

**TOWN OF  
APPLE VALLEY, CALIFORNIA**

**AGENDA MATTER**

**Subject Item:**

**DISCUSSION OF WASTEWATER FUND**

**SUMMARY STATEMENT**

Council had requested information regarding the Wastewater Fund and an explanation of the difference between the Wastewater Fund retained earnings reported in the FY 2010-11 Proposed Budget as compared to the amount of Wastewater Fund retained earnings reported in the Comprehensive Annual Financial Report.

The "Wastewater" Fund was initially established by the Town around 1980 when the Town's initial sewer rate was established at \$8.00 per equivalent dwelling unit (EDU) per month. The Wastewater Fund was established as an "Enterprise fund type" to account for the provision of wastewater services to residents of the Town. All activities necessary to provide wastewater services are accounted for within this fund and are considered a legal use of its resources as defined by governmental accounting standards, official statements of indebtedness and the State of California Government Code.

An "Enterprise Fund" or proprietary fund is defined in Statement on Governmental Accounting Standards (SGAS) 34 as a fund type used to report an activity for which a fee is charged to external users for goods or services. The accounting activities reported in the Wastewater Fund are similar to commercial accounting in that revenues and expenses are accounted for on a full accrual basis, depreciation expense is recognized on the Statement of Changes (income statement), and all costs are intended to be recovered through user charges.

In governmental accounting a "fund" is defined as "a fiscal and accounting entity with a self-balancing set of accounts recording cash and other financial resources, together with all related liabilities and residual equities or balances, and changes therein, that are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations." This definition was promulgated by the National Council on Governmental Accounting (NCGA Statement 1) which is the immediate predecessor of the Governmental Accounting Standards Board (GASB) as the authoritative accounting and financial reporting standard-setting body for state and local governments.

(Continued)

**RECOMMENDED ACTION**

1) That the Town Council receive and file the report.

Proposed by: Marc Puckett, Finance Director Item Number \_\_\_\_\_

T. M. Approval: \_\_\_\_\_ Budgeted Item: Yes  No  N/A

Council Meeting Date: 8/09/11

Many of the questions related to the difference between the Wastewater Fund retained earnings reported in the Fiscal Year 2011-12 Proposed Budget and the Town's Comprehensive Annual Financial Report (CAFR) results from the application of accounting reporting standards for preparation and presentation of the Town's financial statements. In accordance with governmental accounting standards, a budget is not required to be prepared for all funds or fund types. However, all funds and fund types are required to be presented within the Town's CAFR. As a result, when the CAFR presentation is compared to the budget presentation, there are sometimes differences in the total revenues, expenditures or retained earnings balances not readily apparent to the reader.

To explain further, and as related to the Wastewater Fund, the difference in the balances (\$34m in Retained Earnings in the Wastewater Fund (5010) versus the \$44m reported in the Wastewater (Sewer) Fund as Total Net Assets in the Town's financial statements) results specifically from this reporting issue.

For example, in the Town's CAFR, Fund numbers 5010, 5020, 5030, 5040, and 5050 are combined for presentation purposes in compliance with GASB Statement Number 34. However, within the Town's internal accounting records, management has chosen to segregate and track these funds separately for management reporting purposes although there is no requirement to do so within the applicable accounting standards. This presentation issue is why the Town's CAFR shows Total Net Assets in the Sewer Fund of \$44,252,034 and Unrestricted Net Assets of \$11,051,835 as of June 30, 2010, and the Town's Budget and Trial Balance shows Total Fund Equity in the Wastewater Fund (5010 only) of \$33,744,935.50 as of June 30, 2011. Please note that this is a preliminary estimate. The Town's books have not yet been closed for the fiscal year. It takes approximately two months for staff to close the books and prepare all the necessary schedules in preparation for the audit by independent external auditors. This presentation issue is why, when asked by Council at the last Council meeting about the difference, staff requested to sit down and discuss this matter in detail.

The additional Wastewater sub-funds (5020, 5030, 5040, and 5050) were established by management as debt service funds to account for debt issuance and payment activities dating back to 1981. However, debt activities are no longer recorded in funds 5020, 5030, and 5050. Therefore, these funds need to be closed into fund 5010 to "clean up" the accounting reporting on the Town's internal accounting records. The equity in these three funds alone exceeds \$6.4 million and should be added to the total equity in the Wastewater Fund 5010 maintained in the Town's internal accounting records.

In addition, to convolute the issue even more, terminology eliminated by GASB Statement number 34 which became effective on June 15, 1999, is still in use in the Town's internal accounting records. Below is an excerpt out of a GASB 34 implementation guide available to practitioners to assist with implementation of the pronouncement:

As GASB 34 eliminates the use of contributed capital, reclassify contributed capital to retained earnings as of the effective date of reporting model. Record all contributed capital received after the effective date as revenues. Refer to GASB 34 Paragraphs 102 and 103 for guidance on where such revenues will be reported. The following entry should be made at the fund level to reclassify contributed capital at initial implementation to retained earnings:

Dr Contributed capital  
Cr. Retained earnings

This entry should have been recorded in the Town’s accounting records as part of the year-end closing entries for the fiscal year ended June 30, 1999 and would have closed Contributed capital into Retained earnings. As of June 30, 2011, Contributed capital is still reflected in all five of the Wastewater Funds in the Town’s internal accounting records. This accounting standard and the associated entries to affect its implementation are being recorded as part of the year-end closing procedures for the current fiscal year.

When GASB 34 was implemented, the categorization of retained earnings should have also changed for consistency purposes to those categories of net assets used in presentation of the financial statements. Net assets are divided into three components—*invested in capital assets (net of related debt)*, *restricted*, and *unrestricted*. The first component is the difference between the amount shown for capital assets and the outstanding debt incurred to finance those capital assets. Restricted net assets represent resources that are constrained to a particular purpose. Unrestricted net assets are essentially all resources not included in the other components. For the Wastewater Fund, these categories of net assets and their respective balances, should not be reported upon without first combining all Wastewater funds as presented in the Town’s financial statements.

As of June 30, 2010, and as reported in the Town’s CAFR, the balance of net assets (fund equity) is as follows:

<b>Wastewater (Sewer) Fund Net Assets as of June 30, 2010</b>	
Invested in Capital Assets, Net of Related Debt	\$31,382,013
Restricted for Capital Projects	1,106,925
Restricted for Debt Service	711,261
Unrestricted	11,051,835
<b>Total Net Assets</b>	<b>\$44,252,034</b>

Once the 2011 fiscal year-end closing process is complete, these balances will be updated and reported out in the Town’s Fiscal Year 2011 CAFR.

As a side note, the terms “cash” and “retained earnings” appear to have been used interchangeably at times in reference to the balance of retained earnings (net assets). In short, when a total for “cash” is reported upon, it only references cash on hand as of the reporting date. Retained earnings (net assets) is a measure of the results of operations of the fund since the fund was created.

Questions were also raised regarding use of the Wastewater Funds for acquisition of the Golf Course water rights. In 2010, Wastewater funds were used to acquire the reversionary water rights for the golf course through a settlement agreement entered into with the High Desert Community Foundation and authorized by Town Council. At the time, it was deemed an appropriate expenditure of these funds since the Public Works department is actively involved in the final design stage for construction of a sub-regional wastewater treatment facility which will, upon completion, provide recycled water to irrigate the golf course and other public facilities. Staff performed their due diligence regarding the use of these funds to acquire the reversionary water rights and determined that it was an appropriate use in compliance with accounting standards and the State Government Code. As part of the settlement, the High Desert Community Foundation was paid

\$750,000 for the reversionary water rights. This payment and related legal expenses totaling \$654,859.42 were paid from and recorded into the Wastewater Fund.

Summary Statement

Page 4

Upon closing escrow for the purchase of the golf course, the Town will acquire water rights that are currently valued at \$2.9 million. Council has authorized the purchase of these water rights into the Wastewater Fund. For the same reasons stated previously in acquisition of the reversionary water rights from the High Desert Community Foundation, use of Wastewater Funds for this purchase is an appropriate use. Currently, no loan exists between the Golf Course Fund and the Wastewater Fund.

To sum up, as of June 30, 2011 (pre-closing) unrestricted net assets in the Wastewater Fund as a whole is approximately \$11 million and total net assets is approximately \$44 million as stated in the Town's financial statements. Reporting out unrestricted net assets for Fund 5010 separately should not be done without combining the five funds maintained on the Town's internal accounting records as referenced herein. Use of Wastewater Funds to acquire water rights is an appropriate use of wastewater funds under current accounting standards and state law.