



## Staff Report

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File #: REPORT 19-0038, Version: 1

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### Honorable Mayor and Members of the Hermosa Beach City Council Regular Meeting of January 22, 2019

#### **2017-18 COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR) (Including Report from Independent Auditor) (Finance Director Viki Copeland)**

#### **Recommended Action:**

Staff recommends that the City Council receive and file the 2017-18 Comprehensive Annual Financial Report (CAFR), which includes the report from The Pun Group, LLP, the City's independent auditors.

#### **Executive Summary:**

For the 2017-18 fiscal year, the City again received an unmodified opinion, which indicates that the auditor believes the financial statements present a fair picture of the financial position of the City, as opposed to a modified opinion, in which the auditor "modifies" or limits his opinion for specific reasons, such as lack of capital asset accounting, significant internal control deficiencies or non-compliance with other Government Accounting Standards Board (GASB) requirements.

Since comparative information for the General Fund for 2016-17 and 2017-18 is not included in the CAFR, it is presented in the analysis section. Some of the comments from the Transmittal letter and Management's Discussion and Analysis (MD&A), located in the Financial Section of the CAFR, are repeated herein for the purpose of having this staff report stand alone.

Overall, General Fund Revenue increased by 2.2% and expenditures increased by 1%. The year-end transfer of unspent funds in the General Fund was made to the Insurance fund, since the net position in the Insurance Fund was lower than the funding goal of \$3,000,000 due to several settlements and the recording of year end claims liabilities. The year-end transfer from the General Fund brought the 6/30/18 balance up to \$2,516,161.

#### **Background:**

Annually, the City has a financial audit performed by an independent, certified public accounting firm. The auditor's report is located behind the second divider that is labeled "Financial Section".

The report was submitted to the Government Finance Officers Association (GFOA) to qualify for the Certificate of Achievement for Excellence in Financial Reporting. The City received the award for the 2016-17 CAFR and has received the award since 1990. The award program requires a high level of compliance with governmental standards, inclusion of information well beyond the general-purpose

financial statements and an unmodified audit opinion.

There were several new Governmental Accounting Standards Board (GASB) statements effective for fiscal year 2017-18, however only GASB 75 *Accounting and Financial Reporting for Postemployment Benefits Other than Pensions* had any effect on the City's financial statements.

GASB 75, effective July 1, 2017, requires net other postemployment benefits (OPEB) liabilities to be included in the financial statements for the first time. The July 1, 2017 beginning balance was restated to reflect the impact. GASB 75 updates OPEB accounting and financial reporting standards to be consistent with the pension standard in GASB 68. The main impacts to the financial statements are the recording of the net OPEB liability in the government-wide financial statements on pages 21-25, and enhanced disclosures to Note 10- Other Postemployment Benefit Plan on pages 77-80 and Required Supplementary Information on pages 93 to 94. There is no impact to the fund financial statements.

In 2014-15, the City implemented GASB 68 *Accounting and Financial Reporting for Pension* and GASB 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date- an amendment of GASB Statement No 68*. While GASB 68 and 75 implemented changes to the accounting and reporting of net pension and OPEB liabilities, neither impact the way pension and OPEB liabilities are funded. Since the net pension and OPEB liabilities are payable over an extended time horizon, they do not represent a claim on current financial resources.

Also, as a helpful reminder in reading the CAFR, the GASB 34 reporting model that was implemented in 2002 dictates the following:

- Present financial information in specific formats, namely, the Government Wide Financial Statements, beginning on page 21. These statements are designed to show net assets and equity of the City as a whole and to provide information on the cost of services and show how programs are financed.
- Requires Management's Discussion and Analysis (MD & A) to present financial highlights and assess performance for the year.
- Requires reporting on "major" funds rather than aggregate fund types.
- Requires accrual accounting (in the Government Wide Statements) for all governmental funds, meaning that long term assets and liabilities (such as capital assets, including infrastructure) are included in addition to short term assets and liabilities. All revenues and all costs of providing services are also reported, not just those received or paid in or soon after year-end.

GASB 54 *Fund Balance Reporting and Governmental Fund Type Definitions*, implemented in 2012-13, established fund classifications based upon constraints imposed on the use of resources in governmental funds. The primary initial impact of this classification change is that funds previously held separately, the Contingency Fund, Compensated Absences Fund, and the Retirement Stabilization Fund are now shown in the General Fund in the "Committed" or "Assigned" totals on

page 31, the Balance Sheet for Governmental Funds. The City's policy for these funds shows on pages 55-56 in Note 1 of the CAFR and the detailed amounts show in Note 11 on page 81.

### **Analysis:**

Since comparative information for the General Fund for 2016-17 and 2017-18 is not included in the CAFR, it is presented below. Some of the comments from the MD&A and Transmittal letter, as mentioned above, are repeated herein for the purpose of having this staff report stand alone. Additional information and analysis can be found in the Transmittal Letter starting on page v and in the MD&A starting on page 7.

### **General Fund Revenue**

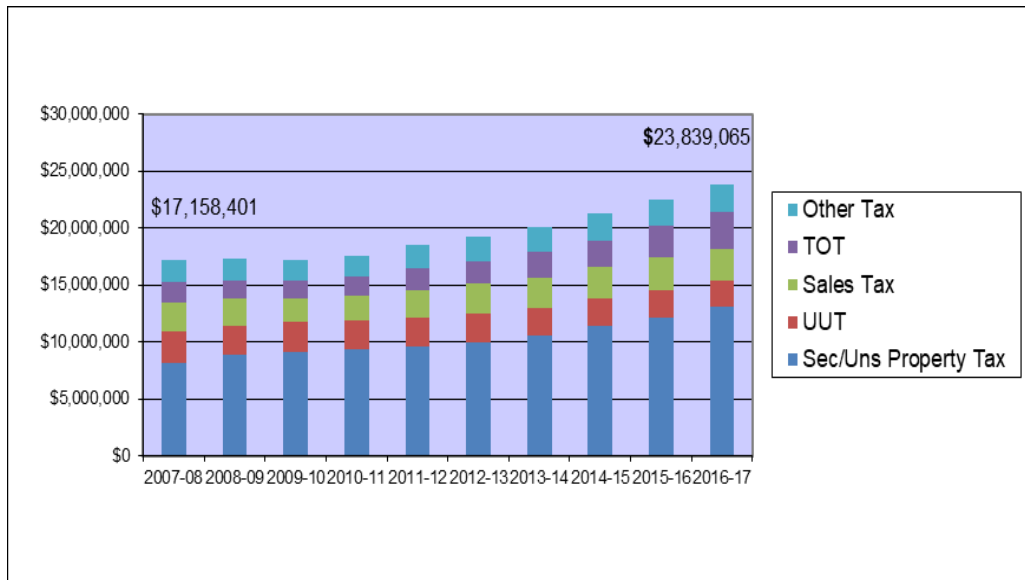
General Fund revenue increased 4% over 2016-17, however due to a change in the way Utility User Tax (UUT) revenue is reported in the General Fund *for financial statement purposes only*, the overall increase was reduced to 2.2%. UUT revenue decreased by 3.1% overall, however the General Fund shows a UUT decrease of 33.54%. See the Utility User Tax section for further explanation.

REVENUE SOURCE	Revenue FY 2017-18 Amount	Increase (Decrease) Over FY 16-17	% Of Increase (Decrease)	% Of Total
Property Taxes	\$17,072,844	\$1,319,762	8.38%	44.53%
Sales Tax	\$3,151,207	\$264,909	9.18%	8.22%
Utility Users' Tax *	\$2,229,905	(\$72,119)	-3.13%	5.81%
Transient Occupancy Tax	\$3,295,207	\$58,181	1.80%	8.59%
Other Taxes	\$1,642,962	(\$39,492)	-2.35%	4.29%
Licenses and Permits	\$787,563	(\$180,393)	-18.64%	2.05%
Fines and Forfeitures	\$1,921,215	(\$149,384)	-7.21%	5.01%
Use of Money and Property	\$708,505	(\$9,734)	-1.36%	1.85%
Intergovernmental Revenue	\$117,774	\$1,598	1.38%	0.31%
Charges for Services	\$7,170,767	\$201,084	2.89%	18.70%
Miscellaneous	\$177,509	\$50,691	39.97%	0.46%
Interest	\$66,019	\$66,019	N/A	0.17%
<b>Total</b>	<b>\$38,341,477</b>	<b>\$1,511,122</b>	<b>4.10%</b>	<b>100.00%</b>
UUT Revenue Recorded in Storm Water Fund*	-\$700,000	-\$700,000		
<b>Adjusted Total</b>	<b>\$37,641,477</b>	<b>811,122</b>	<b>2.15%</b>	

\* \$700,000 in UUT revenue was removed from the General Fund and shown in the Storm Water Fund as revenue rather than a transfer.

### **Taxes**

Revenue from taxes generates 71% of General Fund revenue. The graph below tracks select tax revenue sources over the past ten years.



### Property Tax

Total property tax revenue increased 8.4%. The graph above shows secured tax, which increased 8% and unsecured tax, which increased 2.4% respectively. Hermosa Beach's assessed valuation for secured and unsecured property increased 7.4% overall. The 7.4% growth was the 9<sup>th</sup> highest of 88 cities in Los Angeles County. Median home prices in Hermosa Beach for June 2018 were \$1,740,000 as compared to Los Angeles County's median price of \$615,000. The average median home price for Hermosa Beach for fiscal year 2017-18 was \$2,026,432 compared to \$1,830,667 for the prior year.

### Sales Tax

Sales tax revenue is up 9.2% from 2016-17 primarily due to increases in the Eating and Drinking Places under the Retail Group and the overall Manufacturing and Wholesale Group. The primary change in the Manufacturing and Wholesale Group is due to a home occupation business for computer sales.

### Sales Tax By Class\*

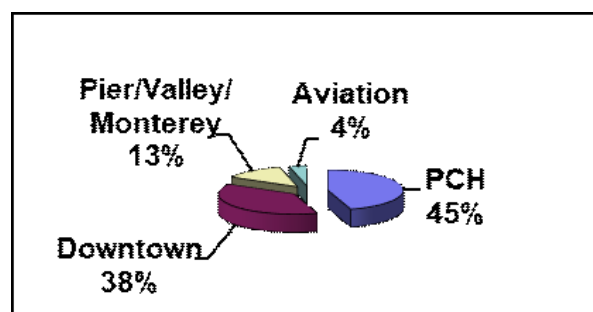
RANK / BUSINESS CLASS	2017-18	INC/(DEC)	% Change Previous Year	% OF TOTAL
<b>Retail Group</b>				
Eating/Drinking Places	\$1,031,825	\$50,608	5.16%	38.59%
Building Materials	\$254,907	\$22,334	9.60%	9.54%
Other Retail Stores	\$225,468	\$5,231	2.38%	8.43%
Food Stores	\$178,985	\$17,870	11.09%	6.70%
Auto Dealers & Supplies	\$145,365	\$8,590	6.28%	5.44%
Furniture/Appliance	\$127,389	\$138	0.11%	4.77%
Service Stations	#	#	12.57%	#
Drug Stores	#	#	1.17%	#
Apparel Stores	\$74,151	\$2,286	3.18%	2.77%
All Other Retail	\$67,517	\$2,493	3.83%	2.53%
<b>Total Retail Group</b>	#	#	5.69%	<b>86.16%</b>
<b>Total Manufacturing &amp; Wholesale</b>	\$189,967	\$89,324	61.25%	<b>8.80%</b>
<b>Total Business, Service, Repair</b>	\$100,181	(\$11,535)	-8.02%	<b>4.95%</b>
<b>Total Non-Store/Part Time Retailers/Adjustments</b>	\$2,255	(\$47)	-1.89%	<b>0.09%</b>

\* Threshold for inclusion, \$300 per quarter

\* Service station and drugstore amounts are not listed because there are too few in the category.

### Sales Tax by Geographic Area

LOCATION	Revenue 2016-17	% OF Total	% Chg	Revenue 2017-18	% OF Total
PCH	902,162	43%	11%	1,002,774	45%
Downtown	837,837	39%	1%	846,338	38%
Pier/Valley/Monterey	296,729	14%	-2%	291,381	13%
Aviation	91,844	5%	-9%	83,874	4%



### Transient Occupancy Tax (TOT)

Transient occupancy tax continues to be up, increasing 1.8% over 2016-17. Hotel occupancy was

consistent with the prior year at 81.4% in 2017-18 compared to 81.5% for 2016-17. Revenue was nearly \$3.3 million, the City's highest year ever.

### **Utility User Tax (UUT)**

The City transfers \$700,000 in Utility User Tax revenue annually to the Storm Drain Fund for operations and maintenance. In 2017-18, the \$700,000 transfer from the General Fund was recorded as UUT revenue instead of a transfer in the Storm Drain Fund *for financial statement reporting purposes*. UUT was down overall by \$72,118 or 3.1% in 2017-18.

### **Licenses and Permits**

The License and Permit category decreased 19% because of a decrease in taxi franchise fees due to a reduction in the franchise fee from \$1,100 per cab to \$610 per cab and a decrease in the number of cabs required per franchise. With new legislation passed that requires taxis to obtain permits only where they are "substantially located", the forecast for this revenue is uncertain.

### **Fines and Forfeitures**

Fines and Forfeitures were down 7% due to a decrease in court fines/parking caused by personnel shortages and a decrease in municipal court fines. When staffing issues occur, part-time personnel will be used to supplement the existing staff. Municipal Court Fines have decreased as a result of an increased use of diversion programs implemented by the courts.

### **Service Charges**

Service Charges show an increase of 2.9% due to having a full year of revenue related to business license application and renewal fees and the credit card processing fee, which were recommended by the user fee study in 2016-17 and implemented December 2016. Ambulance transport, parking meter and lot revenue, and public improvement plan check fees were all up over 2016-17.

### **General Fund Expenditures**

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GENERAL FUND	Expenditures 2017-18 Amount	Increase (Decrease) Over 16-17	% Of Increase (Decrease)	% Of Total
Legislative/Legal	\$1,302,500	(\$146,009)	-10.08%	3.69%
General Government	\$3,684,961	\$44,565	1.22%	10.44%
Public Safety	\$21,338,362	\$50,739	0.24%	60.47%
Community Development	\$1,945,096	\$112,862	6.16%	5.51%
Culture/Recreation	\$1,383,630	\$100,993	7.87%	3.92%
Public Works	\$5,087,725	\$217,920	4.47%	14.42%
Capital Outlay	\$544,259	(\$21,329)	-3.77%	1.54%
Total	\$35,286,533	\$359,741	1.03%	100.00%

Expenditures show an increase of 1% due to the following:

- The Legislative and Legal decrease is primarily due to a decrease in legal fees in 2017-18. Legal fees were up in 2016-17 due to oil and short-term vacation rental litigation.
- The General Government increase is mainly due to a change in staff allocation. The Emergency Management Coordinator position moved from the Fire Department to the City Manager's Department due to the transition of fire services to Los Angeles County Fire on December 30, 2017.
- The Public Safety increase is largely due to an increase in personnel costs in the Community Services division and increased personnel and contract services costs in the Police Department. While Community Services staffing issues have been ongoing, there was an increase in regular and overtime hours in 2017-18 over 2016-17. Additionally, a new Community Services Officer position was hired in conjunction with the increased parking enforcement hours approved in March 2018. The Police Department had increased personnel costs due to promotions and increased contract services costs related to a private security contract for downtown. The increase in the Community Services division and Police Department costs were partially offset by a decrease in fire services costs associated with personnel vacancies during the first six months of the year, prior to the transition to LA County Fire Services.
- The Community Development increase is primarily due to personnel costs. The allocation of the full-time permanent Code Enforcement Officer/Fire Inspector position changed from a 50-50 split between the Fire Department and Community Development to 100% to Community Development in 2017-18, the Building and Code Enforcement Official, Community Development Director, and Planning Manager were no longer allocated to the Source Reduction/Recycling Program, and there were staffing vacancies in the Assistant and

Associate Planner positions in 2016-17.

- The Culture and Recreation increase is mainly due to an increase in part-time/temporary personnel costs. Hourly rates for part-time/temporary personnel were adjusted January 1, 2018 to align with the minimum wage increase. Additionally two new Recreation Specialists were hired for Monday -Thursday office hours, in place of utilizing Recreation Leaders, and the role of Lead Youth Programs Counselor was filled.
- The Public Works increase is primarily due to higher personnel and contract services costs. The Associate Engineer position was filled a full year in 2017-18 in comparison to 6 months in 2016-17. There were also increased part-time temporary hours for the Public Works Intern and Inspector positions over 2016-17. Both positions were added during 2016-17. Contract services increased due to a new landscape maintenance contract and citywide sweeping, steam cleaning and porter services.
- Capital Outlay decreased slightly over 2016-17 largely due to prior year expenditures related to the installation of a solar photovoltaic system on the community center roof and equipment purchased for South Park.

### **General Fund Unspent Funds**

The policy of transferring unspent funds in the General Fund to the Insurance Fund, Equipment Replacement Fund (ERF) and Compensated Absences Fund was implemented in 1995-96 to build equity and provide funds for amounts owed to employees for accumulated leave. The policy was changed in 1998-99 to discontinue allocating funds to the Compensated Absences Fund (since the target amount was reached), to create a Capital Improvement Fund for street and other capital improvements and to include a goal for Contingency funds in the policy. The Contingency Policy was changed from 15% of appropriations for operating funds to 16% in 2013-14 in keeping with best practices.

The City Council amends the policy, as necessary, when goals or targets are met and depending on where funds are needed. For several years, funds available at year end were transferred to the Insurance Fund to cover estimated insurance claims liabilities and the oil settlement agreement. From 2013-14 to 2015-16, funds available at year end were transferred to the Capital Improvement Fund. The 2016-17 and 2017-18 transfers went to the Insurance Fund to help cover the 2016-17 oil settlement agreement and 2017-18 liability claims settlements.

### **Insurance Fund**

The net position in the Insurance Fund is lower than the funding goal of \$3,000,000 due to several settlements and the recording of year end claims liabilities. The year-end transfer of unspent funds



from the General Fund brought the 6/30/18 balance up to \$2,516,161.

Other primary expenses in the Insurance Fund are related to Worker's Compensation and General Liability divisions. Claims payments for worker's compensation are higher by \$13,028 and liability cases are higher by \$1,557,743 in 2017-18. The year-end liability is established annually through an actuarial study performed by the Independent Cities Risk Management Authority's independent actuary. The total claims expense is higher by \$969,531, primarily due the settlement of claims in 2017-18.

### **Changes to Claims Expense**

DEPARTMENT/DIVISION	2016-17	2017-18	Increase (Decrease)
Workers Compensation Division			
Change to:			
Claims Paid	\$1,114,765	\$1,127,793	\$13,028
Year-end Liability	234,159	187,443	(46,716)
	<u>\$1,348,924</u>	<u>\$1,315,236</u>	<u>(\$33,688)</u>
Liability Division			
Change to:			
Claims Paid	\$459,706	\$2,017,449	\$1,557,743
Year-end Liability	447,196	(107,328)	(554,524)
	<u>\$906,902</u>	<u>\$1,910,121</u>	<u>\$1,003,219</u>
Total Claims Expense	\$2,255,826	\$3,225,357	\$969,531

### **General Plan Consistency:**

PLAN Hermosa, the City's long-range planning document, was adopted by the City Council in August 2017, and envisions a future where "Hermosa Beach is the small town others aspire to be; a place where our beach culture, strong sense of community, and commitment to sustainability intersect." One of the guiding principles to achieve the vision is to make decisions and take actions that help contribute to the City's economic and fiscal stability.

A focus of the Governance chapter in the General Plan is to ensure that decision-making and leadership is conducted in an ethical, transparent, and innovative manner that reflects community values. Goal 1 of the Governance chapter speaks to maintaining a high degree of transparency and integrity in the decision-making process.

Other relevant General Plan policies are listed below:

### ***Infrastructure***

- 1.2 Priority investments. Use City Council established priorities and the Capital Improvement Program (CIP) to identify and allocate funding for projects identified in the infrastructure plan.
- 1.9 Preventative street maintenance projects. Include street slurry projects and other preventive projects in the CIP each year, with sufficient funding.

*Public Safety*

- 5.2 High level of response. Achieve optimal utilization of allocated public safety resources and provide desired levels of response, staffing, and protection within the community.

**Fiscal Impact:**

The 2017-18 CAFR provides a financial overview for the previous fiscal year. Audited fund balances will be used to update the 2018-19 Fund Summary Report utilized as a part of the upcoming 2018-19 Midyear Budget Review, which is scheduled for February 26<sup>th</sup> at 7:00pm.

**Attachments:**

1. 2017-18 Comprehensive Annual Financial Report

The Comprehensive Annual Financial Report is also available for review online at <http://www.hermosabch.org/index.aspx?page=209>.

**Respectfully Submitted by:** Viki Copeland, Finance Director

**Approved:** Suja Lowenthal, City Manager