



**CITY OF MARTINEZ**

**CITY COUNCIL AGENDA  
September 5, 2012**

**TO:** Mayor and City Council  
**FROM:** Alan Shear, Assistant City Manager  
**SUBJECT:** Response to Grand Jury Report: Financial Transparency with Meaning  
**DATE:** August 29, 2012

**RECOMMENDATION:**

Approve and authorize the City Manager to sign the attached responses to the Grand Jury Report #1213, "Financial Transparency with Meaning" by the 2011-2012 Contra Costa Grand Jury.

**BACKGROUND:**

The California Constitution established Grand Juries in each county. With respect to public agencies, Grand Juries are authorized to "investigate and report upon the operations, accounts and records of the officers, departments, functions, and the method of performing the duties of any such city and make such recommendations as it may deem proper. A governing body has 90 days to respond to the presiding judge of the superior court on findings contained in a Grand Jury Report.

In June, Martinez (as well as other public agencies in Contra Costa County) received the attached Grand Jury Report titled "Financial Transparency with Meaning" (Attachment A) which contained recommendations specific to certain jurisdictions. Accordingly, the attached draft responses (Attachment B) are presented for the City Council's consideration to transmit to the presiding judge.

**FISCAL IMPACT:**

Responding to the Grand Jury report took staff time.

**ACTION:**

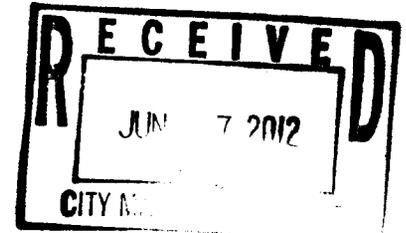
Motion to approve and authorize signature of the attached response.

Attachments:

- A. Grand Jury Letter & Report
- B. Letter to Contra Costa County Grand Jury

**APPROVED BY:**

  
City Manager



June 6, 2012

Philip A. Vince, City Manager  
City of Martinez  
525 Henrietta Street  
Martinez, CA 94553

Dear Mr. Vince:

Attached is a copy of **Grand Jury Report No. 1213, "Financial Transparency With Meaning?"** by the 2011-2012 Contra Costa Grand Jury.

In accordance with California Penal Code Section 933.05, this report is being provided to you at least two working days before it is released publicly.

Section 933.5(a) of the California Government Code requires that (the responding person or entity shall report one of the following actions) in respect to each finding:

- (1) The respondent agrees with the finding.
- (2) The respondent disagrees with the finding.
- (3) The respondent partially disagrees with the finding.

In the cases of both (2) and (3) above, the respondent shall specify the portion of the finding that is disputed, and shall include an explanation of the reasons therefore.

In addition, Section 933.05(b) requires that the respondent reply to each recommendation by stating one of the following actions:

1. The recommendation has been implemented, with a summary describing the implemented action.
2. The recommendation has not yet been implemented, but will be implemented in the future, with a time frame for implementation.
3. The recommendation requires further analysis. This response should explain the scope and parameters of the analysis or study, and a time frame for the matter to be prepared for discussion. This time frame shall not exceed six months from the date of the publication of the Grand Jury Report.

4. The recommendation will not be implemented because it is not warranted or is not reasonable, with an explanation thereof.

Please be reminded that Section 933.05 specifies that no officer, agency, department or governing body of a public agency shall disclose any contents of the report prior to its public release. Please insure that your response to the above noted Grand Jury report includes the mandated items. We will expect your response, using the form described by the quoted Government Code, no later than **SEPTEMBER 6, 2012.**

It would be greatly appreciated if you could send this response in hard copy to the Grand Jury as well as by e-mail to [clope2@contracosta.courts.ca.gov](mailto:clope2@contracosta.courts.ca.gov) (Word document).

Sincerely,



Lloyd Bell, Foreperson  
2011-2012 Contra Costa County Civil Grand Jury

**A REPORT BY  
THE 2011-2012 CONTRA COSTA COUNTY GRAND JURY**

725 Court Street  
Martinez, California 94553

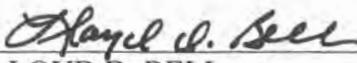
**Report 1213**

# **Financial Transparency with Meaning**

**“So far, so good...or maybe not”**

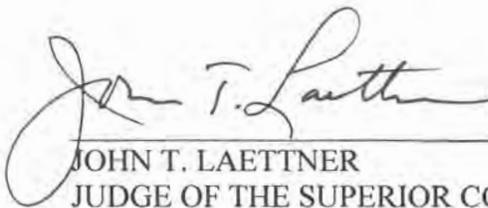
APPROVED BY THE GRAND JURY:

Date: May 24, 2012

  
\_\_\_\_\_  
LLOYD D. BELL  
GRAND JURY FOREPERSON

ACCEPTED FOR FILING:

Date: 5/31/12

  
\_\_\_\_\_  
JOHN T. LAETTNER  
JUDGE OF THE SUPERIOR COURT

Contra Costa County Grand Jury Report 1213

**Financial Transparency with Meaning**  
**“So far, so good...or maybe not”**

**TO: Cities of Contra Costa County**

**SUMMARY**

The nineteen cities in Contra Costa County are currently trying to cope with the same financial problems. Revenue available to fund city operations has been decreasing. At the same time, the need for programs and services to support the residents has been increasing. The potential impact of unfunded future pension and healthcare liabilities demands immediate attention. Structural changes associated with redevelopment agencies represent a potential threat to a city's debt rating and its ability to raise money. Maintenance and replacement of city assets is being deferred until some unidentified future time.

This difficult situation is not likely to change in the foreseeable future. As a result, it is especially important for residents to understand what actions their elected representatives are taking and what impact these actions are having in terms of services being provided and possible demands for new, additional taxes and assessments. To facilitate this, the cities have a responsibility to find new ways to provide easy to understand and easy to access financial information in a timely manner.

Cities have always had complex budget and reporting processes. The present state of the economy makes those processes even more difficult to follow. While posting lengthy budget documents and auditor's reports on a website has been the accepted past practice, it is no longer, in itself, a suitable way to keep residents advised and involved. Most residents do not have the time to attend city council meetings or review meeting minutes or read complicated reports. It is time to introduce a better way of keeping the public informed.

A long-standing indicator of the financial health of a city has been the amount it is holding as a reserve. The management of reserves and the public's understanding of the status of those reserves are important. To be meaningful, there must be a reference point, i.e., a minimum amount to be maintained. However, not every city has a formal policy on how much should be held in reserve, and not every city has a formal policy for replenishing the reserve after it has been used. These times demand that a rigorous policy be in place to guarantee that the reserve is used as intended and in the best interests of the community.

In recognition of the dramatic change in the financial environment, the types of information

provided must be reviewed and changed to give a timely and transparent picture of the situation. Reporting a reserve position is not enough to gauge the health of a city's finances. Presenting additional measurements of fiscal health may present a more accurate picture.

## **BACKGROUND**

### **Current Practice**

Every city is required by law to pass a balanced budget. Prior to the beginning of an upcoming twelve-month financial reporting period, all cities go through a budget process to estimate the revenues they can anticipate being available to pay for operations. This process also determines the types and levels of services provided to residents. Cities define the scope of the services they provide to the residents and budgeted expenditures estimate the cost to do so. The budget process also takes into account the funding requirements to support other obligations and liabilities, such as post-employment employee benefits.

As part of their budget process, some cities use five or ten-year projections of the city's operations as additional input. These projections are totally dependent upon assumptions of future events and conditions.

Cities also try to set aside funds to cover unanticipated costs. If a funding deficit is identified, the city may reduce services or choose to access reserves or budget stabilization funds accrued during past periods. It may take a combination of all of the above to create a final balanced budget.

The proposed budget is then presented to the city council in a public meeting where it is discussed and adopted. At that time, it becomes the city's financial operating plan. It is typically made available to residents on the city's website.

Periodically, the actual results are compared to the projections in the budget and discussed in a public meeting. When the year is completed, an independent accounting firm conducts an audit of the results and issues a report regarding the validity of the city's representation of the financial conduct of their business for that year. This is incorporated in a Comprehensive Annual Financial Report (CAFR). The law requires that this document become available to the public within 180 days of the end of the year. The CAFR is typically posted on the city's website.

The Government Finance Officers Association of the United States and Canada (GFOA) established the Certificate of Achievement for Excellence in Financial Reporting Program to encourage and assist local governments to go beyond the minimum requirements of generally accepted accounting principles and prepare comprehensive annual financial reports that evidence the spirit of transparency and full disclosure. The awarding of a Certificate recognizes an individual government whose CAFR achieves the highest standards in government accounting and financial reporting. Many of the County's nineteen cities have received a Certificate. However, the GFOA award does not include an evaluation of readability, ease of understanding of the CAFR by the public, or the best way to communicate the information.

## **The Challenge**

In the past four years, cities have been presented with a unique set of challenges. They have been confronted with decreasing revenue, increasing demand for services, recognition of unfunded future liabilities, and structural changes (e.g., dissolution of redevelopment agencies) requiring a potential reclassification of their debt position.

Despite reductions in personnel, outsourcing of work, departmental consolidation, renegotiation of salaries and benefits, and elimination of some services during the past three to four years, most cities have not been able to bring costs in line with available revenue. To make up the difference, they have been forced to draw on reserve funds intended to provide additional money to support the desired level of city services during more difficult times. Just as families and individuals try to save some money to set aside for a “rainy day,” cities also try to set aside money during “good times” to be available when circumstances warrant.

Because of its importance in helping cities work through a period of extreme economic challenges, reserves have become a commonly used key indicator of the financial health of a city. The amount of money in the reserve and whether it is growing or diminishing over time, may be an indication of whether or not the city is, or will be, facing a lack of resources to support its services.

Cities have differing definitions and measures of reserve positions. Some cities have a policy on how much reserves to keep, when and how to access them, and how to replace them. Some cities do not. In addition, the complex accounting methods employed from one city to the next make it challenging for residents to gauge the financial condition of their city or to compare it to other cities.

All cities have adopted the new reserve categories recommended by the Governmental Accounting Standards Board (GASB) known as GASB 54 for Fiscal Year 2010-2011. GASB 54 requires the cities to segment their general fund reserves into five categories based upon the extent to which they are bound to honor constraints on how those funds may be spent. The five funds are:

- Non-spendable fund balance
- Restricted fund balance
- Committed fund balance
- Assigned fund balance
- Unassigned fund balance

The last three funds combined make up the *unrestricted general fund reserve (unrestricted reserves)*. Unrestricted reserves are designed to provide adequate cash flow and offset economic downturns and revenue shortfalls. This is also available to provide for one-time funding in the event of an emergency situation such as a natural disaster or unanticipated liability.

## Managing Reserves

Drawing on the unrestricted reserves is one way that cities can offset declining revenues and balance the budget. This allows them to continue to provide the services needed by residents. However, there is a limit to how long cities can continue this practice. Eventually, the unrestricted reserves are exhausted and cities must accelerate implementation of other actions to address an imbalance between money available and costs for operations.

It is common for the amount of money in the unrestricted reserves to be considered an indicator of the relative financial health of the city. Also, it is considered appropriate to evaluate the city's position with respect to this indicator over an extended period of time, usually years.

Cities have been facing an extraordinarily complicated set of conditions for the past four years and their dependence on access to unrestricted reserves has become acute. As the unrestricted reserves are being drawn down, the balance in the fund can no longer, by itself, be considered the sole indicator of financial health. How the fund balance has changed over time is important. Perhaps most important is the state of the fund balance relative to the minimum level established by the city's policy.

Not all cities have established policies for the creation and maintenance of minimum unrestricted reserves. This contradicts the best practice recommendation by GFOA, which states that while the adequacy of the unrestricted reserves should be assessed based upon a government's own specific circumstances, the minimum balance should be no less than two months (about 16%) of regular general fund operating revenues or expenditures.

The GFOA recommends that governments establish a formal policy on the level of unrestricted reserves that should be maintained in the general fund. Such a guideline is recommended to be set by the appropriate policy body and to provide both a framework and specific plans for restoring the level of unrestricted reserves if they fall below the minimum level.

As an example of the application of the GFOA recommended practice, the reserve policy currently in place for the City of El Cerrito is:

It is a goal of the City to achieve a general operating reserve of 15%, with a minimum of 10%, of projected General Fund operating expenditures in each fiscal year. As part of the annual budget process, the City Council shall consider a Ten-Year Plan that attempts to maintain the minimum reserve balance of 15%. The City Council may adopt a deficit budget so long as the projected reserve does not go below 10% in any year of the Ten-Year Plan. Should the General Fund reserve fall below 10%, each budget year the City will adopt a plan to restore the reserve percentage to 10% within five years and 15% by the tenth year of the Ten-Year Plan.

The portion of the reserve below 10% should be utilized only for a financial emergency (as determined by the City Council), natural disaster or significant unanticipated liability. If this portion of the reserve is utilized for such an event, the Ten-Year Plan presented with the Annual Operating Budget must be

developed so that the 10% base threshold is replenished within five years.

The unreserved fund balance in the Equipment Replacement Fund may be transferred to the General Fund only for a fiscal emergency where the current year revenues have decreased from the prior year or for one-time uses such as natural disasters or unforeseen liabilities.

The reserves between the 10% and 15% level are designed to be used by the City to deal with revenue fluctuations that arise as a result of changes in the economy and provide opportunities to maintain services and programs where funding may be difficult. Also, a portion of any operating reserve in excess of 10% of annual revenues resulting from the previous fiscal year's operations could be committed to capital improvement projects or used to retire existing debt, fund future liabilities or potential legislative actions, establish or replenish equipment replacement funds, and/or establish or replenish deferred maintenance funds as long as the amount is considered in the adopted Ten-Year Plan to achieve a balance of 15% within ten years.

On the other hand the City of Martinez does not have a reserve policy. The residents cannot compare unrestricted reserves to a reserve policy as an indicator of the health of their city.

### **New Measurement**

In the current volatile financial environment, some cities are finding that adopting a budget, performing variance analyses, completing a CAFR, and relying on unrestricted reserves as a measure of fiscal health are no longer adequate. Additional indicators are available that take into account the reality and fluidity of the current situation, such as:

**Budget to Actual Performance** – This measure is used for internal management, measurement and reporting. Key decisions are made based on comparison of budget to actual. This metric is generally measured on a quarterly basis, presented to the city council, and made available to the public.

The GFOA recommends “that all state and local governments present mandated budgetary comparisons as part of their audited basic financial statements. The retention of the budget to actual comparison as a basic financial statement ensures that the strong link that has existed between the budget and financial reporting in the past will continue to enhance the credibility of both in the future.”

The City of Martinez looks at budget to actual on a quarterly basis. On the other hand, the City of Hercules does not.

**Days Cash Available** – Days cash available (running liquidity) is a measurement of the number of days a government can operate normally without additional revenue.

While the GFOA has not recommended this calculation as a best practice, the City of Pinole provides this information to the City Council on a regular basis. At a

February 7, 2012 presentation it was reported, "As of June 30, 2011, there was only enough cash available in the City Treasury to finance City activities for approximately two and one-half (2.5) months."

**Working Capital** – The working capital ratio measures the relationship between current assets and current liabilities. It is computed by dividing current assets by current liabilities. Best practice is that an entity maintain adequate levels of working capital in its enterprise funds to alleviate revenue shortfalls and unanticipated expenses. The GFOA recommends a target amount for working capital in enterprise funds be 90 days of annual operating expenses as a baseline with no less than 45 days as the minimum acceptable level.

The City of Pinole tracks working capital in the general fund and reports on it to the City Council on a quarterly basis.

**Ratio of Retirement Obligations to General Fund Revenues** – Retirement obligations are defined as the total of funded and unfunded future costs, such as pensions and other post-employment benefits. The indicator is the ratio of total retirement obligations to annual general fund revenues. Retirement obligations have risen over time and may continue to do so.

### **A Word on Bond Ratings**

Bond ratings are sometimes mentioned as an indicator of a city's financial stability and fiscal health. However:

- The bond ratings are based upon the specific reason for which the bonds were solicited. The financial information taken into account may be much narrower than the scope of a city's revenues and expenditures.
- The criteria used to rate bonds vary from rating agency to rating agency. This may result in different bond ratings coming from analyses of the same financial information.
- Bonds ratings are developed when a city applies for a bond and when the bond is issued. Bond ratings are infrequently updated unless a new application is received. As a result, bond ratings can be old and not reflective of a city's current financial condition.

### **A New Communication Tool**

In recent years, the internet has had a tremendous impact on public communication expectations. People expect to be able to get to information quickly, and they expect that information to be summarized so they can decide what they want to focus on.

Some governmental agencies and private sector businesses use the dashboard concept on their website to communicate key information. A financial dashboard reduces complex issues to simple summary form. Each indicator is displayed with a simple description, a number, and then a means to show if the number is good, bad, or indifferent. For example:



## FINDINGS

1. The budget process, government accounting systems, and financial statements provided to the public are complex and not readily understandable to most residents trying to assess the fiscal health of their city.
2. Review of examples of financial reports from cities made it clear that despite the intent for transparency and full disclosure, the documents were often difficult to understand.
3. Comparing the financial health of cities is difficult based only on information currently available to the public.
4. Not all cities have approved reserve policies or guidelines in place, making use of reserve levels for an assessment of financial health incomplete.
5. Cities have differing definitions and measures of reserves, which may prevent meaningful comparisons between the cities on this gauge of financial health.
6. It was often impossible to verify whether a city was meeting its reserve level policy using publicly available numbers, definitions, and guidance.
7. Some cities have had difficulty maintaining GFOA minimum recommended levels of unrestricted reserves, whether or not they had approved policies requiring maintenance of defined levels.
8. A city's ability to respond to future shortfalls may be impaired if it lacks a reserve policy containing specific plans for restoring reserves to a minimum required level.
9. There are other key financial indicators in addition to levels of reserves that could provide a better picture of a city's financial health.
10. Information about the financial health of a city is often difficult for the public to understand.

## RECOMMENDATIONS

1. The city should provide its city council and residents with a budget to actual performance comparison and the status of unrestricted reserves on a quarterly basis.

2. To increase financial transparency, the city should consider disclosing to the public the following key indicators of financial health: days cash available, working capital and ratio of retirement obligations to general fund revenue.
3. The city should consider having a reserve policy that addresses recommended minimum unrestricted reserve levels, the processes for drawing down reserves, and the process for replacing reserves when they are below the recommended level.
4. The city should consider adjusting its reporting process to include additional indicators of fiscal health in an easily accessible and understandable format.
5. The city should consider creating a dashboard of fiscal health indicators on its website.

### **REQUIRED RESPONSES**

Each city needs to respond only for its own practices.

<b><u>City</u></b>	<b><u>Findings</u></b>	<b><u>Recommendations</u></b>
City of Antioch	1-10	1-5
City of Brentwood	1-10	1-5
City of Clayton	1-10	1-5
City of Concord	1-10	1-5
Town of Danville	1-10	1-5
City of El Cerrito	1-10	1-5
City of Hercules	1-10	1-5
City of Lafayette	1-10	1-5
City of Martinez	1-10	1-5
Town of Moraga	1-10	1-5
City of Oakley	1-10	1-5
City of Orinda	1-10	1-5
City of Pinole	1-10	1-5
City of Pleasant Hill	1-10	1-5
City of Pittsburg	1-10	1-5
City of Richmond	1-10	1-5
City of San Pablo	1-10	1-5
City of San Ramon	1-10	1-5
City of Walnut Creek	1-10	1-5



## City of Martinez

525 Henrietta Street, Martinez, CA 94553-2394

(925) 372-3505 / Fax (925) 229-5012

September 5, 2012

Lloyd Bell, Foreperson  
2011-12 Contra Costa County Grand Jury  
P. O. Box 431  
Martinez, CA 94553-0091

Dear Mr. Bell:

On behalf of the Martinez City Council, this letter responds to Contra Costa County Grand Jury Report #1213: "Financial Transparency with Meaning" The City Council authorized this response at its meeting on September 5, 2012. In accordance with your request and Section 933.05 of the California Penal Code, the City will respond to each finding and recommendation separately.

### **Finding #1**

The budget process, government accounting systems, and financial statements provided to the public are complex and not readily understandable to most residents trying to assess the fiscal health of their city.

**City Response: The City partially disagrees with the finding. We believe our budget process is easily understandable to the public. Our annual budget document provides a more simplified financial statement and very detailed information about the City. The City's budget makes it clear to residents where revenues come from, specific projects and programs on which money is spent, and what cash is available in reserve.**

**The City agrees that government accounting systems and financial statements are very complex and only understandable to those skilled in governmental accounting. The format of financial statements is required by the Governmental Accounting Standards Board (GASB).**

### **Finding #2**

Review of examples of financial reports from cities made it clear that despite the intent for transparency and full disclosure, the documents were often difficult to understand.

**City Response: The City agrees with the finding.**

**Finding #3**

Comparing the financial health of cities is difficult based only on information currently available to the public.

**City Response: The City agrees with the finding.**

**Finding #4**

Not all cities have approved reserve policies or guidelines in place, making use of reserve levels for an assessment of financial health incomplete.

**City Response: The City agrees with this finding.**

**Finding #5**

Cities have differing definitions and measures of reserves, which may prevent meaningful comparisons between the cities on this gauge of financial health.

**City Response: The City agrees with the finding**

**Finding #6**

It is often impossible to verify whether a city was meeting its reserve level policy using publicly available numbers, definitions, and guidance.

**City Response: The City agrees with the finding**

**Finding #7**

Some cities have had difficulty maintaining GFOA minimum recommended levels of unrestricted reserves, whether or not they had approved policies requiring maintenance of defined levels.

**City Response: The City agrees with the finding**

**Finding #8**

A city's ability to respond to future shortfalls may be impaired if it lacks a reserve policy containing specific plans for restoring reserves to a minimum required level.

**City Response: The city partially disagrees with the finding. Although the City doesn't have a formal reserve policy, an informal policy already exists. Any use of reserves is done at a public meeting.**

**Finding #9**

There are other key financial indicators in addition to levels of reserves that could provide a better picture of a city's financial health.

**City Response: The City agrees with the finding.**

### **Finding #10**

Information about the financial health of a city is often difficult for the public to understand.

**City Response:** The City partially disagrees with the finding. Reporting financial information to the public varies widely among agencies and there is no set standard for reporting other than the prescribed financial statement format for the Comprehensive Annual Financial Report (CAFR). However, as stated in Finding #1, the City's budget document is easy to understand as it provides a more simplified financial statement and very detailed information about the City.

### **Recommendations #1**

The city should provide its city council and residents with a budget to actual performance comparison and the status of unrestricted reserves on a quarterly basis.

**City Response:** Revenues and expenditures do not flow smoothly over the course of the year. For example, the City's largest revenues property tax, property tax swap and In-lieu isn't received until December and January. If the City was to do a budget to actual performance comparison before significant revenues are received, this could lead the reader to incorrectly conclude that the City is in financial difficulty. The City conducts a budget update at a City Council meeting every six months which compares revenues to expenditures, and projections for end of the year unassigned fund balances. The City also provides a first quarter budget review when the Comprehensive Financial Report is given to Council. Since the City produces an annual CAFR, which budget to actual comparisons are required, the City is following GFOA's recommendation as outlined on page 5 of the grand jury report.

### **Recommendations #2**

To increase financial transparency, the city should consider disclosing to the public the following key indicators of financial health: days cash available, working capital and ratio of retirement obligations to general fund revenue.

**City Response:** This recommendation will be reviewed and may possibly be implemented with the quarterly investment report and/or the budget process.

### **Recommendations #3**

The city should consider having a reserve policy that addresses recommended minimum unrestricted reserves level, the processes for drawing down reserves, and the process for replacing reserves when they are below the recommended level.

**City Response:** An informal policy already exists for unrestricted reserve levels. The decision and process to draw down reserves is done at a public meeting.

Mr. Bell  
September 5, 2012  
Page Four

**Recommendations #4**

The city should consider adjusting its reporting process to include additional indicators of fiscal health in an easily accessible and understandable format.

**City Response: This recommendation has been implemented. The City believes that our budget document, which is available online, contains very understandable and uncomplicated fiscal health indicators to our public. The City has received GFOA's budget award which GFOA states:**

***"What are the benefits in receiving the budget award?"***

*Users of the budget documents will have access to a high quality report promoting better transparency to citizens and other stakeholders.*

**In addition, the City received the following comments from the GFOA review of the FY11-13 budget as part of the award process:**

***"Good explanation of forecast assumptions."***

***"Great revenue details and graphs."***

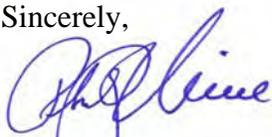
***"Very easy to read document."***

**Recommendations #5**

The City should consider creating a dashboard of fiscal health indicators on its website.

**City Response: This recommendation will not be implemented. The City believes the forthcoming implementation of recommendation #2 will provide the needed indicators of fiscal health.**

Sincerely,



Philip A. Vince  
City Manager

c: Mayor and City Council  
Jeffrey Walter, City Attorney  
Alan Shear, Assistant City Manager