



**NAPA COUNTY GRAND JURY  
2015-2016**

**May 24, 2016**

**FINAL REPORT**

**IS NAPA COUNTY  
FINANCIALLY HEALTHY?**



# IS NAPA COUNTY FINANCIALLY HEALTHY?

## SUMMARY

The Grand Jury investigated the Financial Health of Napa County and how financial information is made available to county residents. To narrow its investigation of county finances, the Jury chose to focus on the general fund structure and the balance sheet. The analysis began with the study of ten year trends of several key financial indicators. The “The 6 things you should know about Napa County’s finances and budget” a page on the County Executive Office’s section of the county website, provided the framework of the investigation.

Napa County has achieved the highest Standard and Poors’ rating available to a government entity; this gives the county access to financing at the lowest available interest rates. The Jury found that the county has a rigorous budgeting process and is diligent in adhering to a set of conservative financial management practices that help the county maintain a sound financial position. The county also maintains adequate reserves for emergencies. However, the Jury found that many of the documents which are intended to communicate the county’s financial condition are not where they are supposed to be, according to the county website, and some do not exist at all. The Jury recommends that these documents be made available to the public when and where they are supposed to be.

The Jury found that the county’s practice of including multi-year project budgets in the county’s current year financial reporting generates artificial variances, which obscure the county’s true financial condition. The Jury recommends that the county adopt a capital projects schedule, which would document the county’s multi-year project commitments and explain this complication in the county’s current year financial reporting.

The Jury found further that there is a lack of accountability for the goals which county divisions submit as part of the annual budget process. Progress on goals set in one year is not consistently reported the following year. The Jury recommends that, as part of the budget process, divisions be required to report on goals they set the previous year, with explanations if they were not completed or carried over to the next year.

The Jury learned that there may be a significant financial advantage in setting aside funds in an IRS Code Section 115 irrevocable trust to pay down the unfunded pension liabilities. (See footnote on page 9.) The Jury recommends that the county consider doing so.

## GLOSSARY

BOS	–	Board of Supervisors
BPMR	–	Budget Performance Measurement Report
CAFR	–	Comprehensive Annual Financial Report
CalPERS	–	California Public Employees' Retirement System
CEO	–	County Executive Officer
FEMA	–	Federal Emergency Management Agency

FY	–	Fiscal Year
FYE	–	Fiscal Year Ending
GASB	–	Government Accounting Standards Board
GFOA	–	Government Financial Officers Association
OPEB	–	Other Post-Employment Benefits
PMR	–	Performance Measurement Report
S & P	–	Standard and Poors' Bond Rating Service

## **BACKGROUND**

The 2015-2016 Grand Jury began its inquiry by reviewing the 207 page FYE June 30, 2014 CAFR. It became obvious that understanding the complete County of Napa financial structure would not be possible over a single Grand Jury one-year term. The Grand Jury initially chose to focus on the General Fund structure and Balance Sheet. Since evaluating one year's information only provides the Grand Jury with a limited view of the County of Napa Financial situation, the Grand Jury researched historical data and created a series of graphs that represent salient features of the County's finances over the last ten years. The ten-year history for Cash and Investments (Appendix 2), Net Assets (Appendix 3), Unrestricted Funds (Appendix 4), and Net Position (Appendix 5) by category provided a starting place to begin to interview members of the County Management.

## **METHODOLOGY**

During the investigation the Grand Jury found a webpage on the County of Napa website that identified, in 2012, the "The 6 things you (county residents) should know about Napa County's finances and budget." These 6 issues along with the Budgetary Comparison Schedule General Fund for FYE 2014 became the basis for the Grand Jury's initial investigation. During the process of the investigation a number of other paths of inquiry became evident. Additional investigations were conducted into the Napa County website and the use of performance measures in managing divisional efforts. These additional investigations were deemed to be sufficiently important by themselves to be documented in separate reports. The Grand Jury believes separating these reports will provide better understanding of the County of Napa's financial condition to Napa County residents.

The Grand Jury met with many county officials, both elected and appointed to understand the complexity of the financial structure. It was important to understand how management perceived certain aspects of the reporting process.

## **DISCUSSION**

The Jury was interested in taking a close look at the fiscal condition of Napa County and the financial management practices followed by county leadership. This review was facilitated by a document on the County Executive Office website entitled "The 6 things you should know about Napa County's finances and budget." This document credits the county's rigorous financial management practices and the maintenance of substantial reserves with the county's ability to

achieve an AA+ bond rating, the highest available to California counties. This document also mentions that the county BOS stays on a sound financial track by utilizing periodic 5-year forecasts, fiscal status reports, fiscal contingency plans, and a long range financial strategic plan. In addition, this document mentions that performance measures are included as part of the budgeting process. It also stresses that transparency of financial information is important and claims that budgets and other financial documents are available on-line, at the county administrative building, and in the county libraries.

Napa County uses a rigorous process to define and refine financial needs and budgets throughout the year. Each year, specific budget policies are adopted to customize and fine-tune county procedures based upon current economic, social and regulatory factors. Recommended budgets are prepared at the start of each fiscal year, Adopted Budgets are approved and updated throughout the year as required. Reserves and Contingency Funds are maintained to provide flexibility to effectively respond to changes in economic conditions or to deal with natural disasters. Strategic financial plans provide overall guidance to the process.

The Jury's investigation was focused on verifying these claims.

### Sound Financial Management Practices

In FY 2012, the BOS documented formal written budget policies used to govern the development of county budgets. Based on actual financial performance over the past several years, the policies appear to control costs and support decisions that protect the county's financial health. It is evident from these reports that the county budgets conservatively. Tax revenue is routinely underestimated and General Fund expenses are routinely overestimated. The resulting positive variances have been placed in Capital and Reserves and increased the county's "Net Asset Position" from \$238 Million in FY 2005 to \$426 Million in FY 2014, an increase of 79% (See Appendix 5).

In addition, the county policies follow other conservative practices, such as not "backfilling" shortfalls in funding for state programs with county tax dollars and not approving projects unless dedicated funding sources have been identified. Controls are in place to prevent overspending of any budget without the allocation of additional funds from reserves or elsewhere.

### Fund Sourcing

Napa County has a number of sources for revenue. To best understand the complexity of sourcing funds and allocating them in the budgeting process, funds can simply be divided in to two categories:

Unrestricted Funds (Appendices 4 and 5) are monies received by the county, basically from taxes and fees. The county uses this money for payroll, utilities, operating expenses, and capital projects. The amount of "Unrestricted Funds" varies each year from a high in 2012 of \$134 Million to a low of \$96 Million in 2005. These variances depend on economic conditions and previous years' expenditures. Proper management of "Unrestricted Funds"

allows the county to maintain services during difficult times. It should be noted that during downturn of 2008, the county did not reduce head count and services. Since the county does not authorize projects and programs that are not fully funded, there are funds that are committed within "Unrestricted Funds" by the BOS. These funds can be reallocated depending on current priorities.

Restricted Funds (Appendix 5) are monies that are specifically designated for individual projects and programs. "Restricted Funds" have grown from \$66 Million in 2005 to \$152 Million in 2014, an increase of 130%. These are funds that must be spent on specific projects and programs required by the funding source. A great deal of accuracy is required in reporting how, where, and when these funds are used.

### Healthy Reserves and Contingencies

County budget policy requires that 3% of the General Fund appropriation be placed in an Operating Contingency Fund. Policy also requires that reserves be maintained at a level equal to at least 20% of the General Fund. This commitment to retain at least 23% of the General Fund appropriation in reserves and contingencies far exceeds the GFOA's recommended standard of 16.7%. The county has consistently met this 23% commitment in recent years, except in FY 2015, when reserves and contingencies fell to 17.65% (still over the GFOA standard) due to expenses associated with recovery from the August 2014 earthquake. It should be noted that the county is placing repayments of these expenses from FEMA and insurance into reserves and contingencies.

### Financial Results Masked by "Aid from Other Governments"

Although conservative financial management practices appeared to have contributed significantly to the county's financial performance, that performance has been masked by artificial variances associated with the budget line item "Aid from other governments." This line item includes money that is received from the state, the federal government, or other funding sources for capital projects. The county's policy of requiring new programs or projects to be "fully funded" before they are approved has led to the practice of including the total appropriated budget amount for capital projects in the current year budget, even though those projects may take several years to complete. At the end of a given fiscal year, only the money received for the projects that year will appear as actual funds received. False negative variances are thus generated on the revenue side of the ledger. Likewise, on the expense side of the ledger, departments budget total budgets for multi-year projects in the current fiscal year. False positive variances are generated when they only incur expenses for the current year. In FY 2014, the negative variance in "Aid from other governments," the revenue side, was \$7.2 Million. The favorable variance in expenditures for projects was \$8.3 Million. These large artificial variances skew the county's financial performance figures and mask the true budget performance.

## Goals and Accomplishments

Since the BOS committed to establishing a set of Budget Performance Measures in 2007, divisions have prepared a set of annual goals. These were originally included in the annual BPMR and in 2014 became part of the annual Recommended Budget. Because the division's goals are submitted with their annual budget requests, the Jury found that there is an implied connection between the divisions' accomplishments and the funds spent in a given year. However, until the instructions went out for the FY 2017 budget, the divisions were not accountable for reporting the status of those goals, let alone achieving them, the following year. Goals are frequently dropped or carried over to subsequent years without explanation. For instance, the 57 divisions established a total of 262 goals in FY 2015. Of those, only 102 (39%) got any sort of mention the following year, accomplished or not. 79 (30%) were carried over to the following year, without explanation, and 81 (31%) were dropped, also without explanation.

## Long range Strategic Planning

The 5-year forecast is identified by the county as one of the key documents for long range strategic financial planning. The Jury agrees that the 5-year forecast would be extremely useful in understanding the future impact of financial decisions made by the BOS. However, the Jury found that the 5-year forecast, after being completed in FY 2012 was not produced again until 2016.

## Availability of Financial Documents

The county recognizes the importance of transparency in making a wide range of financial documents available to the public. The county states on its website that budgets and other financial documents are available on-line, at the county administrative building, or in the county libraries. But, the jury found that many of these documents are not where they are supposed to be. For example, the Recommended Budget was only available for six of the last 10 years, and the CAFR and the 5-year Financial Forecasts were not available at all in the Main Library.

## Financial Responsibility

A key factor in having sound financial control is the ability to provide accurate, transparent financial information. Napa County's Financial Report, CAFR, although not easily understood by the general public, has received the Certificate of Achievement for Excellence in Financial Reporting from GFOA for the past ten years. The requirement for government financial reporting is complex and annually the hundreds of pages of documentation are only understood by a small number of county residents, who are mostly senior county employees.

## Unfunded Pensions

The Jury also inquired about the status of unfunded pensions and other payroll benefits. We found that CalPERS calculates the required payments for the unfunded pensions and benefits

based on the performance of its investment portfolio and the amount and timing of the county's obligations, with certain "smoothing" functions. According to GASB 68, the county's unfunded pension liability is \$155 Million and its OPEB obligation is \$43 Million. It should be noted that the pension obligation and OPEB for the Napa County Superior Court employees are included in this number. These annual payments are the responsibility of the State of California. In the future these obligations will be separated, making the County of Napa obligation clearer. Under the current structure, paying down obligations will also pay down state obligations. That would not be in the interest of Napa County. Over the past ten years, the county has made the required payments, consistently meeting its obligation to CalPERS. However, the Jury did discover a provision that would allow the county to make payments in excess of those calculated by CalPERS, if it chose to do so. CalPERS estimates that for every \$1 Million in excess payments, the county could reduce obligations by \$5 Million over 25 years.

There is an opportunity for Napa County to become more flexible in managing pension and OPEB obligations by forming an IRS Code Section 115 irrevocable trust.\* The trust is a place to designate funds for pension obligations that are not constrained by the investment policies of CalPERS. Money placed in the trust can be invested at more favorable rates than current CalPERS achieves. This money can be used in two ways: first, to pay down obligations once the Superior Court obligations have been separated; and second, to make annual payments in years where economic conditions restrict cash flow.

## **FINDINGS**

**F1:** The County of Napa has been very diligent in maintaining Fiscal Policies that achieved the highest possible Bond Rating from S&P.

**F2:** The BOS have established a series of Budget Policies that call for holding the line on spending and using a Fiscal Contingency Plan to prepare for the future. The BOS have consistently maintained the County of Napa budgeting and spending within the limits that were established in 2011.

**F3:** The Grand Jury finds that the financial documentation in the CAFR for "Aid from other governments" on the Budgetary Comparison Schedule is confusing. The schedule overstates "Inflow" and Capital Works Project anticipated expenditures.

**F4:** The BOS has maintained an impressive position in Contingencies and Reserves that provides the County of Napa with a healthy financial future.

**F5:** Napa County uses divisional "Goals" to support the request for funding on an annual basis. However, they have not require reporting divisions to provide progress or completion of "Accomplishments" as follow-up in the next year.

**F6:** The County Executive Office did not prepare on an annual basis a Five-Year Financial Forecast from 2012 to 2015.



**F7:** The County of Napa has maintained exceptional Financial Reporting (CAFR) as recognized by GFOA.

**F8:** The County of Napa has maintained the appropriate payments to CalPERS for the Pension Plan and OPEB, but has not taken advantage of using Fund Balances to pay down Unfunded Pension and OPEB obligations.

**RECOMMENDATIONS**

**R1:** As the result of **F3**, the Grand Jury recommends that Napa County institute a schedule in the Management’s Discussion and Analysis Section of the CAFR that explains the negative variance from “Actual Amount (Budgetary Basis)” and “Variance with Final Budget” in “Aid from other governments.” The Grand Jury believes that including the information outlined below will clarify the actual situation for the average citizen.

Explanation of Aid from other governments						
County Capital Project no.	County Project Description	Date Project Initiated	Total Amount Budgeted	Actual Amount Realized in Previous Years	Actual Amount Realized This Year	Amount Carried Forward
The amount carried forward for the total of all projects will be the same as the Negative Variance in Aid from other governments						

**R2:** As the result of **F8**, the Grand Jury recommends that the BOS consider using some positive Fund Balances each year to begin to pay down the Unfunded Pension and OPEB by establishing an 115 Irrevocable Trust.\*

**R3:** As the result of **F5**, the Grand Jury recommends that the BOS and the CEO must require every division to report current status of every Goal that was prepared to support the previous years Recommended Budget.

---

\*This type of trust is authorized by Section 115 of the Internal Revenue Code solely for the purpose of funding post-employment benefit for workers and cannot be revoked by the employing agency. The timing of the utilization of funds is determined by the employing agency.

## **REQUEST FOR RESPONSES**

Pursuant to Penal Code section 933.05, the grand jury requests responses as follows:

From the following individuals:

County Executive Officer **F1, F5, F6, F8, R1, R3**

Auditor Controller **F3, F7, R1**

From the following governing bodies:

Board of Supervisors **F2, F3, F4, R1, R2, R3**

## **DISCLAIMER**

Reports issued by the Grand Jury do not identify individuals interviewed. Penal Code section 929 requires that reports of the Grand Jury not contain the name of any person or facts leading to the identity of any person who provides information to the Grand Jury.

## APPENDIX 1

### Documents Reviewed

2016 Performance Measurement Guidelines

2015 Performance Measurement Guidelines

6 things you should know about Napa County's budget and finances

County of Napa California Comprehensive Annual Financial Report for the Fiscal Year  
Ended June 30, 2014

County of Napa California Comprehensive Annual Financial Report for the Fiscal Year  
Ended June 30, 2013

County of Napa California Comprehensive Annual Financial Report for the Fiscal Year  
Ended June 30, 2012

County of Napa California Comprehensive Annual Financial Report for the Fiscal Year  
Ended June 30, 2011

County of Napa California Comprehensive Annual Financial Report for the Fiscal Year  
Ended June 30, 2010

County of Napa California Comprehensive Annual Financial Report for the Fiscal Year  
Ended June 30, 2009

County of Napa California Comprehensive Annual Financial Report for the Fiscal Year  
Ended June 30, 2008

County of Napa California Comprehensive Annual Financial Report for the Fiscal Year  
Ended June 30, 2007

County of Napa California Comprehensive Annual Financial Report for the Fiscal Year  
Ended June 30, 2006

Performance Measurement Training Manual, August 15, 2013 County of Napa California  
Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2005

County of Napa, Performance Measurement Report, January 2013

County of Napa, Performance Measurement Report, January 2014

County of Napa, State of California, Budget Performance Measurement Report, Fiscal Year 2009/2010

County of Napa, State of California, Budget Performance Measurement Report, Fiscal Year 2010/2011

County of Napa, State of California, Budget Performance Measurement Report, Fiscal Year 2011/2012

County of Napa, State of California, Recommended Budget, Fiscal Year 2015/2016.

Napa County 2020 Strategic Financial Plan, January 5, 2016

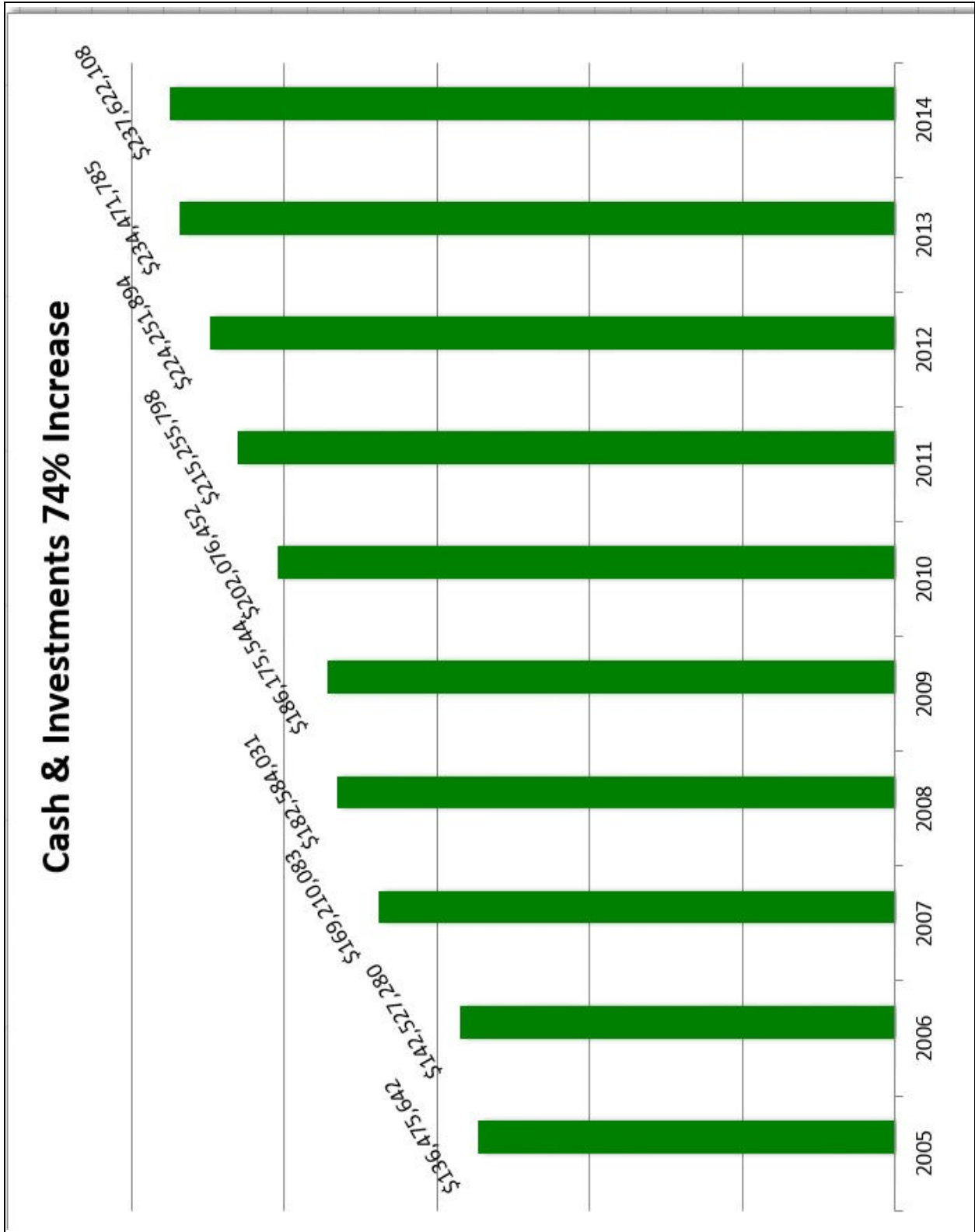
Napa County Budget Policies, Fiscal Year 2016-2017

Napa County Department of Corrections, Senate Bill 863 Jail Construction Project, Updated Jail Inmate Population Projections, March 2015

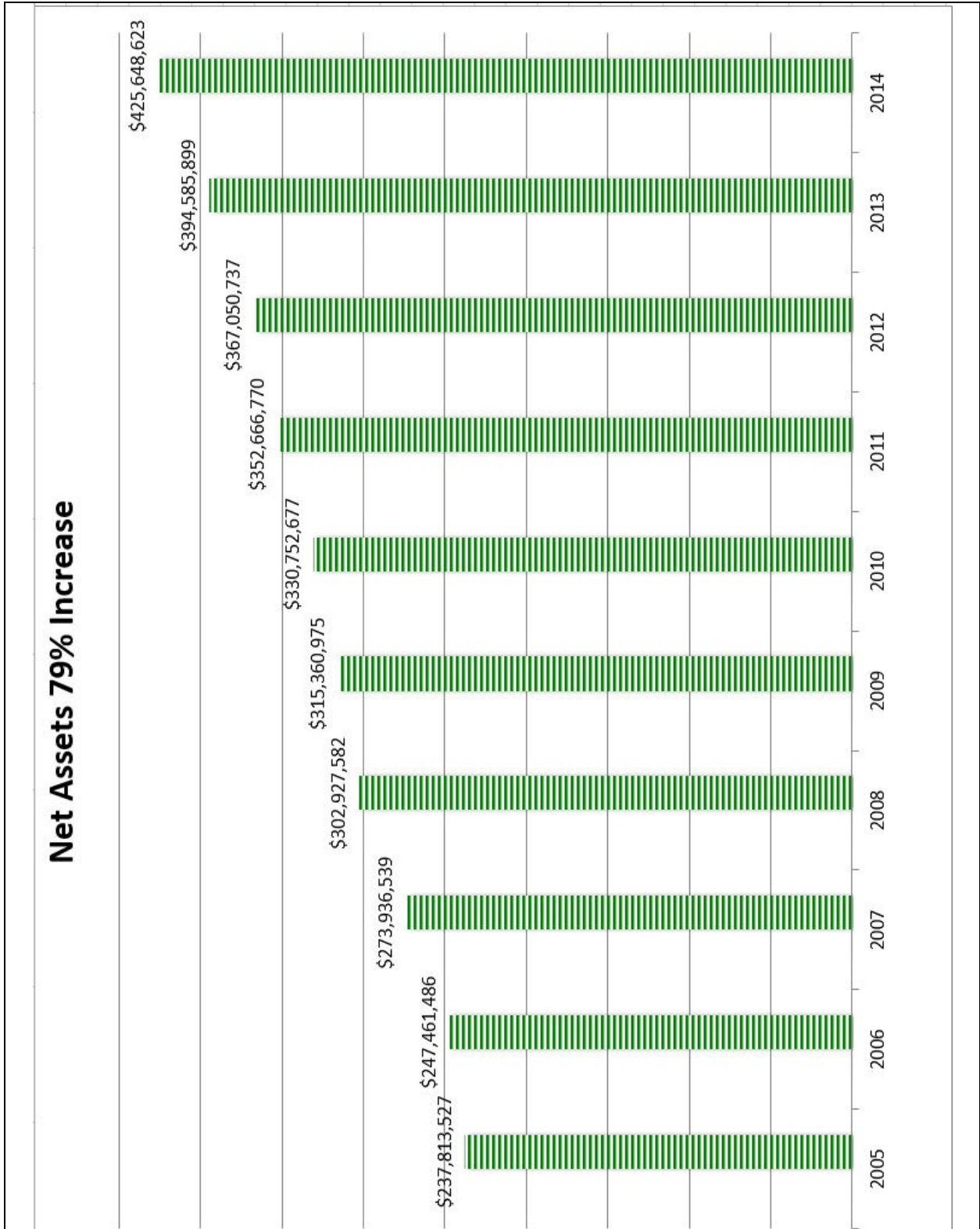
Board of Supervisor's Budget Policy FY 2011-2012

<http://countyofnapa.org/Pages/DepartmentContent.aspx?id=4294976068>

APPENDIX 2

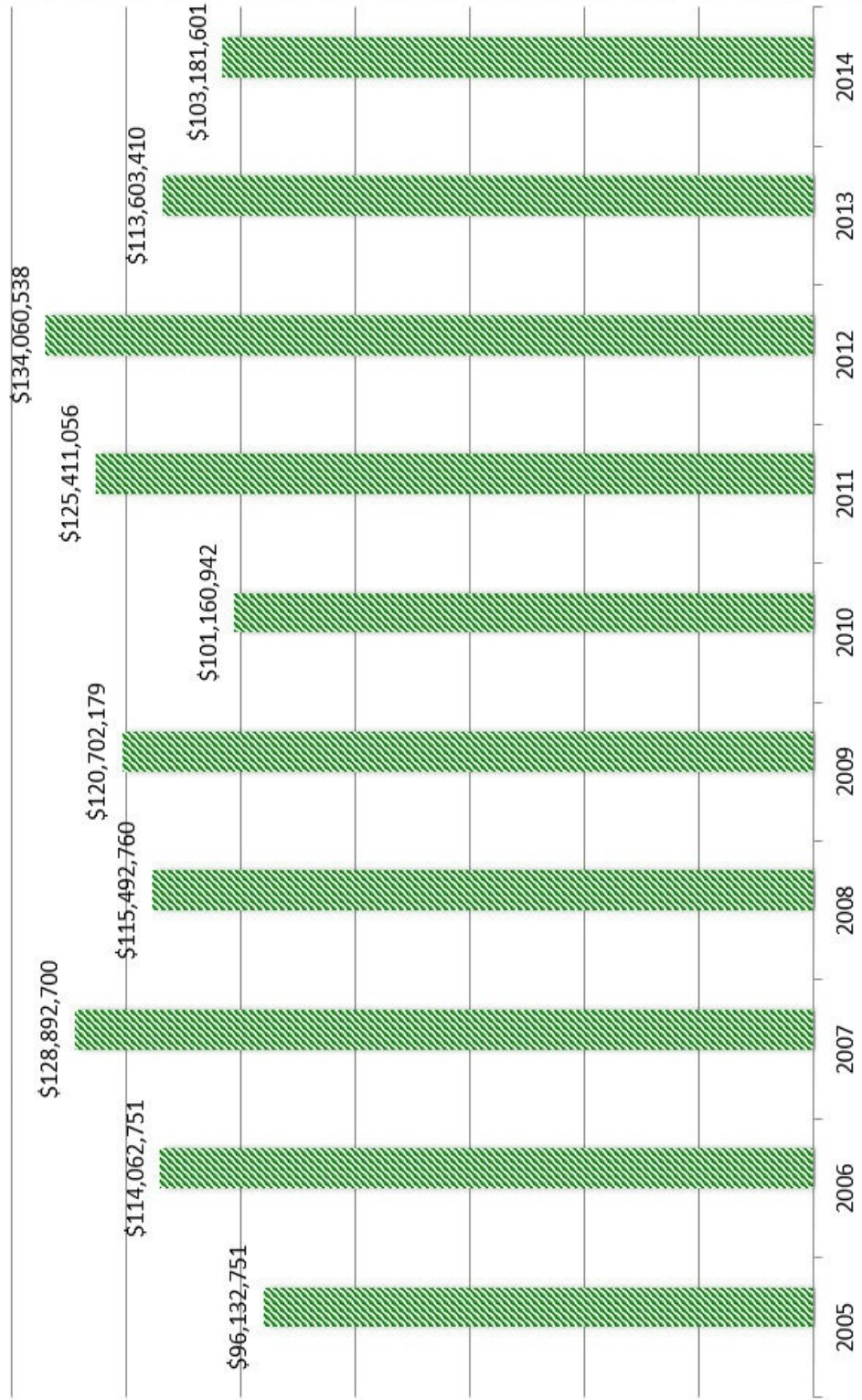


APPENDIX 3



APPENDIX 4

Unrestricted Funds



## APPENDIX 5

