CITY COUNCIL
AGENDA REPORT

MEETING OF FEBRUARY 23, 2012

FROM: CITY MANAGER AND FINANCE DEPARTMENTS

SUBJECT: FINANCIAL MANAGEMENT IMPROVEMENTS

RECOMMENDED ACTION:
Approve the financial management improvements recommended in this report and direct staff to return with follow-up actions where necessary for formal implementation.

BACKGROUND:
Bill Statler served as the Interim Finance Director from September 15, 2011 through February 5, 2012. Based on his observations and a review of the City's financial management policies, procedures and practices, this report presents recommended system improvements.

DISCUSSION:
The recommended financial management improvements presented below are based on two key principles:

Effective Use of Limited Resources. All of the proposed changes stem from the concept that the City should focus its limited resources on high-value, high-priority services. In light of recent staffing reductions and resource constraints, this means modifying and/or eliminating "red tape," low-value efforts – while still maintaining appropriate internal controls, accountability and transparency. Ensuring that current policies, procedures and practices continue to make sense is especially important in the context of other system improvements that may have been made over time (and thus are now duplicative in their goals but with increased resource commitments because the organization has not let go of the old procedures when the new ones were implemented). This includes technology changes that provide the foundation for productivity improvements; "best practices" that have surfaced since policies and procedures were last reviewed; and the simple passage of time since authority limits were last set. In short, being good stewards of the public resources entrusted to the City means using limited resources wisely in achieving the City's goals and objectives.

Effective Council Policy and Decision Making. Like most of us, the Council is agenda-driven: if something appears on the Council's agenda, it should be a reasonable to assume the item relates to an important policy decision that only the Council should make. That said, there are times when items are on the agenda when there is no discretionary action for the Council to take. Virtually all "receive and file" actions fall into this category: if this is truly the only action required of the Council, the action could be as readily achieved – and with far fewer staff resources - by placing the item in the Council's mail box. Many "ratification" actions fall into this category as well. For example, if the Council is simply reviewing an action that has already

taken place and cannot be revoked, then what is the discretionary action that being asked of the Council? In this case, informing the Council on a more timely basis than the next agenda via a number of other communication methods may be far more effective.

Why does this matter? Because as a practical matter, even the most minor of Council agenda items requires significant staff resources to produce: it requires preparation by the assigned staff member and review by the department head; possible review by Finance for any fiscal considerations and by the City Attorney for legal ones; final review and approval by the City Manager; and agenda coordination; and after action follow-up and records management by the City Clerk's Office. Stated simply, there is a significant transaction cost associated with all agenda items. Where there are legitimate policy issues the Council needs to decide, this effort is certainly justified. However, where there are not, placing items on the agenda diverts limited resources from higher priority areas in delivering important services to the community. And given the wide variety of communication media available than in the past, there are equally effective ways (perhaps more so) of ensuring transparency and community access to City information.

Lastly, placing items on the agenda where the Council does not have a meaningful role makes poor use of the Council's time, too. There are many issues that require significant hours of Council commitment, including attending community meetings and events; making site visits on planning items; reading numerous and lengthy reports; and preparing for and attending Council meetings. Limiting the placement of items on the agenda where the Council action is truly needed will help Council members focus their efforts on things that matter and make a difference.

While these two principles apply to all of the City's "business practices," the following are recommended changes to the City's financial management practices.

Register of Warrants

Historically, Council approval was required before any disbursements could be made. For this reason, city councils throughout the State approved a Register of Warrants. Over time, the State has made changes allowing for greater discretion in approving disbursements prior to council approval in recognizing the need to pay vendors on a timely basis, improve productivity by making accounts payable an ongoing process rather than a peak workload twice per month; and that many disbursements were being made electronically through wire transfers and automated clearing house (ACH) transactions rather than by check. Based on State law changes (primarily Government Code Section 37208), the City adopted Ordinance 806 in 1998 allowing for payment approval by the City Manager (or designee), but with check disbursements to be returned to the Council after their issuance for ratification.

Since then, Government Code Section 37208(c) has been added that "warrants or checks may be presented to the legislative body for ratification and approval in the form of an audited comprehensive annual financial report." The City prepares audited comprehensive annual financial reports; and accordingly, Council ratification is no longer required. Accordingly, in accordance with the principles discussed above, staff recommends discontinuing the placement of the Register of Warrants on the Council agenda for ratification: under authorization provided by the Council 14 years ago in 1998, there is no discretionary action to be taken by the Council; and this will free-up staff resources for more important tasks. The check register will remain a public document and available for public (or Council) review at any time.

Accounting for Cash Flow Interfund Borrowings

As the Council is aware, the City used significant reserves in responding to the storm drain damage in March 2011. This has led to the need to borrow from other funds on a temporary basis to cover short-term General Fund cash flow needs.

There are two conceptual approaches in accounting for these types of short-term interfund borrowings:

- Formally posting "due to/due from" between affected funds on a periodic basis in the general ledger.

- Only posting interfund payables and receivables (due to/due from) at year-end (if applicable at all by then).

This second approach is the most prevalent financial management practice:

- In most cases (and in the case of Capitola), there will not be an outstanding receivable/payable at year-end; and as such, significant staff effort goes into posting transactions during the year for no net effect at year-end. If there is an outstanding due to/due from at year end, this is significant and should be shown this way. In accordance with generally accepted accounting principles (GAAP), it will also be fully disclosed in the audited financial statements.

The City's financial position on a cash basis is better presented by showing negative cash balances if they in fact arise. In fact, posting interfund cash "due to's" and "due from's" masks the cash position of any fund needing short-term advances: it will never show a cash deficit.

Accordingly, in order more effectively use limited staff resources and better reflect individual fund financial condition, staff recommends not posting interfund payables and receivables during the fiscal year, but showing any applicable interfund "due to/due from" as appropriate under "GAAP" in the City's audited financial statements.

Streamline and Improve Financial Reporting
Traditionally, the monthly "Treasurer's Report" was focused on cash and investments. Over time, the City has expanded this to also provide broader monthly financial information and placed this report on the Council agenda.

A drawback with this approach is it diverts attention away from its core purpose: reporting on cash and investments. There are more effective ways of reporting on the City's fiscal status, such as a quarterly financial newsletter that is emailed to, Council, all employees, and posted on the City's web site. This report could consolidate existing quarterly revenue and budgetary reports with cash and investment information to produce a document that provides an overall view of the City's financial status. Quarterly reports will be more meaningful for their intended audience: the Council, community, senior managers and the organization as a whole.

In overcoming this drawback, staff recommends the following financial reporting improvements:
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- Shift the focus to quarterly reporting, where more meaningful information and analysis will be provided. Along with general purpose reporting, this could include focused reports on key revenues such as sales tax and transient occupancy tax (TOT).
- File monthly information with the City Clerk and Council containing the information that is required in Government Code Section 41004. This would include a one to two page summary of receipts, disbursements, and fund balances

- Discontinue providing these reports as Council agenda items but instead more broadly distribute this information in other ways.

In short, shifting to quarterly off-agenda reporting will result in more meaningful reports, better monitoring of the City's fiscal status and better use of limited staff resources. The following is a web site link that provides examples of the types of interim reports broadly distributed to the Council, organization and community by the City of San Luis Obispo for investments, sales tax, TOT and financial reports: www.slocity.org/finance/reports.asp.

Budget Administration
Under Section 3.20.050(D) of the municipal code, the "budget officer" (City Manager for practical purposes) "is authorized to approve transfers and revisions of appropriations within a budget unit." However, Council approval is required for any budget amendment of $10,000 or more.

There are four drawbacks with this approach:

- This limit was set in 1998: fourteen years ago. Solely due to the passage of time, some revision in the limit is appropriate.

- It is unclear what constitutes a $10,000 budget amendment. Is transferring $5.500 from one line account to another a $5,500 budget amendment or $11,000? If budget amendments for 20 line items of $1,000 each are processed at the same time, with no net increase in expenditures, does this constitute an amendment in excess of $10,000?

- The current policy does not explicitly limit staff authority to appropriate expenditures from available fund balance. A narrow interpretation of current policy could lead to the conclusion that, if under $10,000, the City Manager could have the authority to amend the budget in a way that results in an increase in net appropriations.

- The City's Municipal Code also requires budget amendments of $10,000 or more should be placed on the Council's regular agenda for consideration and discussion. This requires Council to devote additional time to presentations by staff when the information contained in the staff report may be sufficient to justify action.

For clarity and improved budget management, staff recommends the following budget amendment policy:

Council has the sole authority for adopting the City's budget, and may amend or supplement the budget at any time after its adoption by majority vote of the Council.

After the budget adoption, any supplemental appropriations of fund balance, or budget transfers over $25,000 within a "Budget Unit" will require Council approval. Budget amendments that require Council approval may be placed on the consent agenda.

Level of Budget Control

The "level of budget control" – the level at which expenditures are not to exceed appropriations – is a separate issue from budget amendment authority. The City's existing Budget Policies (page 11 of the 2011-12 Budget) do an excellent job of articulating these, summarized as follows:

- Budget control is at the "Budget Unit," which is defined as the "department, fund or other organizational unit whose financial activities are accounted for separately."

- In the case of the General Fund, the Budget Unit is the department level.

No changes in the City's budget control policies are recommended.

In addition, the City Manager and the Finance Director will establish budgetary control procedures for transfers below the $25,000 threshold

Purchasing Update
There are four primary drivers behind updating the City's purchasing policies:

- More meaningfully involving the Council in the purchasing process.

- Resolving discrepancies between the City's Purchasing Ordinance adopted in 2001 and purchasing procedures adopted by the Council in 2002 and revised in 2006.

- Integrating all purchases – supplies, equipment, services and construction projects – into one system.

- Accounting for the passage of time since the City's purchasing authority limits were last formally set ten years ago.

Council Involvement in the Purchasing Process
Like most cities, the Council is currently involved in the purchasing process at the "contract award" stage in the bid process. There are two drawbacks with this late involvement:

- Detailed bid packages defining the items to be purchased and the process for doing so have already been prepared, limiting the Council's input and making any changes awkward at best (and most likely requiring the issuance of new invitations for bids or requests for proposals). This requires added staff work – which was likely very extensive to begin with – and delays the purchase of needed supplies, equipment, services and construction projects.

- When the Council is being asked to weigh, it is often for the relatively simple ministerial task of determining who submitted the lowest bid.

It makes more sense to move the Council's involvement to an earlier stage, where it can better exercise policy discretion: approval of the bid package and authorization to invite bids or request proposals.

This provides the Council with meaningful discretion on whether to purchase the item at all and at what cost; and to define the work scope and the term and conditions of the purchase. However, once these parameters are in place, the recommended approach delegates to staff the ministerial action of determining who submitted the lowest bid and awarding the contract. In those few cases where bids come in above budget or there are other unexpected issues, bid award would return to the Council. This revision will make purchasing more efficient while retaining appropriate internal controls and more meaningfully involving the Council in the formal purchasing process.   In fact, on many important purchases and bids, Council is been engaged prior to the issuance of a bid, or RFP. This proposed change codifies this practice, and streamlines the process at the ministerial contract award stage.

Discrepancies between Purchasing Ordinance and Purchasing Procedures
The following compares key features of the City's Purchasing Ordinance adopted in 2001 (Municipal Code Section 3.16) and purchasing procedures adopted in 2002 and revised in 2006:

Purchasing Ordinance (2001)	Purchasing Procedures (2002, Revised 2006)
Scope: Supplies, equipment and general services (operation and maintenance); does not address consultant (professional) services	Scope: Similar but includes consultant services
Over the Counter (No Specific Bidding Requirements	
City Manager/delegated staff authority: $10,000 or less	Department Heads: $2,000 or less
Informal Bidding (Open Market)	
$10,000 to $20,000 *There is an internal contradiction within the Ordinance (most likely a typo at the time): in two places, Section 3.16.070 places the limit at $20,000; Section 3.16.070(A) says $25,000.*	$2,000 to $10,000
Verbal or written quotations: Up to $10,000	Same
Written quotation: $10,000 to $50,000	Formal bid process
Award via purchase order or contract by City Manager/delegated staff	Award Via purchase order
Formal Bidding	
More than $50,000	More than $10,000
Policies/procedures not addressed	Formal Invitation for Bids (IFB) or Request for Proposal (RFP) process; prepared and issued by staff; formal published notice; sealed bids/proposals
	Award by Council
	Formal contract (purchase orders typically issued as well)
Construction Projects	
Not addressed	Partially addressed

It is not clear why the City adopted some policies via ordinance in 2001 (Attachment 1) and then augmented them with additional policies and procedures a year later (but not by ordinance) – some of which seem to be in conflict. While the 2001 (revised in 2006) policies (Attachment 2) are more recent, typically ordinances are viewed as being superior to other Council actions. On the other hand, the 2002/2006 policies are clearer and more comprehensive than the 2001 Ordinance.

With very few exceptions, the types of policies and procedures set forth in Attachment 2 are typically included in the Purchasing Ordinance. This approach eliminates the potential for conflicts between policy documents and places them in one easily accessible place. Accordingly, staff recommends that any updates place all key policies and procedure in the Purchasing Ordinance. There will still be the need for internal administrative procedures for implementation; but the key policies should be comprehensively set forth in one place: the Purchasing Ordinance.
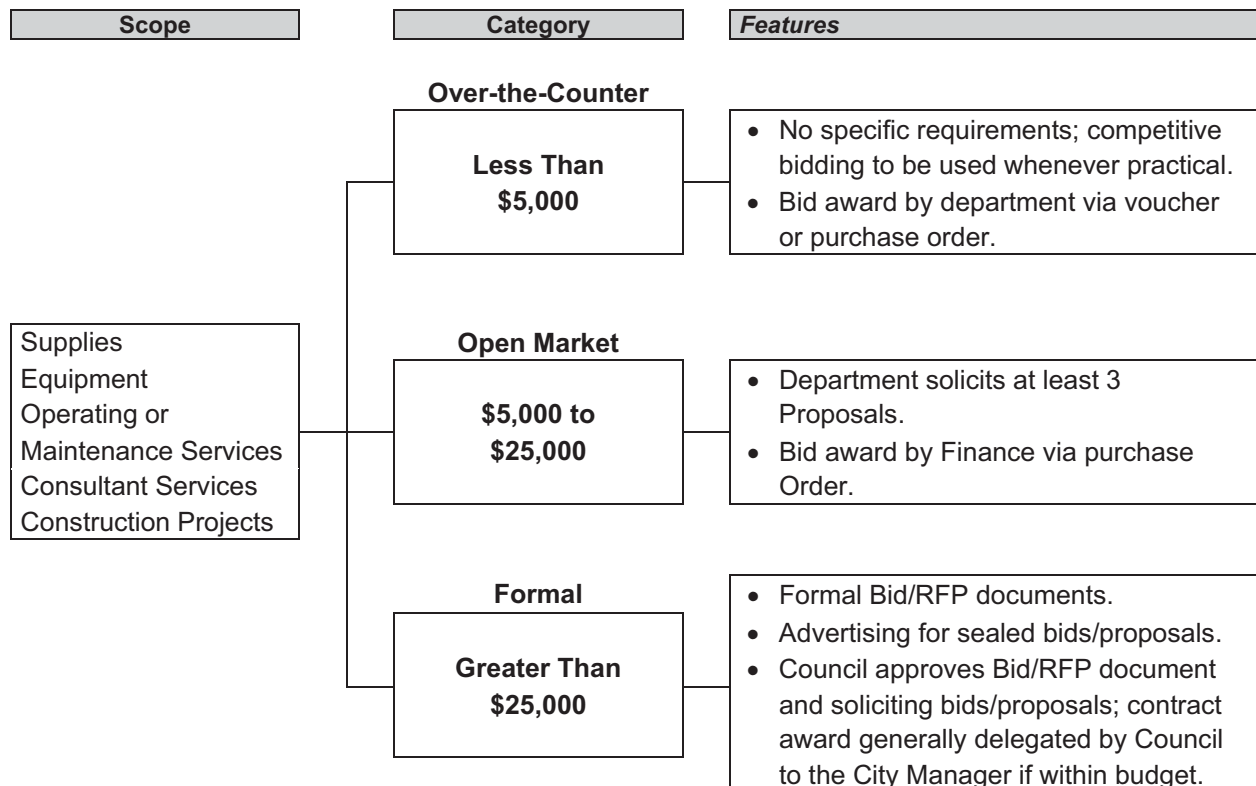
Integration of Purchasing Policies into One System

For consistency and ease of administration, policies and procedures for construction projects should be more clearly integrated with the City's other purchasing policies for supplies, equipment and services.

Updated Purchasing Limits

The following provides an overview of the proposed purchasing system. Key changes reflect the concepts discussed above, summarized as follows:

- Council involvement is earlier in the formal bid process.

- Policies and procedures are integrated for all purchases: supplies, equipment, maintenance and operation services, consultant services and construction projects.

- Staff approval of purchases are set at $5,000. This is a decrease from the $10,000 level set in the 2001 Purchasing Ordinance, and an increase in the $2,000 level set in the 2006 procedures. Although no specific purchasing requirements are established for this level of purchase, competitive bidding should be used whenever practical. Along with clarifying policies and procedures between the two documents, this change will facilitate Internet purchases as well as smaller purchases from local vendors.

- Open market procedures (informal bidding procedures) are set at $10,000 to $25,000. This is a decrease from the limit of $50,000 set in the Purchasing Ordinance and the $10,000 limit in the 2006 Procedures.

- Formal bidding/requests for proposals are set at purchases in excess of $25,000.

Proposed Purchasing System Overview

Scope	Category	*Features*
	Over-the-Counter **Less Than** **$5,000**	• No specific requirements; competitive bidding to be used whenever practical. • Bid award by department via voucher or purchase order.
Supplies Equipment Operating or Maintenance Services Consultant Services Construction Projects	**Open Market** **$5,000 to** **$25,000**	• Department solicits at least 3 Proposals. • Bid award by Finance via purchase Order.
	Formal **Greater Than** **$25,000**	• Formal Bid/RFP documents. • Advertising for sealed bids/proposals. • Council approves Bid/RFP document and soliciting bids/proposals; contract award generally delegated by Council to the City Manager if within budget.

Use of Resolutions
Extensive use of resolutions has its roots in the fact that until fairly recently, many cities did not routinely prepare staff reports for each Council agenda item, For this reason, resolutions with their "whereases" and "therefores" were the only formal documentation for why the council made the decision it did.

Accordingly, with the advent of staff reports that clearly lay-out the recommendation, the reasons for the recommendation and its fiscal impact, resolutions often do not fill the same need that they did in the past. However, many resolutions continue to be prepared when they are no longer needed: the staff report contains the same information (and often in greater detail). Where this occurs, limited staff resources are being used to prepare duplicative work for the same outcome.

There are times when resolutions are needed. For example, the State Government Code requires that many planning actions be approved by resolution; and grant regulations may require this as well. It may also be appropriate to adopt major policies by resolution. However, the vast majority of Council actions do not require resolutions.

In general, staff recommends limiting the use of resolutions in the future to only those circumstances where they are truly needed (such as those discussed above). While this applies to a wide variety City agenda items, there are two specific financial management areas where resolutions are not required and as such staff recommends no longer preparing them:

- *Budget Amendments.* The staff report should always be clear on the budget amendment action needed.

- *Contracts.* In this case, not only should the staff report discuss all significant issues, but the resolution duplicates information provided in the agreement itself.

Next Steps
All of the recommended changes can be placed into operation fairly quickly. Before doing so, however, it will be important to develop internal procedures and staff training to ensure that they are understood throughout the organization. Additionally, in some cases, municipal code and resolution changes will be necessary to formally implement them. Where this is needed, staff will return within 60 days with the revisions. However, before investing the resources necessary to do so, staff wanted Council direction to make these changes.

FISCAL IMPACT
There are no direct fiscal impacts associated with the recommended changes. However, they will result in improved organizational effectiveness, freeing-up limited resources for higher priority services while maintaining appropriate internal controls, accountability and transparency.

ATTACHMENTS
1. Purchasing Ordinance (Municipal Code Section 3.16)
2. Purchasing and Procurement Policy

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Reviewed and Forwarded
By City Manager: