



City Council Agenda Item Staff Report

CITY OF SAN BRUNO

DATE: February 13, 2024

TO: Honorable Mayor and Members of the City Council

FROM: Alex D. McIntyre, City Manager

PREPARED BY: Nick Pegueros, Chief Financial Officer
Yu-Chiao Chao, Accountant
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SUBJECT: Receive and File the Annual Comprehensive Financial Report, Report on Agreed-Upon Procedures Applied to Appropriations Limit Schedule, and Other Required Outside Agency Reports for the Fiscal Year Ended June 30, 2023

BACKGROUND:

San Bruno Municipal Code Section 2.28.030(b) and California state law require the City to engage an independent certified public accountant to audit the City's financial transactions and reports annually. The City engaged Badawi & Associates (Auditors) to conduct the audit, with this year's audit being the firm's second for San Bruno. The audit examines the financial statements, evaluates compliance with applicable laws and regulations, and assesses the City's internal controls against fraud. The Annual Comprehensive Financial Report (ACFR) is the City's formal financial statements document, and it includes important disclosures about a city's financial policies, assets, liabilities, and performance over the past two years.

DISCUSSION:

Overall Financial Health

Net position, the difference between assets and liabilities, is a measure of fiscal health over time, with an increase often indicating sound financial management. As of June 30, 2023, the City's combined net position stood at \$293.6 million, up \$99.2 million or 51% from the previous year. However, such a substantial year-over-year increase warrants further analysis to determine if it stems from one-time events or represents a structural shift in the City's finances. The Fiscal Year 2022-23 (FY23) saw two significant one-time events contributing to the \$99.2 million rise in net position. First, the City received \$56.6 million in impact fees and community benefits, largely restricted in use and considered one-time revenue. Second, the net position benefitted from a \$22.9 million contribution by the San Bruno Community Foundation for the new Recreation and Aquatic Center (RAC). Additionally, transient occupancy and cardroom taxes increased by \$1.1 million and \$1.0 million, corresponding to rises of 43.6% and 43.3%, respectively.

The ongoing litigation of the City's tax share agreement with Walmart.com is a major concern. On April 17, 2023, the California Department of Tax & Fee Administration (CDTFA) issued a

reallocation notice of approximately \$27.5 million to the City and Walmart, proposing redistributing sales taxes from the tax share agreement to other jurisdictions. The City and Walmart filed for legal relief on October 26, 2023, to affirm the City's sales tax allocation. A loss in this case could significantly impact the City's structural revenues, with limited alternatives to recover the potential sales tax shortfall from other retailers.

General Fund Overview

The financial statements present all unrestricted funds under the "General Fund" column, consolidating the City's General Fund operations and reserves, Measure G, and the American Rescue Plan Act. Fiscal Year 2022-23 (FY23) ended with a \$6.6 million deficit resulting from the use of one-time monies to support transfer to capital improvement program funds. Revenues totaled \$69.7 million, up \$6.3 million or 10.0% from the previous year, due to moderate growth in taxes, licenses, permits, and charges for services. Expenditures totaled \$59.0 million, marking an increase of \$5.6 million or 10.5% from the previous year, primarily due to increased allocations to public safety and maintenance of general public works and streets. Net interfund transfers totaled a negative \$17.4 million to support capital improvement projects. Details on each Fund reported in the "General Fund" column of the financial statements are available in the Supplementary Information section of the ACFR.

New Major Fund: Developer Agreements and Impact Fee Funds

Developer agreement and impact fee revenues in FY23 totaled \$56.6 million, primarily from Google/YouTube campus expansion, and are recorded across nine distinct Funds to ensure the proper use of impact fee collections under state law and the terms of development agreements. The nine funds are consolidated into one column, "Developer Agreements and Impact Fees," and are a "major fund" on the face of the basic financial statements. Details on each developer agreement and impact fee Fund are available in the Supplementary Information section of the ACFR.

Enterprise Funds Overview

The Water Fund's net position rose by \$0.8 million to \$71.1 million, a significant drop from the previous year's \$5.5 million increase due to the suspension of rate adjustments for the Fund's operations and capital improvements. Revenues remained steady while expenses grew by about \$4.9 million. Although the City adopted a five-year rate plan with annual 5% increases in 2017, the City chose not to raise water rates in the final two years of the five-year plan due to the pandemic. The City resumed its past practice of annual rate increases to ensure the enterprise's fiscal solvency by adopting a five-year water rate plan, effective January 1, 2024.

Similarly, the Wastewater Fund's net position increased by \$4.4 million to \$77.4 million, less than the previous year's \$5.4 million increase, again due to suspended rate adjustments, resulting in nearly unchanged revenues and a \$2.1 million (16.4%) rise in expenses. Although the City adopted a five-year rate plan with annual 5% increases in 2017, the City chose not to raise wastewater rates in the final two years of the five-year plan due to the pandemic. The City resumed its past practice of annual rate increases to ensure the enterprises' fiscal solvency by adopting a five-year wastewater rate plan, effective July 1, 2023.

As of June 30, 2023, the CityNet Fund had a negative equity balance of \$21.5 million, comprised of negative cash and non-cash liabilities such as unfunded pension liabilities. The negative equity balance included \$16.0 million owed to the General Fund due to multi-year reliance on advances from the General Fund to sustain operating charges, including franchise

fees, internal service allocations, and general overhead allocations. The Fund has been experiencing annual operating losses, including losses of \$794,852 in FY23 and \$861,293 in the prior year.

City staff are working to improve CityNet's revenue and subscription margins. One major step was increasing service rates between 9% and 12% effective August 1, 2023, which improved year-over-year operating income for the first six months of Fiscal Year 2023-24 (FY24). However, additional rate increases, potentially between 2% and 5%, are being considered to further financial stability. In FY24, City staff will evaluate whether rate increases are sufficient to begin repayment of the amounts owed to the General Fund. The CityNet Enterprise may no longer be a going concern if rate increases are insufficient to repay amounts owed to the General Fund. In December 2023, the City issued a Request for Interest to gauge the private-sector's appetite to acquire CityNet's customer base and infrastructure as part of a broader strategy to ensure continuity of services to the community.

The Stormwater Fund, as of June 30, 2023, also had a negative equity balance of \$2.2 million, comprised of negative cash and non-cash liabilities such as unfunded pension liabilities. The negative equity balance included \$0.6 million owed to the General Fund. The enterprise reported operational losses of \$1,099,400 in FY23, up from \$590,107 in the previous year. Like CityNet, Stormwater requires transfers from the General Fund to meet its operational and capital spending requirements. Starting in July 2023, the City began collecting \$798,993 annually from the garbage franchise to offset stormwater service costs, which are affected by the amount of garbage in culverts and drains. This new revenue covers about 70% of the deficit, and efforts are ongoing to reduce the General Fund's support of the enterprise.

Report on Transfers Between Funds

The City Council's adopted fund balance and reserve policy requires reporting of transfers from the General Fund to other funds to offset negative cash balances in the receiving fund. Three funds received transfers from the General Fund in FY23 to offset their negative cash balances. The causes of these negative funds result from cumulative deficits, as discussed above, for CityNet and Stormwater Enterprises and are recorded as advances with an expectation of repayment over time. For FY23, the State/Federal Grants fund also required a transfer from the General Fund to meet cashflow needs resulting from the 2023 Winter Storm Emergencies. The City has applied for federal emergency relief funds available to local governments for eligible expenditures associated with the emergencies. Reimbursement requests are pending. The following summarizes the reduction in resources available for operations, capital, and reserves in the General Fund to eliminate negative cash positions in other funds.

Transfer from General Fund to:	
CityNet Enterprise	\$16,036,799
Stormwater Enterprise	642,426
State/Federal Grants	1,450,548
Total	\$18,129,773

Transportation Development Act Program (TDA) Report

The TDA audit report, Attachment 5, raised an audit finding that the City did not file the audit report to the Metropolitan Transportation Commission within 180 days of the close of Fiscal Year 2022 (FY22). Due to staff transitions in the Finance Department, the City incorrectly asserted that a TDA audit was not required for FY22, thereby failing to submit a fiscal audit in

accordance with Section 99245 of the Public Utilities Code (PUC) for each year expenses are encumbered against the TDA Program. PUC Section 99245 states that the City must submit its TDA audit within 180 days of the end of the fiscal year. The City acknowledges the need for corrective actions to address the failure to identify TDA expenditures in the FY22 year-end close procedures. Staff is developing a structured and robust grants management procedure in response to this recommendation, effective for the June 30, 2024, audit. This procedure will specifically focus on tracking revenue and expenditure, emphasizing timely and comprehensive year-end processes.

FISCAL IMPACT:

There is no fiscal impact.

ENVIRONMENTAL IMPACT:

The action is not a project subject to CEQA. City Council's action is not considered a "Project" per CEQA Guidelines and therefore no further environmental analysis is required.

RECOMMENDATION:

Receive and File the Annual Comprehensive Financial Report, Report on Agreed-Upon Procedures Applied to Appropriations Limit Schedule, and Other Required Outside Agency Reports for the Fiscal Year Ended June 30, 2023.

ALTERNATIVES:

1. Receive and file report and request that the City's auditor provide a presentation at a future City Council meeting.

ATTACHMENTS:

1. City of San Bruno Annual Comprehensive Financial Report (ACFR) for the Fiscal Year Ended June 30, 2023
2. Independent Accountants' Report on Agreed-Upon Procedures Applied to Appropriations Limit Schedule
3. Measure A Fund Audit Report for the Fiscal Year Ended June 30, 2023
4. Measure W Fund Audit Report for the Fiscal Year Ended June 30, 2023
5. Transportation Development Act Program Audit Report for the Fiscal Year Ended June 30, 2023