



Understanding a Municipality’s Complete Financial Picture

Understanding a City’s financial health is as complex as it is important. Public financing and required reporting procedures are governed by state, local law, and in some cases federal law. Municipal finance can be difficult to understand and easy to misinterpret. However, a careful review of official documents and resources will help you navigate the basics of public financing.

EVALUATING A CITY’S FISCAL HEALTH

[The Comprehensive Annual Financial Report \(CAFR\)](#)

- The CAFR is published once a year and is a set of financial statements that comply with the accounting requirements established by the Governmental Accounting Standards Board (GASB). The City’s Statement of Net position can be found in the CAFR on page 19 and shows a positive net position for Governmental Activities of \$180 million. This represents the City’s net assets minus net liabilities for Governmental Activities.
- The City’s Fund Financial Statement on pages 24-25 of the CAFR shows the balance sheet of governmental funds. This shows current assets and current liabilities. Brea’s CAFR contains audited financial statements and a statistical section, as well as City management’s discussion and analysis of the fiscal year reported. This Fund Financial Statement should be taken into account in order to complete the picture of a city’s financial health.
- A City’s fiscal health is evaluated annually by bond agencies, such as Standard & Poor’s and Moody’s. Their review is thorough and exacting. Bond agencies look at the level of debt. They look at the credit quality of the issuer; their ability and willingness to pay what they’ve promised. Agencies also study a city’s economic base to analyze its economic future. They review its financial structure and how the place operates. Is it paying its bills? Meeting payroll? Paving the streets? Brea’s Bond Rating is AA.

Indicators of a City’s Fiscal Health include:

- Balanced General Fund Budget.
- Strong General Fund Reserve Fund.
- Ability to meet all financial obligations on time.
- Making required pension contributions on time.
- Public service levels meet or exceed standards of the community.

- Meets recognized standards of financial reporting determined by the Government Finance Officers Association (GFOA) and the Government Accounting Standards Board (GASB).*

What about Brea's Fiscal Health?

Brea is able to check of all of these indicators of good municipal fiscal health.

- ✓ Yes, Brea always balances its Budget.
- ✓ Brea maintains a strong General Fund Reserve Fund greater than the dictates of the City Council Policy.
- ✓ Brea meets all financial obligations on time.
- ✓ Brea makes regular pension fund contributions, and in fact, has the funds to make the required unfunded liability annual payment early in order to realize savings. (The savings for Fiscal Year 2019/20 is \$299,955.)
- ✓ In addition, Brea is saving funds to offset the Pension Unfunded Liability.
- ✓ Brea offers enhanced public service levels that consistently meet or exceed standards of the community.
- ✓ Brea meets the standards of financial reporting and has earned achievement awards from the Government Finance Officers Association for excellence in financial reporting.

About the Pension Reform

- Like many California Cities, the City of Brea is a member of the CalPERS pension fund. CalPERS is the nation's largest public pension fund. California cities are facing a rising pension costs due to a number of factors including lower than expected returns, and catch up from the Great Recession increased longevity of retirees, and fewer new employees (as compared to the Baby Boomers) paying into the system.
- Pension reform has been identified as a top priorities by the Brea City Council.
- As this issue is impacting cities statewide, significant, long-term solutions must come from the State Legislature in Sacramento. Still, cities must do their part and stay on top of it. Brea officials are completely aware of the issue and are addressing it at the local, regional and state levels.
- There are no easy solutions to the Pension reform, as it is a complex issue, which makes it easy for the media and others to misunderstand the process.

Following are some important facts to keep in mind:

- The City of Brea makes bi-weekly payments to CalPERS for all active PERS employees. Brea also makes an annual contribution to CalPERS toward paying down the Unfunded Pension Liability. These costs are accounted for in the city's annual budget.
- In the past four (4) years the City Council has set aside \$6.75 Million in a *Section 115 Irrevocable Pension Trust Fund*, under separate investment management, to be used, as necessary, to meet our pension obligations, and is an asset on our balance sheet. These funds have grown to approximately \$8.5 Million as of June 30, 2019
- A City's Unfunded Pension Liability refers to the total cost for future benefits that will be paid out through the retirement of the vested CalPERS employee, less the amount of assets held by CalPERS for these benefits. This obligation is meant to be paid regularly, over time similar to making a monthly mortgage payment to pay down the home loan debt.

- A City’s Unfunded Pension Liability is sometimes used by the media and others to imply that Brea, and other Orange County cities, are not fiscally prudent, or are close to financial crisis. This is an unfair and inaccurate characterization for the City of Brea. Pension costs are definitely an important issue and one that Brea takes very seriously and as previously stated, is taking steps at the local and state level to address the issue.
- As part of the FY 2019-20 budget process, the City Council updated its General Fund Reserve Policy, which increased the Reserve level from 8%-10% to 10% - 25% of the total projected expenditures for the fiscal year.
- The Fiscal Year 2019-20 Budget document, adopted on June 18, 2019, shows the estimated revenue over expenditures for FY 2018-19 to be in excess of \$4 million after funding the 25% General Fund Reserve.
 - On June 18, 2019, the City Council provided direction to City staff to use these excess funds to pay off some outstanding bonds.
 - Additionally, the remaining funds are recommended to be invested in the City’s Section 115 Irrevocable Pension Trust Fund—Other Post-Employment Benefits (OPEB). These funds would contribute toward future retiree medical commitments with the balance reported as assets. This is a proactive approach to addressing these obligations.
- Cities that choose to have their own Fire and Police Departments, (like Brea) will show a larger pension liability as compared to contract cities. The term “contract cities” refers to those cities that contract out its fire, police and/or other city services, to another agency or county, or cities that receive those services through their basic property tax levy. Contract cities do not carry the liability to provide for these services on the city’s books. Consequently, it is not accurate, or fair, to compare financial data between a full service city and a contract city.
- The pension liability for contract cities is reported on the “contractor’s” balance sheets. For example, if a city contracts for fire services with the Orange County Fire Authority, (OCFA), the pension liability will be carried on OCFA’s financial records.
- These reasons are why using the Unfunded Pension Liability number, without the proper context and understanding can be confusing and misleading.

PITFALLS TO AVOID WHEN REVIEWING CITY FINANCIAL RECORDS

Often the media, bloggers and others will fall in to the trap of trying to simplify complex financial statements and budgets and will fall into one of these pitfalls, while still reporting misleading conclusions as fact. Here are some common mistakes.

- **Taking budget numbers out of context.** A budget is a multi-faceted document and must be understood in the proper context.
 - One misleading bit of information that circulates every once in a while is a ranking of OC Cities using financial information out of context. The ranking is based on a city’s “Unrestricted Net Position” (UNP) number reported in the CAFR, which reflects the *some* net assets minus *some* net liabilities. (The UNP does not tell the whole story. It considers only part of a city’s assets and liabilities). The ranking divides the UNP by the city’s population and uses that to “grade” the financial health of cities countywide. This is an inaccurate depiction of a city’s overall fiscal health for a number of reasons.

- The Unrestricted Net Position figure reported in the CAFR includes costs for governmental activities including net pension obligations for full-service cities. Contract cities do not report their pension obligations in the CAFR, like full service cities do. Therefore such comparisons are not accurate.
- Additionally, the per capita number quoted for Brea does not reflect our service level of the larger population we serve during the day. The City of Brea has a population of almost 45,000. However, it serves a population of over 100,000 people who come to work, and recreate.
- A city's Fund Financial Statement balance sheet (on pages 24-25 of the CAFR) is a better, more accurate way to measure fiscal health as it details all of a city's available funds: cash, investments and reserves.
- **Comparing the balance sheets of full-service cities to full or partial contract cities.** This is a mistake that the media and others often make. Full-service Cities and contract cities differ greatly in how their revenues and expenditures are reported.
 - Comparing the finances OC cities with each other is like comparing apples to oranges. Orange County is made up of contract cities and full-service cities which makes a difference in how certain a municipalities finances are reported, among many other things. (The City of Brea is a full-service city.) Additionally, the service level and many other variables differ greatly among OC cities.
 - For example, a full-service city, like Brea, carries the pension liability on their financial records per GASB* 68. However, a contract city that contracts with the county for Police and/or Fire services for instance, does not carry the pension liability for its police and/or fire services on its financial records. That figure is in the County's records.
 - Additionally, cities have different service levels and standards based on Community needs and desires. Comparing cities balance sheets without taking this into consideration, will not yield accurate results.
- **Relying on unofficial sources such as media soundbites, rumors, blogs or social media** in order to understand complex municipal issues. For official Brea information always visit the *CityofBrea.net*. The city has long been committed to transparency; the website features a permanent "Brea Transparency" short cut on the home page.

WHERE TO LOOK

The City of Brea is a fiscally conservative municipality. The City adopts a balanced budget every fiscal year. The City maintains healthy General Fund Reserves. In Brea, all of the Budget documents and related reports, such as Comprehensive Annual Financial Report CAFR, are readily available online.

[General Operating Fund Budget](#)

- The General Fund Budget reports City operating revenues and expenditures. The General Fund provides the resources necessary to sustain the day-to-day activities and pays for all administrative and operating costs. It is required that General Fund Revenues exceed Expenditures. The Brea City Council requires that a minimum of 10%-25% of the Operating Budget be held in Reserves.

[Capital Improvement Program \(CIP\)](#)

- The CIP is a seven-year plan that identifies capital projects, provides a planning schedule and identifies options for financing the plan.

Comprehensive Annual Financial Report (CAFR)

- The CAFR is published once a year and is a set of financial statements that comply with the accounting requirements established by the Governmental Accounting Standards Board (GASB).
 - The report is subject to review by the city's auditors to ensure that it is prepared in accordance with generally accepted accounting principles and that the amounts and disclosures are fairly presented in all material respects. The City Council receives and files the CAFR annually.
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