



TOWN OF APPLE VALLEY

TOWN COUNCIL STAFF REPORT

To: Honorable Mayor and Town Council **Date:** February 13, 2017

From: Kofi Antobam, Director of Finance **Item No:** 16
Finance Department

Subject: COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR) FOR THE
FISCAL YEAR ENDED JUNE 30, 2017

T.M. Approval: _____ **Budgeted Item:** Yes No N/A

RECOMMENDED ACTION:

It is recommended that the Town Council receive and file the Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2017.

SUMMARY:

The Town is required to engage a public accounting firm to conduct an annual independent audit of the Town's basic financial statements in accordance with Governmental Auditing Standards issued by the Comptroller General of the United States. The audit must be conducted by licensed Certified Public Accountants who, at the conclusion of their test work, must opine upon the accuracy and completeness of the statements and whether the statements present fairly the financial position of the governmental activities, business-type activities, each major fund, and the aggregate remaining fund information of the Town as of June 30, 2017.

The June 30, 2017 audit was conducted by the public accounting firm of Van Lant and Fankhanel, LLP, who have issued their Independent Auditor's Report accompanying the financial statements. The Auditors have issued an unqualified "clean" opinion" letter meaning that the financial statements present fairly in all material respects, the respective financial position of the governmental activities, business-type activities, each major fund, and the aggregate remaining fund information of the Town as of June 30, 2017.

Also, a component of the audit is an evaluation of the internal controls of the Town and the issuance of a report noting any material weaknesses or significant deficiencies in those controls. The auditors identified three of such weaknesses. The Comprehensive Annual Financial Report (CAFR) and related reports are attached for your review to receive and file.

BACKGROUND:

At the end of every fiscal year, the financial statements and books and records of the Town are audited by an outside independent public accounting firm. After issuance of the Auditor's Independent Report, the Town issues audited financial statements inclusive of the Auditor's Report as part of its CAFR. The presentation format of the CAFR is in accordance with professional standards established by the Government Finance Officers Association of the United States and Canada (GFOA). The Town is required to present Audited Basic Financial Statements annually. Preparation and presentation of the CAFR significantly exceeds those reporting minimum requirements. In addition to the CAFR, three letters addressed to the Town Council accompany the CAFR which present a Report on Internal Controls (Attachment 2), a Letter to Those Charged with Governance (Attachment 3), and Appropriations Limit report. If the auditors identified discrepancies regarding internal financial management controls and financial management practices, these discrepancies would be identified in these Letters.

The Town annually submits its CAFR to the GFOA's Certificate of Achievement for Excellence in Financial Reporting awards program for consideration for the award. The Town's fiscal year 2016 CAFR received the Certificate of Achievement award and the Town's fiscal year 2017 CAFR has again been submitted for consideration for this award.

Presented for your review are the following CAFR financial highlights for FY 2016-2017:

Town-wide Financial and Audit Highlights:

- The assets of the Town of Apple Valley exceeded its liabilities at the close of the most recent fiscal year by \$450,854,747 (*net position*). Of this amount, \$415,009,907 represents the net investment in capital assets or infrastructure assets. Also, \$7,642,548 (*unrestricted net assets*) may be used to meet the government's ongoing obligations to citizens and creditors.
- The governmental activities total net assets decreased by \$2,313,013 and the Business-Type total net assets increased by \$2,107,395. These changes are attributable to depreciation of capital (infrastructure) assets, change in cost allocation methodology and addition of Apple Valley Choice Energy (AVCE).
- As of the close of the current Fiscal Year, the Town's governmental funds reported combined ending fund balances of \$34,847,471, a decrease of \$2,103,219 in comparison with the prior year.
- As of the end of the fiscal year, the General Fund fund balance totaled \$12,846,989 which represented a net decrease or net loss for the fiscal year of \$4,026,806. \$1,766,647 of the total fund balance is unrestricted.

- The auditors rendered an unqualified “clean” opinion which means that the financial statements present fairly in all material respects, the respective financial position of the governmental activities, business-type activities, each major fund, and the aggregate remaining fund information of the Town as of June 30, 2017.
- The auditors detected three deficiencies in internal controls.

A more detailed discussion of the financial statements is found in the Transmittal Letter and the Management Discussion and Analysis (MD&A) sections contained within the CAFR.

Mr. Greg Fankhanel and/or Mr. Brett Van Lant, Certified Public Accountants and Managing Partners at Van Lant and Fankhanel, LLP, will be attending the February 13, 2018 Council meeting to present their findings and answer any questions that the Town Council may have regarding the presentation of the CAFR.

ATTACHMENTS:

1. Comprehensive Annual Financial Report for the year ended June 30, 2017.
(Distributed to the Town Council on January 23, 2018. Also available for the public’s review on the Town website and at the Town Clerk’s office).
2. Report on Internal Control
3. Letter to Those Charged with Governance
4. Appropriations Limit Report

**Independent Auditor's 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***

Town Council
Town of Apple Valley
Apple Valley, 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, business-type activities, each major fund and the aggregate remaining fund information of the Town of Apple Valley (the "Town"), as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the Town's basic financial statements, and have issued our report thereon dated December 29, 2017.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Town'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 Town's internal control. Accordingly, we do not express an opinion on the effectiveness of the Town'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 material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings and questioned costs, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

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. We consider the deficiencies described in the accompanying schedule of findings and responses, listed as items 2017-1 and 2017-2, to be material weaknesses.

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. We consider the deficiency described as item 2017-3 in the accompanying schedule of findings and responses to be a significant deficiency.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Town'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 instances of noncompliance and other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and responses as items 2017-1 and 2017-2.

Town of Apple Valley's Response to Findings

The Town of Apple Valley's responses to the findings identified in our audit are described in the accompanying schedule of findings and responses. The Town's responses were not subject to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

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 Town'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 organization's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Van Lant + Fankhaenel, LLP

December 29, 2017

**TOWN OF APPLE VALLEY
SCHEDULE OF FINDINGS AND RESPONSES
Year Ended June 30, 2017**

2017-1: Expenditures in Excess of Adopted Budget

The following is a continuation from the prior year:

Condition:

On June 14, 2016, the Town Council adopted Resolution 2016-14 approving the budget for the fiscal year ended June 30, 2017. In addition, in February 2017, Town Council approved budget amendments as part of a mid-year budget review. As displayed in the Town's Comprehensive Annual Financial Report (CAFR), actual expenditures in the General Fund exceeded the budgeted appropriations in the current fiscal year by approximately \$2,996,000.

Criteria:

The budget, upon adoption by the Town Council through resolution, became a legal document establishing the authorized expenditures for the fiscal year.

Cause of Condition:

The Town's expenditures exceed the appropriated budget in the General Fund.

Recommendation:

We recommend the Town strengthen internal controls to ensure that actual expenditures do not exceed appropriated budget amounts. Although Town staff completed mid-year budget reviews and Town Council authorized additional appropriations, we recommend requesting budget amendments throughout the fiscal year, as necessary, to be approved by Town Council, to ensure that all expenditures are in accordance with the budget established by the Town Council.

Management's Response:

Expenditures resulting in the finding were a result of a change in the Town's cost allocation plan methodology which was discussed with Town Council; however, no budget amendment was submitted to Council for consideration to formally approve a budgetary appropriation. Staff will continue to improve budgetary controls by requesting budget amendments throughout the fiscal year as necessary.

**TOWN OF APPLE VALLEY
SCHEDULE OF FINDINGS AND RESPONSES
Year Ended June 30, 2017**

2017-2: Deficit Spending

The following is a continuation from the prior year:

Condition:

The unrestricted (or available) fund balance in the Town's General Fund has decreased by approximately \$6.4 million over the past two fiscal years, leaving a balance of \$1,766,647 as of June 30, 2017. Cash and investment balances in the General Fund have decreased by approximately \$6.4 million over this same period as well. The decreases in unrestricted fund balance are the result of the Town's expenditures/expenses exceeding revenues, and long-term advances made to other funds.

Criteria:

The unrestricted fund balance in the General Fund has decreased significantly over the previous two fiscal years. It appears this may be due to structural deficits in the financial operations of this fund, along with providing long-term advances to other funds.

Cause:

The decrease in the fund balance of the General Fund resulted from total expenditures and net transfers exceeding revenues.

Potential Effect of Condition:

If the current trends described above continue, the financial condition of the General Fund could negatively affect the level of services the Town can provide to citizens in the future.

Recommendation:

In light of the above information, we recommend the Town consider its current financial position and related policies in the fund described above to determine if financial policy and budget revisions are necessary. Financial policies should be established to ensure continued financial solvency in the long-term, while maintaining necessary services for the citizens of Apple Valley.

Management's Response:

The Town has established financial policies to ensure continued financial solvency long-term and will continue to review these policies. A variety of measures are being undertaken in the 2017-18 fiscal year to ensure that solvency is maintained and any budgetary deficits eliminated.

**TOWN OF APPLE VALLEY
SCHEDULE OF FINDINGS AND RESPONSES
Year Ended June 30, 2017**

2017-3: Vendor Contracts

The following is a continuation from the prior year:

Condition:

As part of our risk assessment procedures we reviewed disbursements to various vendors for supplies, services, and projects. In addition, we compared selected invoices with various vendor contracts. While performing these procedures, we found contracts that were entered into many years ago. For example, the Town has agreements with a company to provide Building and Safety Services and a separate agreement to provide engineering services. Town staff provided copies of agreements for Building and Safety Services and Engineering Services which were entered into in April 1994 and November 2005, respectively, with no stated expiration dates. The agreements indicate the various services to be provided throughout the year. Town management has represented to us that an informal review and evaluation of these services has been completed periodically in the recent past, including comparing costs with other cities, however, we were not provided any formal documentation as evidence.

Criteria:

In a strong internal control environment, a government agency that contracts for services should include contract expiration dates in contracts that exceed a specified amount to ensure that the agency will properly monitor and review the contract at a specified date.

Cause of Condition:

Some of the Town's contracts do not have a specified expiration date and management has not maintained documentation of formal evaluations of these services. Also, the Town has not competitively bid for these services in many years.

Potential Effect of Condition:

There is no formal documentation that the Town is receiving the best possible service for the best possible price.

Recommendation:

We recommend the Town review its contracts with various vendors and determine which contracts may be outdated or do not have expiration dates. The Town should then, based on the established purchasing policies and procedures, determine whether they need to prepare a formal request for proposal for the applicable services, or document the reasons why a request for proposal was not completed. New agreements should include not-to-exceed prices/rates and

**TOWN OF APPLE VALLEY
SCHEDULE OF FINDINGS AND RESPONSES
Year Ended June 30, 2017**

contract expiration dates. As contracts and agreements expire, the Town should determine if they want to extend the agreement, based on satisfactory performance and value, or whether they need to go through another request for proposal process.

Management's Response:

Most, if not all Town contracts and agreements do contain termination dates or clauses that terminate the contract upon a specified notice period between 30 days and one year. As contracts and agreements expire, Town staff does determine if the contract should be extended based on satisfactory performance and value or whether an RFP process is warranted. Management will establish a formal procedure to ensure that all contracts and agreements contain expiration dates and that reviews of these contracts or agreements are documented in the future.

December 29, 2017

Town Council
Town of Apple Valley
Apple Valley, CA

We have audited the financial statements of the governmental activities, business-type activities, each major fund, and the aggregate remaining fund information of the Town of Apple Valley for the year ended June 30, 2017. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards, *Government Auditing Standards*, and the Uniform Guidance, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter to you dated April 17, 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 Town are described in Note I to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the fiscal year ended June 30, 2017. We noted no transactions entered into by the Town 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 financial statements were:

Management's estimate of the fair value of investments is based on information provided by financial institutions. We evaluated the key factors and assumptions used to develop the fair value of investments in determining that it is reasonable in relation to the financial statements as a whole.

Management's estimate of capital assets depreciation is based on historical estimates of each capitalized item's useful life. We evaluated key factors and assumptions used to develop the estimated useful lives in determining that they are reasonable in relation to the financial statements as a whole.

Management's estimate of the net pension liability is based on actuarial information provided by the California Public Employee Retirement System's (CalPERS) actuarial office. We evaluated the key factors and assumptions to develop the net pension liability in determining that it is reasonable in relation to the financial statements as a whole.

Management's plans to repay the advances from the General Fund to the Apple Valley Golf Course and Parks and Recreation Funds, and eliminate the deficit fund balances in those funds, are based on the assumption that the Town will successfully impose a new tax measure to increase the revenues in the Parks and Recreation and Golf Course Funds. We evaluated the key factors and assumptions used to develop the repayment plan in determining that it is reasonable in relation to the financial statements 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:

The disclosure of the fair value of investments in Note IV A to the financial statements represents amounts susceptible to market fluctuation.

The disclosure of accumulated depreciation in Note IV E to the financial statements is based on estimated useful lives which could differ from actual useful lives of each capitalized item.

The disclosure of the net pension liability in Note V C to the financial statements is based on the Town's proportionate share of the total pension liability of the pool and includes assumptions for discount rates, which could differ from actual discount rates. Note V C discloses the differences in the net pension liability assuming different discount rates.

The disclosures in Notes IIIA, IV B, and V F regarding Management's plans to repay the advances from the General Fund to the Apple Valley Golf Course and Parks and Recreation Funds, and eliminate the deficit fund balances in those funds are based on the Town's ability to successfully impose a new tax measure in the future.

Difficulties Encountered in Performing the Audit

During our audit, we discussed the Town's application of cost allocations from the General Fund to the Sewer and Solid Waste Enterprise Funds with the Assistant Town Manager of Finance and Administration. Although adjustments to the cost allocations were ultimately made by management to reflect the cost allocation study that was completed in March 2017, the Assistant Town Manager of Finance and Administration was reluctant to make these adjustments, causing delays in the completion of the 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 trivial, and communicate them to the appropriate level of management. None of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to the financial statements taken as a whole.

Disagreements with Management

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

Management Representations

We have requested certain representations from management that are included in the management representation letter dated December 29, 2017.

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 Town'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 Town's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

It should be noted, as disclosed in Notes IV B and V F to the financial statements, the Town's Parks and Recreation and Apple Valley Golf Course Funds had significant deficit fund balance/net position, as well as current year operating deficits as of the end of the 2016-17 fiscal year. These deficits existed in previous fiscal years, and have not improved in fiscal year 2016-17. The note disclosure also describes actions the Town has taken or will be taking to address these fund deficits.

It should also be noted, the unrestricted fund balance in the General Fund decreased \$4,916,789 in the current fiscal year. The decrease represents approximately 278% of unrestricted fund balance in the General Fund as of the end of the fiscal year.

Findings and Recommendations

In addition to our audit opinion on the financial statements, we issued our "Independent Auditor's 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*" dated December 29, 2017, in which we identified material weaknesses, significant deficiencies and compliance findings for expenditures exceeding the budgeted appropriations in the General Fund, issues regarding vendor contracts, and spending deficits in the General Fund.

Other Matters

With respect to the supplementary information accompanying the financial statements, 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 the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

New Accounting Pronouncements

As described in Note I to the financial statements, in June of 2016, GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. GASB Statement No. 75 will be required to be implemented for the fiscal year ending June 30, 2018 and will have an impact on how the Town reports the outstanding liabilities related to postemployment benefits other than pensions.

Restriction on Use

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

Very truly yours,

Van Lant + Fankhauser, LLP

**INDEPENDENT ACCOUNTANT'S REPORT ON AGREED-UPON PROCEDURES
APPLIED TO APPROPRIATIONS LIMIT WORKSHEETS**

Town Council
Town of Apple Valley
Apple Valley, California

We have performed procedures enumerated below to be the accompanying Appropriations Limit worksheet of the Town of Apple Valley, for the year ended June 30, 2017. These procedures, which were agreed to by the Town of Apple Valley and the League of California Cities (as presented in the publication entitled *Agreed-upon Procedures Applied to the Appropriations Limitation Prescribed by Article XIII B of the California Constitution*), were performed solely to assist the Town in meeting the requirements of Section 1.5 of Article XIII B of the California Constitution. The Town's management is responsible for the Appropriations Limit worksheet. This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of the procedures is solely the responsibility of those parties specified in this report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested of for any other purpose.

The procedures performed and our findings were as follows:

1. We obtained the completed worksheets and compared the limit and annual adjustment factors included in those worksheets to the limit and annual adjustment factors that were adopted by resolution of the Town Council. We also compared the population and inflation options included in the aforementioned documents to those that were selected by a recorded vote of the Town Council.

Finding: No exceptions were noted as a result of our procedures.

2. For the accompanying Appropriations Limit worksheet, we added last year's limit to total adjustments and agreed the resulting amount to this year's limit.

Finding: No exceptions were noted as a result of our procedures.

3. We agreed the current year information presented in the accompanying Appropriations Limit worksheet to the other documents referenced in #1 above.

Finding: No exceptions were noted as a result of our procedures.

4. We agreed the prior year appropriations limit presented in the accompanying Appropriations Limit worksheet to the prior year appropriations limit adopted by the Town Council during the prior year.

Finding: No exceptions were noted as a result of our procedures.

We were not engaged to, and did not, perform an examination, the objective of which would be the expression of an opinion on the accompanying Appropriations Limit worksheet. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you. No procedures have been performed with respect to the determination of the appropriations limit for the base year, as defined by the League publication entitled *Article XIII B of the California Constitution*.

This report is intended solely for the use of the Town Council and management of the Town of Apple Valley and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Van Lant + Fankhanel, LLP

December 29, 2017

TOWN OF APPLE VALLEY
APPROPRIATIONS LIMIT COMPUTATION
2016 – 2017

| | <u>2016 - 2017</u> |
|---|----------------------|
| Change in Per Capital Personal Income | 5.37% |
| Population Change | |
| Town Population Growth | 1.14% |
| Change in Per Capita Personal Income Converted to a Ratio | 1.0537 |
| Population Change Converted to a Ratio | 1.0114 |
| Calculation of Growth Factor | 1.065712 |
| 2015 - 2016 Appropriations Limit | <u>\$ 33,370,752</u> |
| 2016 - 2017 Appropriations Limit (\$33,370,752 X 1.065712) | <u>\$ 35,563,611</u> |