City's total fund balance over the last three years.

The auditor noted the city's total fund balance has decreased 9% on average over the last 3 years. According to the auditor, the City could continue to experience a 9% reduction in fund balances for several years without impacting the City's ability to operate. The auditor noted however, the fund balance cannot cover excess expenditures indefinitely.

Trend analysis of the City's Fund Balance by opinion unit factoring out restrict funds:

Fund Name	2004	2005	2006	2007
Total Fund Balance	$4,658,921	$4,307,597	$4,042,117	$3,511,362
		-8%	-6%	-13%

The auditor has asked for a response on how the City will address the risk of this current trend.

City's Response:
City staff recommend focusing on improving operating fund balances by either increasing revenues or decreasing levels-of-service and corresponding expenditures. The City should also ensure impact fees are set at a level sufficient to cover the cost of necessary capital improvements. The City has taken a number of actions since 2004 to address increased operating expenses and declining revenues. The Mayor, Council and Management Team are monitoring funds closely and are discussing further revenue increases especially in the water and sewer utilities. Overall, the City's base rate for utilities (water, sewer, garbage and stormwater) may increase by $18.00 in 2009.

General and Street Fund

Since 2006, the Mayor, City Council and Management Team have taken several steps to increase revenues and decrease expenses in the General Fund and Street Fund. At this point, all potential revenue sources have been implemented with the exception of increasing the utility tax on municipal utilities. Long-term, the City will need to carefully monitor expenses. If revenues can't support services, the City will need to consider reducing levels-of-service to match available revenues.

Water and Sewer Utilities

Since 2004, the Mayor, City Council and Management Team have taken steps to increase revenues and decrease expenses in the water and sewer utilities. The City is completing a water rate study and considering a pure-water system to charge for actual water usage instead of using a base rate. The City is also considering charging customers the state excise tax effective January 1, 2009. The mechanism is already in place to increase the sewer connection fee as improvements are made to the waste water treatment plant and sewer system.

The City Council adopted a $5.75 Stormwater Utility Fee in 2008 which will go into effect on December 1, 2008. This should reduce shared expenditures in the Street Fund and Sewer Utility Fund for street sweeping and storm system management.

Garbage Utility

The City is considering a 20% increase in garbage service fees effective in 2009 to cover the cost increases in fuel expenses and tipping fees. The 2009 budget includes a garbage rate study. The City's recycling franchise with Allied Waste has expired. The City will issue a request for proposal for recycling services as required by the Sultan Municipal Code. There may be an opportunity to increase revenues or decrease expenses.

Analysis:

The following funds appear to have declining balances during the period of analysis (2003-2007). See attachment for details:

- The General Fund balance and Street Fund balance, which share property tax and utility tax revenues, have fluctuate up and down during the analysis period.

  On the revenue side, the City Council increased utility taxes for gas and electric utilities and adopted a 6% utility tax for city provided utilities. In 2007, the City reallocated investment interest to the General Fund. This provided $98,000 in investment interest in 2007. The City anticipates receiving $45,000 in investment interest in 2008 and 2009. However, decreasing permit and service fee revenues over the next several years will continue to reduce fund balances in the General Fund.

  On the expenditure side, the City Council cut expenses to the General Fund and Street Fund in 2007. Over half the City's General Fund budget supports public safety. The City reduced the number of patrol officers from 8 to 6. The police records specialist position was reduced from full-time to half-time. The Council is currently considering a contract with the Snohomish County Sheriff's Office for police services which would result in approximately $95,000 in cost savings to the City. The City Council has discussed not allocating this "savings" to further expenditures but instead setting the savings aside in the Contingency Fund.

  The General Fund also fully supports building inspection services. In 2007, the City reduced the building inspection position from full-time to half-time. In 2008, the City outsourced its building official/building inspector position to Snohomish County to reduce overhead. The City also eliminated the facilities maintenance position in 2007.

- Police emergency – Bond levy used to purchase 800 Mhz radios and make improvements to the police department facility. No adjustments to revenues or expenditures are available in this fund.

- Street construction – Expenditures on street projects. Expenses are made from this fund before grant funds are requested for reimbursement. The City could avoid a negative fund balance by transferring money from the Capital Project Improvement Fund or Impact Fee Fund. However, the overall fund balance would not change.

- LID project fund – Expenditures for mitigation plan with DOE. This fund will be exhausted in 2008 to pay for mitigation bank credits as required by DOE. The City has a legal obligation to complete its required mitigation. No adjustments to revenues or expenditures are available in this fund.

- Water and Sewer Operating Funds – The water utility operating fund balance declined between 2003 and 2006 and then increased in 2007. The Sewer utility has decreased by 36% since 2003.

  The Water and Sewer Utility funds including the operating funds and debt service funds have declined as the number of connection fees used to pay debt service has decreased and the City has been forced to use service fees to cover debt service payments.

In addition, the costs for chemicals to operate both plants and disposal fees for the waste water treatment plant have increased between 20% and 30% over the last two years.

The City Council passed a revised sewer fee ordinance in 2007 which established a series of service fee increase beginning in 2008 and continuing until 2010. The fee increase for 2009 will be $5.04. The fee increase for 2010 will be $3.09. The Council increased the sewer fee connection charge from $7,983 in 2006 to $9,106 in 2007 and $11,282 in 2008.

The City adopted revised water service fees in 2004. The final fee increase for 2009 will be $1.00. The City is in the final phase of a revised water rate study. The City Council may consider adopting a "pure water" system where users pay for every cubic foot of water.

At its budget retreat on October 18, 2008 the City Council discussed having customers pay directly for the state excise taxes for municipal utilities. Currently, the City pays the state excise tax. The excise tax is not included in the service fee for water and sewer. This decision would increase revenues by approximately $40,000 in both the water and sewer funds. The total cost to the customer would be $3.12/month.

The City is moving forward with purchasing and installing new biosolids handling equipment at the waste water treatment plant. The City received $500,000 from the state legislature in 2007 to purchase and install the equipment. The new equipment should significantly reduce operating costs at the waste water treatment plant.

- Water and Sewer Debt Service – Fund balances have been reduced to pay for debt service.
- Cumulative Reserve Utility (Water/Sewer Capital Fund) – Small fluctuations to fund capital projects. The City has an obligation to expense funds to meet capital project needs.
- Garbage – $30,000 decrease in 2007 after several years of fund balance increases.

  The City has instituted an equipment replacement fund. The garbage operating fund transfers money to the equipment replacement fund. There is no net change to fund balances as a result of the transfer.

  Over the last three years, the City has increased its fuel line item from $5,000 in 2006 to $24,000 in 2009. The City was notified by Snohomish County of a 20% increase in disposal (tipping) fees effective January 2009. The City has not increase garbage rates since 2004. A garbage rate study is proposed for 2009.