



AGENCY:	City Council/MID
MEETING DATE:	November 28, 2016
DEPARTMENT:	Finance
PRESENTED BY:	V. Damiani

AGENDA ITEM SUMMARY REPORT

TITLE:

RECEIVE RECOMMENDATION FROM FINANCE & ADMINISTRATION COMMITTEE AND CONSIDER ADOPTION OF JOINT CITY COUNCIL/IMPROVEMENT DISTRICT RESOLUTION APPROVING IMPLEMENTATION OF CORRECTIVE ACTION PLAN TO ADDRESS PRIOR YEAR COST ALLOCATION ERRORS

ISSUE:

While developing the FY2016-17 budget, an accounting error was discovered that in prior years resulted in an over-allocation of non-personnel overhead costs to the Water and Wastewater Enterprises. The Council/District Board directed staff to determine the extent of the error and to return with a corrective action plan. The proposed corrective action plan is brought forward for Council/District Board consideration and approval.

RECOMMENDED ACTION:

Adopt resolution accepting and implementing corrective action plan to address prior year cost allocation errors.

ALTERNATIVE ACTION(S):

Provide alternative direction to staff.

ANALYSIS:

While developing the FY 2016-17 budget, an accounting error was discovered that in prior years resulted in an over-allocation of non-personnel overhead costs to the Water and Wastewater Enterprises. At the Budget workshop held on May 25, 2016, staff was directed to determine the extent of the over-allocation with the intent that the General Fund repay the Enterprise Funds.

City staff subsequently determined that the over-allocation error began in FY 2011. Over-allocations from FY 2011 to Fiscal Year 2016 to the Water Enterprise equal approximately \$1,426,506 and to the Wastewater Enterprise approximately \$1,919,261. The methodology used to calculate the over-allocations as well as the resulting figures have been reviewed by the City's external auditors, JJACPA Inc., and have been found to be reasonable and accurate. The results of the auditor's findings are presented in the attached Agreed Upon Procedures report.

In the course of reviewing the extent of the over-allocation error, a second error was discovered by the City's outside auditors which resulted in an under-allocation of costs from the General Fund to the Enterprise funds in prior years. The auditors noted that although the Enterprise Funds participate in the benefit of certain City facilities, they do not participate in the cost. It was noted that no rent has been charged to either the Water or Wastewater enterprise funds for proportionate use of City Hall, Town Hall or the Corporation Yard. Rather than attempt to calculate back rent for use of the facilities it was recommended that the City transfer a proportionate share of each facility's book value to the enterprise funds. Book value is comprised of the facility's historical cost as well as accumulated depreciation. The amount of fixed assets to be transferred from the General Fund to the Water and Wastewater enterprise funds has been calculated at 25% or \$579,331 each, which is representative of the under-allocated amount.

Thus far, the City Council/District Board has taken the following steps to remedy the cost allocation error:

- Appropriated \$2M in FY 2016-17 Budget for repayment
- Suspended utility rate increases for FY 2016-17
- Corrected the allocation methodology moving forward

In addition to the remedies previously authorized by the City Council/District Board, the proposed corrective action plan includes a transfer of fixed assets and an interfund loan to complete the correction of prior year allocation errors. The complete corrective action plan is summarized below:

**Summary of Over Allocation
Amounts Owed and Repayment Plan
As of 8/15/2016**

	Water	Wastewater	Total
Amounts Owed	\$ 1,426,506	\$ 1,919,261	\$ 3,345,767
Initial Cash Payment	847,175	1,152,825	2,000,000
Fixed Assets Transferred	579,331	579,331	1,158,662
5 Yr Interfund Loan		187,105	187,105
Total Repayment	\$ 1,426,506	\$ 1,919,261	\$ 3,345,767

1. As mentioned previously, the Council/District Board budgeted \$2M in the FY 2016-17 budget for cash payments.
2. The fixed assets transfer includes transfer of 25% of shared buildings to each of the two Enterprise Funds. The shared buildings to be proportionately transferred are City Hall, Town Hall and the Corporation Yard. Details of the proposed assets transfer are attached.
3. The General Fund and the Wastewater Enterprise will enter into an interfund loan for the balance of \$187,105 with a term of 5 years at the LAIF interest rate of 0.55%. The proposed interfund loan document and amortization schedule are attached.

On October 5, 2016, the Finance & Administration Committee reviewed the proposed corrective action plan for the cost-allocation errors and recommended that it be approved by the City Council/District Board.

FISCAL IMPACT:

\$2 million in cash to be transferred from the General Fund to the Water and Wastewater Enterprises. \$1.2 million in fixed assets to be transferred from the General Fund to the Water and Wastewater Enterprises. \$187,105 plus interest of approximately \$2,700 to be repaid to the Wastewater Enterprise Fund from the General Fund over a term of 5 years.

IMPLEMENTATION/TIMEFRAMES:

All accounting transfers to be completed prior to mid-year budget review. Interfund loan to be executed prior to July 1, 2017.

ATTACHMENTS:

1. Proposed Resolution Approving Implementation of Corrective Action Plan
2. Agreed Upon Procedures Report – Cost Allocation Application Review (JJACPA)
3. Schedule of Fixed Assets to be Transferred
4. Proposed Interfund Loan Agreement and Amortization Schedule

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Agency Action ☐ Approved ☐ Denied ☐ Approved as Amended

Resolution No.: _____ Ordinance No.: _____

Moved by: _____ Seconded by: _____

Vote: _____

☐ Deferred/Continued to meeting of: _____

☐ Referred to: _____