

Finance Director Easley's Responses about Audited Financial Statements

A paper was distributed to council at the February 21, 2017 Santa Paula Council meeting in response to Vice Mayor Gherardi's questions about the FY 2015/2016 Audited Financial Statements subsequently presented at this meeting.

Responding to the question about a disappearing line item for "Transfers" from the Enterprise Funds to the General Fund, Director Easley said:

"Overhead has been reclassified as a reduction in expenditures to the General Fund and an expenditures (sic) to the charged funds. Before, overhead was listed as a transfer and would therefore not be included in the calculation of revenue net of expenditures. They should truly be considered a reduction in expenditures as we are sharing the cost of overhead applicable expenditures."

Comingling Direct Expenses with Estimated Expenses Clouds Operating Picture

By reclassifying overhead expenditures based on an estimated rate of proration, the *pro rata* expenditures are comingled with direct expenses, which theoretically are a direct function of running the enterprise. This has the effect of making the actual operating costs of the plant cloudy. Furthermore, because the rate is estimated, this rate can change at any time without review. A 14% rate one year might become 19% in a future year or 25% if the city needs the revenue. See the table below to understand how the transfers become revenue to the General Fund. It should also be obvious that by including these estimated expenses in the net Enterprise income, there will be continual pressure to raise rates and the notion of a rebate will be impossible.

Estimated Expenses Proration Amount Changed Arbitrarily

Earlier in the year, Director Easley said this about the proration methodology via email, indicating that the *pro rata* estimates can be adjusted without review. In the case cited in the email, the rates were lowered, but conceivably, if the city needs revenue, they can be increased arbitrarily.

Prior to fiscal year 15/16, these figures were based on 14% of the funds expenditures, however, 14% was higher than the \$500,000 & \$527,000 which were charged and neither I nor the Dr. Gardner felt that the higher amount was reasonable. For instance, in 2013-2014, the amounts would have been \$646,748 and \$527,829 (See attached).

Rebate Model Did Not Clarify How Transfers Affected Formula

Based on the FirstSouthwest Wastewater Rebate Model which was distributed for the third and second quarters of 2016, it is not clear where these transfers fall in the calculation of the 1.2 bond covenant ratio. However, as an estimated *pro rata* share of citywide administrative fees, any increase in these estimated expenses will distort the 1.2 ratio which could affect the bond rating negatively. And it should be noted that any expense added above the line will necessitate the need for additional revenue from the ratepayers to offset those expenses.

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Honest Mistake, Sloppy Auditing or Obfuscation

The most troubling part of the reclassification of the transfers is the lack of transparency by the staff and the auditing firm. One would think that when making a major six-figure reclassification which would affect the net revenue of the Enterprise funds, this reclassification would merit a note in the Audited Financial Statement. However, no such note appears.

Nor does the transferred revenue appear as income to the General Fund in the audit, as it has in previous years, or is there a note to explain offset expenses. These transfers are completely obfuscated. There is absolutely no reference to them in the Audited Financial Statements as revenue to the General Fund.

If the transfers were indeed charged as an expense, but not transferred, then the Enterprise fund balances would increase theoretically. There does not appear to be reconciliation between the former accounting practice and the new accounting practice where the *pro rata* estimated expenses are comingled with direct expenses.

The city has been transferring up to \$1 million annually from the Enterprise Funds to the General Fund as a regular practice, the lack of disclosure for such transfers is neither GAAP nor transparent. And, it is potentially non-compliant with Proposition 218.

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CITY OF SANTA PAULA GENERAL FUND REVENUE - BY DEPARTMENT

REVENUE TYPE	Actual	Actual	Actual	Estimated	Estimated
	2012-2013	2013-2014	2014-2015	2015-2016	2016-2017
SALES OF REPORTS, MAPS & PUB	4	0	19	1,000	1,500
2% DEVELOPER IMPACT ADMIN FEE	433	638	2,757	12,560	15,000
FILMING FEES	8,420	12,790	6,485	5,755	10,000
MISC-DEPARTMENT REIMB	21,463	0	0	0	0
INSURANCE ADMINISTRATIVE FEE	0	0	30	0	0
RETURNED CHECK CHARGE	3,826	4,024	2,575	2,495	2,800
EMPLOYMENT GARNISHMENT CHARGE	234	243	236	271	250
LEGAL SETTLEMENT REVENUE	54	0	940	0	0
DISASTER RECOVERY	0	0	0	0	0
WATER SERVICE CHARGES	0	0	0	0	0
SUSPENSE-REVENUE	0	0	0	0	100,000
Charges for Services	34,434	17,695	13,041	22,081	129,550
MISCELLANEOUS	3,934	1,375	0	0	0
CASH OVER/SHORT	0	0	2,350	60	0
PRIOR YEAR ADJ REVENUE	(603)	0	0	0	0
CITY DONATIONS	55	0	0	0	0
SALE OF PROPERTY	0	1,551,188	6,440	0	0
Other Revenue	3,386	1,552,564	8,790	60	0
TRANSFER FM NPDES STORMWATER	3,360	3,360	3,360	12,158	9,406
TRANS FM-STORMWATER QUALITY	9,731	9,731	9,731	12,030	28,483
TRANSFER FROM GAS TAX FUND	59,208	59,208	80,000	160,578	286,385
TRANSFER FROM LTF	0	0	0	21,981	44,255
TRANSFER FROM REFUSE FUND	161,005	5,258	0	0	0
TRANSFER FROM SEWER FUND	500,000	500,000	500,000	746,763	310,955
TRANSFER FROM WATER FUND	527,000	527,000	527,000	0	578,861
OVERHEAD FROM EQUIP MAINT	0	0	0	281,153	53,252
FEE STUDY UPDATE & EA PERMITTING	0	0	0	35,127	0
Transfers	1,260,304	1,104,557	1,120,091	1,269,790	1,311,597
Total	10,216,478	11,395,144	11,370,261	11,514,738	11,619,447
GENERAL FUND TOTAL	12,020,614	13,103,817	14,128,849	14,207,422	14,669,470

Chart from approved budget showing transfers to the General Fund from the Enterprise Funds.

City of Santa Paula
Wastewater System Rate Rebate
2nd Quarter CY 2016

	Projected FY 2016	Estimated Actuals FY 2016
OPERATING REVENUES		
Sewer Service Charges	\$11,000,000	\$10,052,096
Sewer Connection Fee	\$100,000	103,325
TOTAL OPERATING REVENUE	\$11,100,000	\$10,155,421
OPERATING EXPENSES		
Total Cost of Sales	\$2,500,000	\$1,802,753
Total Administration	\$1,200,000	\$2,045,128
TOTAL OPERATING EXPENSES	\$3,700,000	\$3,847,881
Net Income Availabe for Debt Service	\$7,400,000	\$6,307,540
Series 2010A	\$391,445	\$391,445
Series 2010B	\$491,825	\$491,825
Series 2015A	\$2,423,549	\$2,423,549
Series 2015B	\$1,561,250	\$1,561,250
Total Debt Service	\$4,868,070	\$4,868,070
Debt Service Coverage	1.52	1.30
Net Income Availabe After Debt Service	\$2,531,931	\$1,439,470
Bond Proceeds Beginning Balance	\$2,874,791	\$2,874,791
- CapEx	(\$1,000,000)	(\$1,608,549)
Bond Proceeds Ending Balance	\$1,874,791	\$1,266,242
Unrestricted Cash Beginning Balance	\$8,213,325	\$8,213,325
+ Net Income	\$2,531,931	\$1,439,470
- O&M Contract Breakage	(\$800,000)	\$0
- CapEx	\$0	(\$150,745)
- Extraordinary Expense (Wastewater Spill)	(\$1,000,000)	(\$1,208,078)
- CY 1st Quarter Rate Rebate (\$60 per account)	(\$378,000)	(\$535,800)
- CY 2nd Quarter Rate Rebate (\$0 per account)		\$0
Unrestricted Cash Ending Balance	\$8,567,256	\$7,758,172
Unrestricted Days Cash	365	325
System Users	6,300	8,930
Monthly User Rebate	\$20.00	\$0.00