



CITY of CAMPBELL
Finance Department

Notice of Meeting
Finance Sub-Committee

Date: February 26, 2018
Time: 1:00 p.m.
Location: Campbell City Hall
Ralph Doetsch Conference Room
70 North First Street, Campbell CA 95008

AGENDA

- I. Call to Order
- II. Presentation and Discussion of FY 2017 Audit Results and Required Communications
 - White, Nelson, Diehl Evans LLP
- III. Oral Requests
- IV. Adjourn

MEMORANDUM



City of Campbell
Finance Department

To: Finance Sub-Committee

Date: February 22, 2018

From: Jesse Takahashi, Finance Director

Subject: **FY 2017 Audit Results and Acceptance of City's Comprehensive Annual Financial Report and Other Reports**

This information is being distributed for the Sub-Committee meeting scheduled for **1:00 p.m. on February 26, 2018**, in the Doetsch Room. Robert Callanan, Partner from the City's auditing firm, White Nelson Diehl Evans LLP, will present the results of the audit as well as discuss their required communications with the City.

BACKGROUND

The Finance Department prepares a Comprehensive Annual Financial Report (CAFR) to report the City's financial results for the fiscal year. The financial statements, and the accounts comprising them, are subjected to an independent audit as required by Campbell Municipal Code Section 2.08.140. The City's audit firm, White Nelson Diehl Evans LLP, issued their report (opinion) on these financial statements which is contained within the CAFR document that is available to you at the following link: <http://www.cityofcampbell.com/FY2017CAFR>.

At the conclusion of the audit process, the auditor also issues its communication to the City Council, in the form of various letters, regarding the audit process and the City's internal control structure and reports its findings and/or recommendations for improvement (Attachments 1-3).

DISCUSSION

Comprehensive Annual Financial Report for Fiscal Year Ending June 30, 2017

The CAFR is divided into three basic parts: 1) Introductory Section 2) Financial Section and 3) Statistical Section. The introductory section includes a letter of transmittal, award certificate and a listing of City officials, staff, Board and Commissions. The financial section includes the auditors' report, management discussion and analysis, basic financial statements, fund financial statements, notes to the financial statements, required supplementary information and other supplementary information. The statistical section contains various schedules of trend information that provides useful information for analytical purposes.

The CAFR document is submitted annually to a national award program which grants a certificate of achievement for excellence in financial reporting to qualifying CAFRs. The City has received this award for the past 29 consecutive years and has again submitted this year's document for consideration.

The "Independent Auditor's Report" reflects a "clean opinion" on the financial statements, meaning that it meets the standards of generally accepted accounting principles. Next is

"Management's Discussion and Analysis," which begins on page 5 of the CAFR, contains significant financial highlights for the fiscal year ending June 30, 2017, as well as an explanation of the different types of financial statements and other information found in the CAFR. Included in the discussion are tables which compare the audit year financial results to the prior year, and an explanation of the significant changes between years.

FY 2017 highlights from the CAFR are as follows:

The City ended its fiscal year with total revenues of \$55.8 million, a decrease of \$6.2 million from the previous year, and total expenses of \$54.1 million, an increase of \$5.4 million compared to the previous year. Excluding property taxes, general revenues, comprised of sales tax, transient occupancy tax and other revenues, decreased \$1.9 million while program revenues, including charges for service, operating and capital grants and contributions accounted experienced a decrease of \$5.3 million.

Other financial highlights of the past year are as follows:

City-wide:

- Total City assets and deferred outflows of resources exceeded its liabilities and deferred inflows by \$39.6 million. Of this amount, \$34.9 million represents the net investment in capital assets while \$17.1 million is restricted for various purposes including affordable housing, streets and roads, community development and debt service. The negative \$12.4 million in unrestricted net position decreased by \$0.2 million since last year.
- Total net position increased from the previous year by \$1.7 million primarily attributable to the net impact from the deferred recognition of employer retirement payments and an increase in the City's net pension liability.

Fund level:

- Total governmental fund balances were \$45.6 million at fiscal year-end, a decrease of \$7.1 million from the previous year.
- General Fund revenues, excluding transfers, decreased \$0.4 million to \$48.0 million from the previous year. Related expenditures increased by \$4.0 million from the previous year to \$46.0 million.
- General Fund's fund balance decreased \$1.3 million to \$28.9 million at fiscal year-end.
- The City realized a small operating surplus in the General Fund; therefore, no draw from its Reserve for Economic Fluctuations was necessary.

General Fund Highlights

The General Fund realized an excess of revenues over expenditures of \$2.0 million, excluding transfers. General Fund revenues, excluding transfers, decreased \$0.4 million from the previous year to \$48.0 million. Property taxes increased \$1.0 million offset by decreases in sales tax of \$0.5 million and licenses and permits of \$1.0 million.

General Fund expenditures, excluding transfers, were \$46.0 million, an increase of \$4.0 million from the previous year. The increase was related primarily to increased costs for Police services and the City's contract with County Fire totaling \$1.5 million, increased general government costs of \$1.2 million, including a regular and special election costing \$0.7 million and continuing work on the General Plan update costing \$0.3 million, as well as increases in other departments related to increased demand for programs and services.

The General Fund's fund balance at fiscal year-end was \$28.9 million, a decrease of \$1.3 million from the previous year. Committed and Assigned fund balances at year end were \$23.9 million and \$4.0 million, respectively. These balances are utilized to fund various emergency and operating funds, including a \$6.0 million reserve for economic fluctuations, \$4.0 million for continuing capital projects, \$5.4 million for future capital improvements and \$4.9 million for emergencies. Unassigned fund balance of \$1.0 million serves as an additional reserve for unanticipated needs that may arise.

Written Communications Letters

The auditor, as required by auditing standards, issues several letters regarding the audit process and results (attachments 1 and 2) as well as any observations and/or findings related to the internal control structure as noted during their audit. There were no findings considered to be a "material weakness" or "significant deficiency."

As part of the audit results, the auditors also issue a "management" letter that pertains to observations and recommendations to improve operating efficiencies or internal controls (attachment 3). There were two comments noted this year, both of which were also noted in the previous year. The comments relate to reviewing old refundable deposits on the books and timely posting of low and moderate income housing asset fund information in accordance with SB341. The auditor will review these comments with the Committee as well as answer any questions from the Committee.

The acceptance of the FY 2017 CAFR and auditor's written communication on internal controls will be agendaized for the Council meeting on March 6th. The results of this meeting will be incorporated into the final staff report submitted to Council.

Committee Members:

Liz Gibbons, Councilmember
Rich Waterman, Councilmember
Brian Loventhal, City Manager
Jesse Takahashi, Finance Director
Vacant, Finance Manager

Attachments:

- 1) Auditor letter on Audit Process Results (SAS 114)
- 2) Auditor letter on Internal Control Over Financial Reporting and Compliance (GAS)
- 3) Auditor letter on Internal Controls and Other Matters

The Honorable Mayor and City Council
City of Campbell
Campbell, California

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the City of Campbell, California (the City), as of and for the year ended June 30, 2017. Professional standards require that we provide you with information about our responsibilities under auditing standards generally accepted in the United States of America and *Government Auditing Standards*, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our engagement letter dated June 7, 2017, and in our letter on planning matters dated October 13, 2017. Professional standards also require that we communicate to you the following information related to our audit.

Significant Audit Findings

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the City are described in Note 1 to the financial statements. No new accounting policies were adopted, and the application of existing policies was not changed during the year ended June 30, 2017. We noted no transactions entered into by the City during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected.

The most sensitive estimates affecting the City's financial statements are as follows:

- a. Management's estimate of the fair market value of investments is based on quoted prices in active markets. When quoted prices in active markets are not available, fair values are based on evaluated prices received by the City's broker or custodian.
- b. Management's estimate of the value of capital assets (infrastructure assets) is based on industry standards.

Significant Audit Findings (Continued)

Qualitative Aspects of Accounting Practices (Continued)

- c. The estimated useful lives of capital assets for depreciation purposes are based on industry standards.
- d. The annual required contributions, pension expense, net pension liability, and corresponding deferred outflows of resources and deferred inflows of resources for the City's public defined benefit pension plans with CalPERS are based on actuarial valuations provided by CalPERS.
- e. The annual required contribution and actuarial accrued liability for the City's Other Post-Employment Benefits (OPEB) plan is based on an actuarial valuation prepared by an outside consultant.
- f. Management's estimate of the workers' compensation claims payable is based on actuarial valuations, and the general liabilities claims payable is based on the claim adjuster's review of reserves for each individual claim.

We evaluated the key factors and assumptions used to develop these estimates in determining that they were reasonable in relation to the financial statements taken as a whole.

Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosures affecting the financial statements were reported in Note 9 regarding the CalPERS defined benefit plans, Note 11 regarding the City's Other Post-Employment Benefits plan, Note 12 regarding claims payable, and Note 17 regarding the recent changes in legislation affecting the dissolved redevelopment agency.

The financial statement disclosures are neutral, consistent, and clear.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management. Management has corrected all such misstatements. In addition, none of the misstatements detected as a result of audit procedures and corrected by management were material, either individually, or in the aggregate, to each opinion unit's financial statements taken as a whole.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditors' report. We are pleased to report that no such disagreements arose during the course of our audit.

Significant Audit Findings (Continued)

Management Representations

We have requested certain representations from management that are included in the management representation letter dated February 20, 2018.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a “second opinion” on certain situations. If a consultation involves application of an accounting principle to the City’s financial statements or a determination of the type of auditor’s opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the City’s auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Other Matters

We applied certain limited procedures to the management discussion and analysis; the schedule of changes in net pension liability and related ratios and the schedule of contributions for the miscellaneous pension plan; the schedule of proportionate share of net pension liability and the schedule of contributions for the safety pension plan; the schedule of funding progress for the OPEB plan; and the budgetary comparison schedules for the general fund and major special revenue funds, which are required supplementary information (RSI) that supplements the basic financial statements. Our procedures consisted of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management’s responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We did not audit the RSI and do not express an opinion or provide any assurance on the RSI.

We were engaged to report on the combining statements and individual fund schedules (supplementary information), which accompany the financial statements but are not RSI. With respect to this supplementary information, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled combining statements and individual fund schedules to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

We were not engaged to report on the introductory section and statistical section, which accompany the financial statements but are not RSI. We did not audit or perform other procedures on this other information, and we do not express an opinion or provide any assurance on them.

Upcoming Changes in Accounting Standards and Regulatory Updates

Procurement Rules under Uniform Guidance

The Uniform Guidance has different procurement rules than those previously required by the Circular A-133. Due to the work required by nonfederal entities to implement these new rules, a two-year grace period was given. In May 2017, an additional one-year grace period was given. Beginning July 1, 2018, nonfederal entities will be required to comply with all of the Uniform Guidance procurement rules. Included in these new rules is the requirement for written policies and procedures.

Commencing with the fiscal year 2018-2019 audits, auditors will request the written policies of the nonfederal entity for all single audits and review the procurement policies and procedures for compliance with the Uniform Guidance procurement rules.

Other Post-Employment Benefit Standards

In June 2015, the Governmental Accounting Standards Board (GASB) issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. The scope of this statement addresses accounting and financial reporting for post-employment benefits other than pension (other post-employment benefits or OPEB) that is provided to the employees of state and local governmental employers. This statement establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources and expense/expenditures for defined benefit and defined contribution plans. This statement requires governments to report a net OPEB liability or asset on the face of the financial statements. The City is required to implement GASB Statement No. 75 in fiscal year ending June 30, 2018.

Restriction on Use

This information is intended solely for the use of management, the City Council, and others within the City and is not intended to be, and should not be, used by anyone other than these specified parties.

White Nelson Dick Evans LLP

Irvine, California
February 20, 2018

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

The Honorable Mayor and City Council
City of Campbell
Campbell, California

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the City of Campbell, California (the City), as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the City's basic financial statements, and have issued our report thereon dated February 20, 2018.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the City's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we have reported to management and the City Council in a separate letter dated February 20, 2018.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the City's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the City's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

White Nelson Dick Evans LLP

Irvine, California
February 20, 2018

The Honorable Mayor and City Council
and Management
City of Campbell
Campbell, California

In planning and performing our audit of the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the City of Campbell, California (the City), as of and for the year ended June 30, 2017, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, we considered the City's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weakness, and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. We did not identify any deficiencies in internal control that we consider to be material weaknesses. However, as discussed below, we identified certain other matters involving the internal control and operational matters that are presented for your consideration. This letter does not affect our report dated February 20, 2018, on the financial statements of the City. Our comments and recommendations, which have been discussed with the appropriate members of management, are intended to improve the internal control or result in other operating efficiencies. Our comments are summarized as follows:

Refundable Deposits

Upon review of detail for refundable deposits, we noted that there were a number of deposits that have remained on the listing for several years with no change. We recommend that the City assigns staff to review the status of refundable deposits and that the appropriate action be taken to clear up deposits with no future obligation. Additionally, we recommend that the City assigns staff to continuously review this account to ensure that the refunds or adjustments to the account are processed timely.

Senate Bill 341 Reporting

Senate Bill 341 (SB 341) requires all successor housing entities to comply with annual report requirements within six months after the end of each fiscal year. The annual report must be posted to the City's website and contain all of the required items as described in Health and Safety Code Section 34176.1 beginning with Subsection (f). We noted that the annual report for the successor housing entity was not posted to the City's website for fiscal year 2016-2017 within six months after the end of the fiscal year. We recommend that management implements policies and procedures to ensure that the required information for SB 341 compliance is reported timely.

This communication is intended solely for the information and use of management, the City Council, and others within the City and is not intended to be, and should not be, used by anyone other than these specified parties.

White Nelson Dick Evans LLP

Irvine, California
February 20, 2018