Hello all,

The City released its 6/30/2016 CAFR Monday evening and hastily scheduled an Audit Committee meeting for Thursday, 430pm. You are invited to attend!

You can find the monster at:

http://stockton.granicus.com/GeneratedAgendaViewer.php?view_id=48&event_id=939

I sent two members of the Committee (and will try to reach the third) my rather prolix raw memo with copies of excerpts from the CAFR. I will save your head from exploding, and just give you a few comments below. The most important recommendation is for the Audit Committee to take no action; ask to schedule a workshop to study and reflect on the CAFR;, and then determine what action to take.

1. Incomplete Audit Report - We Need the Report on Internal Control Matters.

As in prior years, there are 3 findings of material weakness in internal control and other findings, so the City's accounting system cannot be relied upon to produce accurate reports, safeguard assets etc. We need the internal control report that was omitted from the CAFR package in order to evaluate the audit and financial reports.

2. General funds.

As I predicted, the general fund balance is over $90m, to wit: $93.6m. That is an all-time high. Of that, $88m is within the discretion to spend by the City Council. The City continues its refusal to spend funds that are budgeted. This year $25.1m of budgeted expenditures were not made by the City. So when folks complain that there are no funds available to open the Fair Oaks library, or we need a special sales tax to "restore" library and recreation services such as Measure M that will raise $9 million per year, look at the report showing the variances from budget. The City did not spend $25 million that the Council had budgeted. Besides the $25m, look at the restricted funds available for the library, another $12m.

3 Measure A.

The City buries as "other information" an unexplained, non-GAAP, non-audited, no footnotes, no explanation: Measure A and B - Schedule of Sources and Uses.

First, see my letter to the audit committee of last month, and you will understand why there needs to be proper financial statement and a properaudit of Measure A. Over fifty percent (50%) of the amounts listed as expenditures in those 6/30/2015 financials were not spent. Those wereprofoundly misstated financial statements. How much of the claimed expenditures this year were not actually spent? What would this statement look like if it were prepared on a GAAP basis and subject to an audit, where amounts listed as expenditures had to be actually spent? The City is collecting over $29 million per year, prepares a cockamamie report that says it spent millions of dollars that is not spent.

Also, consider just one line item of the financial report: general fund services and reserves $10.3m. We need an accounting for the general fund services spent and the amounts that went into reserves. What is the detailed breakdown of the $10.3m? There is a requirement for an audit and a requirement for accounting, and to have a lump sum of $10.3m without any accounting is clearly a violation of the ordinance. It is as if the City has something big to hide.

The GASB and AICPA technical representatives I spoke to had serious concerns about the 6/30/2015 Measure A financial statement. We cannot find anything like a "Source and Use" statement in any other CAFR.

4. Fiduciary and Internal Service Funds.

For the technical CPAs out there, the treatment of fiduciary funds (the private purpose trust fund) and ISF are very questionable. Let me know if you want to know the technical details, but the effect is to (1) exclude 73m in liabilities from the City's financial statements, and (2) substantially overstate current expenses.

The worst for last: pensions.

5. Pensions - the true unfunded liability is well over $1 billion.

The CAFR displays a staggering increase in unfunded pension liabilities. Per the statement of net position, the net liability is $449.3m versus $414.7m a year before. The one year increase in unfunded pension liabilities, after all the payments, was $34.7m.

But the true unfunded pension liability is far higher than $449.3m. You must add the unfunded pension bonds. The city tells us that the present value of those bonds is only $53.7m. But you must increase this liability by the amount of "contingent general fund payments" that could be millions. Ignoring the millions of "continent" payments, just using the $53.6m results in an unfunded pension liability of $502.9m.

But the City uses an unrealistic discount rate of 7.65% to value the pension liability. The CalPERS Board voted to reduce that 7.65% to 7.5% and now to 7%. The notes to the financial statements show the effect of a 1% change in discount rate. With just a 1% adjustments, the unfunded pension liabilities jump to $716.5m. A proper discount rate is a risk-free 3% or at most 4%, not 7.65% or 7.50% or 6.50. I estimate that the "true" unfunded pension liability using a proper 3% discount rate (as would be required under FASB rules) would be $1.495 billion. If we used the upper end of the risk free scale 4%, the liability would be a mere $1.282 billion.

The Audit Committee should hold a workshop,
with outside experts, where the pension and other issues are carefully explored, analyzed and so the Audit Committee and the Council can become informed and make sensible decision about the audits, financial reports and budgets.