

**MINUTES
CITY OF FALLON
55 West Williams Avenue
Fallon, Nevada
January 27, 2016**

The Honorable City Council met in a special Council meeting on the above date in the Council Chambers, 55 West Williams Avenue, Fallon, Nevada.

Present:

Mayor Ken Tedford
City Councilman, Robert H. Erickson
City Councilwoman, Kelly Frost
City Councilman, James D. Richardson
Chief of Police, Kevin Gehman
City Clerk, Gary C. Cordes
City Attorney, Michael F. Mackedon

The meeting was called to order by Mayor Tedford at 3:30 p.m.

Mayor Tedford inquired if the agenda had been posted in compliance with NRS requirements.

City Clerk Cordes advised that the agenda was posted in compliance with NRS 241.

Public Comments

Mayor Tedford inquired if there were any public comments. He noted that comments are to be general in nature, not relative to any agenda items. No action may be taken on a matter raised under this item until the matter has been specifically included on an agenda as an item upon which action will be taken.

No public comments were noted.

Approval of City of Fallon June 30, 2015 Audited Financial Statements

Mayor Tedford noted that the Audit Committee is present today and includes Councilman Erickson and City Attorney Mackedon.

Councilman Erickson asked Ms. Kristin Chinvarasopak of Eide Bailly to begin her presentation.

Ms. Chinvarasopak explained that she is a partner with Eide Bailly in the Reno office. She had been tasked with the responsibility of conducting and supervising the audit over the City's financial statements for the year ended June 30, 2015. She advised that, since this was her first presentation to the Mayor and Council, she would go over the general pieces of the report and would provide more detailed explanations or additional information if requested. The first report is the Independent Auditor's Report and in that report they expressed an unmodified

opinion on the City's financial statements for the year ended June 30, 2015. Unmodified means clean opinion, no modifications had to be reported. They issue more than one opinion; there are opinion units in these financial statements for each major fund. Major funds include the General Fund, Electric Enterprise Fund, Water Enterprise Fund, Sewer Enterprise Fund and Wastewater Enterprise Fund. All of those had an unmodified opinion as well. Another report is the Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*; also referred to in the industry as the Yellow Book Report. That report is not an expression of an opinion, it talks about the City's internal controls as well as compliance with laws, regulations, grants and significant agreements that would impact those financial statements. As the audit is conducted, a risk assessment is performed to gain an understanding over the City's internal controls and identify any deficiencies that rise to the level of a significant deficiency or a material weakness; it is required to be reported in this report. This year there was one finding in connection with internal controls at the City that was deemed a material weakness and that was the result of having three material adjustments that needed to be made to the financial statements in order for them to be in accordance with accounting principles generally accepted in the United States. They recommended that there be some additional controls put in place over journal entry. It revolved around general journal entries, not the day to day journal entries but some general journal entries that are periodically posted so they recommended some enhancement in controls over preparation and review of those journal entries so that their audit is not needed to point out material misstatements so they would be correct without their assistance. That material weakness is noted in the report along with Management's Response. Lastly, Auditor's Comments are found on the last page of the Comprehensive Annual Financial Report. Those are items that are spelled out in Nevada Revises Statutes (NRS) that must be commented on. This year, it refers to Note 2 to the financial statements in connection with compliance with NRS and Nevada Administrative Code (NAC). Referring to Note 2, there were three items listed in connection with compliance with NRS and NAC. The first item was in connection with charging of direct costs to the enterprise funds and that being a potential violation of statute. The second item was two overexpenditures of budget in the general government function of the Mayor's Youth Fund. The third item was operating and nonoperating expenses exceeding budget in the Public Works Internal Service Fund. Those were the main highlights of the comprehensive report. She inquired if there were any questions or additional information that she could provide.

Mayor Tedford inquired if the Council had any comments or questions.

Councilman Erickson referred to Note 2 and stated that he understood the City has 60 days to make a response to the Nevada Department of Taxation (Taxation).

Ms. Chinvarasopak replied affirmatively.

Councilman Erickson asked Ms. Chinvarasopak, since she now understands the operation of the Electric Fund and the operation of the City, her recommendation on how we should approach clarifying that and what we could do to accomplish the mission of the City and still be in compliance and avoid this issue in the future.

Ms. Chinvarasopak stated that, as more client reports are being issued to the Nevada Department of Taxation with Note 2 violations, the department has been contacting auditors for clarification on some of the items. Auditors have been directing them to Management since these are Managements' financial statements, but she would anticipate that the City would get a call in connection with this because it is not a standard item that they will generally see. They

see overexpenditures, those are fairly common and not unusual; but the one in connection with the Electric Fund and the direct charges and the costs, she believed that Taxation would send correspondence on that. She would paint a picture to them as to why and how it works. It would be important in the City's initial communication with Taxation to help alleviate the comments back and questions from Taxation. As far as the communication and how to respond to them, she advised that the City should let them know how it is operated, why that was derived that way and potentially not part of a cost allocation plan.

Councilman Erickson noted that Ms. Chinvarasopak mentioned that they have other clients that have had this same issue. He asked if there were a lot of other entities that are struggling with this.

Ms. Chinvarasopak stated that she had not personally, nor had she heard of anyone else at the Reno office that had this specific statute reference but they have had other statute items reflected in Note 2 that Taxation has come back and asked about. She could not think of any other entity that had this specific circumstance.

City Attorney Mackedon referred to the charges to the Electric Enterprise Fund and stated for the record that there is no issue about whether this is a deviation or violation of general accounting standards.

Ms. Chinvarasopak stated that was correct; from a generally accepted accounting principles perspective, there was not an adjustment that needed to be made because from that perspective – the financial statements – having these amounts recorded in the Electric Enterprise Fund where they were recorded is not an issue. This is purely in connection with whether or not there is a violation under NRS or NAC.

City Attorney Mackedon confirmed that the actual accounting was adequate and correct, according to their findings. The nature of the compliance issue is the interpretation of the statute; whether the costs that were referred to should be characterized as direct costs or whether they should be characterized as indirect costs or whether some other procedure should be involved.

Ms. Chinvarasopak said that was correct.

Councilman Erickson noted that one other area that was a big change in this year's financial report as a result of GASB 68 & 71 was the reporting of pension plans and that changes a lot of our financial dynamic. He asked her to review that.

Ms. Chinvarasopak explained that all State and local governments now record their proportionate share of Public Employees' Retirement System (PERS), net pension liability. All participants are required to pick up a piece of that and report it as a liability on their individual financial statements. Before this reporting requirement, it was just a footnote disclosure that said statute set the required contribution, we make that contribution to PERS and here was the total of our contribution. Now, the actual recording of the liability is required and includes over four pages of footnote disclosure to go along with that. It does have an impact to the net position of the City when you add an additional \$10.5 million in net pension liability. The State and every local government across the nation had to do the same thing.

Councilman Erickson stated that he looked at that report and the City's \$10 million is just under 1/10 of 1% of the total liability for the PERS system. That is actually a self-correcting liability and the Legislature and the PERS Board sets the contribution rate every other year as well as market return on their investment portfolio so that liability can either go up or down and they have aggressively raised that rate over the last four or five years and he believes part of that liability will be amortized.

Ms. Chinvarasopak concurred; the liability is actuarially determined, so market returns and actual contribution rates factor in. As an example, this had to be applied retrospectively. There was a prior period adjustment to these financial statements to record the liability at June 30, 2014 and then run the current year activity to a liability at June 30, 2015; so the liability did go down from 2014 to 2015. She referred to a footnote and stated that net pension liability at June 30, 2014 was \$13.2 million and at June 30, 2015 it had dropped to \$10.5 million. This number will change annually.

Councilman Erickson referred to City Clerk Cordes' Letter of Transmittal; in it he made the observation that we have absolutely no direct liability to fund that deficit.

Ms. Chinvarasopak concurred. She added that GASB 68, with all the questions from auditors, there was a clear indication that there were some items that needed to be ironed out in practical application of GASB 68; there are multitude corrective pronouncements, modifications and clarifying items that are in the works at GASB and there would likely be several that will follow that will clean and clarify some of these items in connection with the pension standards.

Councilman Erickson again referred to Note 2. The electrical enterprise has historically, even before his time as Mayor (1987-1995), been considered a key component of the City's financial operation and a driver of the economic health of the community. Beginning in 1985, when the Churchill Economic Development Authority (CEDA) was formed, and it was recognized that our participation in that as one of the first economic development authorities, he as a founding board member and subsequently Mayor Tedford as chairman over the years, to try and develop economic viability in the community. We recognized that being involved in economic development at an early stage was imperative to the health of our community. We invested in it then and we have continued to invest in it and have invested in economic development in other ways through the City. The science and art of economic development has dramatically changed since 1985. It is recognized now that when quality companies look for a community to locate in or relocate in – substantial companies that are sustainable – they look long term and one of the key things that they look at is quality of life in the community. They are primarily concerned about the educational opportunities for their employees and their families, public safety, sustainability of the community, the culture and the art of the community and overall components of quality of life in a community such as medical facilities. The Electrical Enterprise Fund is dependent, completely, for its sustainability and its viability, on growth. Without growth and profit the Electrical Enterprise will eventually fail because it requires reinvestment and sustainability in that manner through new growth. The reasoning behind the fact that those costs are direct costs is because they relate directly to the viability and the sustainability of the electric company and by economic development, it is not just bringing in new business, it is also preserving existing business and we all know what the recession of 2007 has done to this State and our community and everybody else; the fact that when a building goes vacant, they stop using power and we still have to buy the power. When we have excess we must sell it on the electrical spot market which at this very stage is a depressed market so we take a loss on every kilowatt hour that we have to sell on the electrical spot market. The way an electrical operation works is that you have to guarantee your customers a regular and continuous source of electricity and so you have to purchase power contracts and they are usually long term contracts, anywhere from three to seven years in duration, and you are required to buy that power under that contract whether you use it or not. So every time a building goes vacant in your community, every time the retail community suffers a loss by closure of a business and no one to replace it, every time a household leaves because they lost their job and there is no job

opportunity, your electrical utility suffers an economic loss. Even if no new businesses come into the community, it is imperative that you sustain the businesses you have and hopefully attract new retail outlets to fill up your vacant storefronts, therefore, they buy electricity. The flip of the coin is new business development and with Mayor Tedford's vision and the City Council's vision, and a lot of great effort in 2001 they built a business park in the City which is an electric company asset. Having an aggressive economic development program to fill that asset is just looking for a return on our investment in that business park. It pays dividends in a number of ways that go beyond the electric department; it creates jobs and those people buy houses and they buy electricity and they shop in retail stores. Maybe that is the difference between a store that is struggling with staying open or going out of business. It is all interconnected and that is the justification behind the fact that these are direct expenses of the electric company. Every electric company in the country, whether a public, stockholder or regulated electric system or a public electric system like the City of Fallon, invests in economic development. That is why we classify those as a direct expense as opposed to a General Fund expense or an indirect expense which would have to be allocated somehow between the other funds. This is our justification behind the fact that it is a direct expense. We need to make that argument, as Ms. Chinvarasopak suggested, to Taxation or the committee on local government, whoever becomes the decision maker on the interpretation of that statute.

Mayor Tedford stated that he brings 28 years experience to this meeting, he spent 45 minutes with Ms. Chinvarasopak explaining how the City operates and how it has operated for 108 years and how it has operated since it had an Electric Enterprise Fund. Everything Councilman Erickson said is exactly true and how that fund is utilized. An enterprise fund is a business to us and how those around us operate theirs as businesses and how this community would suffer without \$406,000 being spent on its behalf. We have a responsibility to the people that live here. There is a reason we entered into the electric business; it was because nobody would do it out here. Every dollar turned there helps in the survival of the City of Fallon government as well as the City of Fallon. This legislation is detrimental to how we operate as a City government that could even influence how we could even survive. This is wrong on many different levels and wrong for the people who have elected us to serve them and keep City government functional in a manner that they have seen it serve them for over 108 years now, through 17 Mayors and numerous City Council members. This is the biggest threat that we face right now. This is where CEDA is funded from. The Tractors & Truffles event hosts 100 people and 85 of them come from Reno; the reason is to try to get those people to invest in Fallon. Some of those people go back and tell other people about Fallon so they will invest here. There is an entire effort that we have done in the last 10-15 years to counteract the loss of half our water. This is a major wound and no one else wants to understand that except the officials sitting here right now. No one realizes how damaging this is; it is damaging to the operation of the City of Fallon and its viability in the future.

Councilman Erickson agreed that we are unique and regulations a lot of times get developed and there are unintended consequences because they do not take into account all the individual players and how it will adversely affect them. If the purpose of the Electric Enterprise Fund is to provide for its sustainability through business development and growth, then efforts to achieve that goal should be a direct cost to the Electric Enterprise Fund.

City Attorney Mackedon reminded that the business park is likely the only place in western Nevada that the Dairy Farmers of America (DFA) plant could be located and that project could not have been done without these expenditures. That plant is the foundation for the largest

dairy industry in Nevada and DFA is producing powdered milk for export to Asia and that is a contribution to the export/import ratio that the Governor's Office pays attention to when it is doing an economic analysis. There would not be a DFA plant unless the City was able to locate that asset within the business park and the same goes for the Gemini plant that is also located in the business park.

Councilman Erickson added that DFA has become the largest purchaser of electrical energy in the City of Fallon so that is the direct correlation to the economic viability of the Electric Enterprise and obtaining a new industry in the community through the efforts of the business park and the outreach efforts that we do in a number of different ways.

Mayor Tedford inquired if there were any public comments or questions.

No public comments were noted.

Councilman Erickson motioned to approve the City of Fallon June 30, 2015 Audited Financial Statements; seconded by Councilman Richardson with the correction of the term expiration for himself which should be June 30, 2017 and Councilwoman Frost which should be June 15, 2019, and approved with a 3-0 vote by the Council.

Public Comments

Mayor Tedford inquired if there were any public comments.

No public comments were noted.

Adjournment

There being no further business to come before the Council, Mayor Tedford adjourned the meeting at 4:12 p.m.



Mayor Ken Tedford

Attest: _____



Gary C. Cordes, City Clerk/Treasurer