

Mayor and Councilmember Advanced Leadership Workshop  
Monterey, CA

Friday, June 26, 2015 9:00 – 3:00pm

City Finances - What You Need to Know



As trustees of the city, elected officials and city managers have special and serious obligations to safeguard the fiscal assets of the public. The panel of experts will start with an overarching financial picture of state and local government finance in California and delve into essential aspects of municipal finance that every city councilmember should know. Learn how cities have gotten into financial trouble and the right questions to ask to know if yours is healthy. Gain insight into major trends, challenges ahead and possible reforms. Obtain essential skills to keep your city budget strong through tough economic times. Determine best practices in financial reporting and identify important questions to ask when building the city budget. Get your questions answered from peers and panelists.

Speakers:

**Michael Coleman**, Fiscal Policy Advisor, League of California Cities, [CaliforniaCityFinance.com](http://CaliforniaCityFinance.com)

**Laura Kuhn**, City Manager, City of Vacaville

**Drew Corbett**, Director of Finance, City of Menlo Park

Workshop Outline

1	Welcome / Introductions <i>Index cards: 1) What question do you want answered from this workshop? 2) other questions – cards collected at lunch.</i>
2	Your role as a councilmember, workshop overview
3	Revenues and fund accounting basics
4	Budgets and budget processes
5	Financial policies
6	Questions and answers (from cards and from the floor)
7	BREAK and peer discussion <i>Find someone you don't know. Share your answers to these questions: a) What is your city's the #1 source of general fund revenue? b) About what % of your general fund does your city spend on police? On fire? c) What are your city's biggest financial challenges? Successes?</i> Questions and answers (time permitting)
8	Financial reporting and auditing
9	Pension and OPEB costs
10	Capital financing and debt management
11	Ethical issues; purchasing best practices
12	LUNCH 12pm-1:30pm
13	Cash management and investments
14	Milestones in municipal finance: a brief history, the state-local relationship
15	Case study: the VLF <i>(if time)</i>
16	Why cities go bankrupt; Diagnosing financial health; Long range financial planning, Top Tips
17	Questions and answers (from cards and from the floor)
	Adjourn – 3pm

## Financial Reporting and Accounting

Financial reports are an essential oversight tool. There are two basic kinds of financial reports:

- **Interim Reports.** These include monthly reports, quarterly reports and mid-year budget reviews.
- **Annual Reports.** Well-managed public agencies typically prepare a report at the end of the year explaining revenues and expenditures levels.

In addition, local agencies that receive federal or other grant moneys may be subject to specific funder financial reporting requirements.<sup>20</sup>

Good interim reporting identifies important trends in time for local officials to act on them before serious problems arise. Audited financial reports alert governing body members if there are irregularities in financial practices and financial reporting. Both kinds of reports require a solid financial information system to track revenues and expenditures and provide that information to decision-makers.

### Questions to Ask

#### Interim Reporting

- What kind of reports do agency managers receive? What do they do with them?
- How often do elected officials receive interim financial reports? Does staff review the information in these reports with local officials?
- Do the reports provide meaningful information that gives local officials an accurate portrayal of the agency's current financial picture to date?
- Do the reports compare expectations with actual results? Do they discuss key variances between the two?

#### Some Financial Warning Signs

- Operating expenses exceeding revenues by more than five percent during the year
- Large mid-year variances in budgeted revenues and expenditures versus actual
- Inadequate or late financial reports
- Depletion of reserves to balance budget, for example if the reserves fall below ten percent of operating costs.
- Outstanding loans between funds at the end of the fiscal year
- Expenses exceeding revenues for two consecutive years, with the second year's deficit being larger than the first year's
- Debt service exceeds 10 percent of current revenues
- Increase in debt service as percentage of operating budget each year
- Qualified auditor's opinions
- Reports of internal control weaknesses from the agency's auditors with no corresponding plan to address (or repeated reports of such weaknesses from year to year)
- Large turnover in staff responsible for monitoring financial status



- Are there adverse patterns?
- Does staff have a plan to address problem areas?
- Are there inconsistencies or conflicting trends?
- Do the reports identify areas of uncertainty or risk in any forecasts contained in the reports?
- Do the reports frequently contain surprises (unexpected developments)?

### **Annual Reporting**

- Are the annual financial reports prepared by a certified public accountant, in accordance with generally accepted accounting principles? Are these reports audited by an outside or independent auditor?
- Have all the required disclosures, for example, those required by the Governmental Accounting Standards Board (GASB—sometimes pronounced “gaz-bee”) been made?
- How long has the outside or independent auditor been auditing the agency? Does the agency periodically change auditors every few years to provide a fresh view of the agency’s financial practices and reports?
- What is the relationship between the auditor and both the agency staff and the governing body? Is the auditor getting the information he or she needs in a timely manner? Is communication open and encouraged?
- Are the audited annual financial reports timely—within six months after year-end?
- Should the agency have an audit committee to select and supervise the work of the outside or independent auditor?<sup>21</sup>
- Are the auditors' opinions “unqualified?” (An “unqualified” opinion means that the auditor concludes the agency followed all accounting rules and that its financial reports present an accurate picture of the agency's financial condition. A qualified opinion is a significant warning sign that demands attention from the governing body.)
- Does the auditor prepare a transmittal letter that clearly and concisely describes the agency's fiscal status?
- Does the auditor issue a letter to the governing body reporting on the agency’ internal controls?
- Does the agency follow the “Award for Excellence in Financial Reporting” guidelines of the Government Finance Officers Association?<sup>22</sup> If not, why not?

## Cash Management and Investments

Sometimes, public agencies have funds on hand that are being held for longer-term needs. These may be invested in a variety of bonds (but not stocks), notes and other instruments allowed by state law.

The governing body's role is to be a wise steward of the public's resources. The objectives in managing public funds are, in priority order:

1. Safety (the likelihood that the agency will get all its money back)
2. Liquidity (the agency's ability to withdraw funds on short notice)
3. Yield (the interest or other return on the investment)

In light of these objectives, prudent public agency investment managers never seek to earn maximum returns on the agency's portfolio at the expense of safety or liquidity. This would expose the agency to an unacceptable level of too much risk.

Instead, they focus on seeking to earn a reasonable rate of return on the agency's investments, while preserving capital in the overall portfolio and meeting the cash flow needs of the agency.

There are funds that specialize in investing public agency funds; the Local Agency Investment Fund (LAIF) of the State Treasurer's office and CalTrust are examples.

### Questions to Ask

- What oversight procedures does the agency use for its investments? Who is responsible for the day-to-day supervision of the agency's investment activities? If that authority has been delegated to the agency's treasurer, has that authority been delegated annually as required by law?<sup>23</sup>
- If that authority has been contracted out, who is responsible for oversight?
- What is the agency's investment policy? Is it understandable? Does the governing body review it annually as the law requires?<sup>24</sup>
- Do governing body members receive and review periodic investment reports?<sup>25</sup> Do these reports include an analysis of cash flow needs?
- Are the investment reports clear and understandable? (A lack of clarity can be a sign of problems or undue investment complexity.)

- Do the reports show numerous investments and transactions? Why? (Many public agencies do not have portfolios that justify “active” management with lots of sales, purchases and trades.)
- Are the agency’s investments diverse or are the agency’s assets invested in just a few places?
- Do the agency’s policies allow investments in derivatives or other potentially high-risk instruments? Does that agency have any such high risk investments?
- Are any bank holdings over the FDIC insurance limit (which may vary from bank to bank) and do such depositories otherwise comply with state and federal standards to provide security for public agency deposits?<sup>26</sup>