



CITY OF NEWPORT BEACH FINANCE COMMITTEE AGENDA

Newport Coast Conference Room, Bay 2E
100 Civic Center Drive, Newport Beach
Monday, March 24, 2014 – 4:00 PM

Finance Committee Members:

Mike Henn, Council Member, Chair
Keith Curry, Council Member
Tony Petros, Council Member

Staff Members:

Dave Kiff, City Manager
Dan Matusiewicz, Finance Director
Steve Montano, Deputy Finance Director

- 1) CALL MEETING TO ORDER
- 2) ROLL CALL
- 3) PUBLIC COMMENTS

Public comments are invited on agenda and non-agenda items generally considered to be within the subject matter jurisdiction of the Finance Committee. Speakers must limit comments to 3 minutes. Before speaking, we invite, but do not require, you to state your name for the record. The Finance Committee has the discretion to extend or shorten the speakers' time limit on agenda or non-agenda items, provided the time limit adjustment is applied equally to all speakers. As a courtesy, please turn cell phones off or set them in the silent mode.

4) APPROVAL OF MINUTES

Approval of the November 18, 2013 Finance Committee meeting minutes.

5) CURRENT BUSINESS

- A. Review of June 30, 2013 Audit Results: Review results of the June 30, 2013 financial audit and audit of Federal Funds (Single Audit).
- B. 2014 Finance Committee Workplan Overview: Staff will seek approval of tentative Finance Committee agenda topics scheduled for the year.
- C. Enterprise Resource Planning (ERP) Update: Review status of ERP selection process and tentative implementation plan if contract is approved by Council. This item will give

This Finance Committee is subject to the Ralph M. Brown Act. Among other things, the Brown Act requires that the Finance Committee's agenda be posted at least seventy-two (72) hours in advance of each regular meeting and that the public be allowed to comment on agenda items before the Finance Committee and items not on the agenda but are within the subject matter jurisdiction of the Finance Committee. The Finance Committee may limit public comments to a reasonable amount of time, generally three (3) minutes per person.

It is the intention of the City of Newport Beach to comply with the Americans with Disabilities Act ("ADA") in all respects. If, as an attendee or a participant at this meeting, you will need special assistance beyond what is normally provided, the City of Newport Beach will attempt to accommodate you in every reasonable manner. If requested, this agenda will be made available in appropriate alternative formats to persons with a disability, as required by Section 202 of the Americans with Disabilities Act of 1990 (42 U.S.C. Sec. 12132), and the federal rules and regulations adopted in implementation thereof. Please contact the City Clerk's Office at least forty-eight (48) hours prior to the meeting to inform us of your particular needs and to determine if accommodation is feasible at (949) 644-3005 or cityclerk@newportbeachca.gov.

opportunity for Committee Members to ask questions or request more information in advance of formal Council action.

- D. Discretionary Reserve Level Discussion: City reserves are critical financial tool used for strategic planning and managing risk. Council Reserve Policy, F-2, establishes the framework and parameters of the City's discretionary reserves. It is important to periodically reevaluate this policy to make sure it remains current with strategic objectives and financial risks faced by the City. Staff will review this policy at a summary level, recommend certain adjustments and seek Committee comment and direction.

6) FINANCE COMMITTEE ANNOUNCEMENTS OR MATTERS WHICH MEMBERS WOULD LIKE PLACED ON A FUTURE AGENDA FOR DISCUSSION, ACTION OR REPORT (NON-DISCUSSION ITEM)

7) ADJOURNMENT

**CITY OF NEWPORT BEACH
CITY COUNCIL FINANCE COMMITTEE
NOVEMBER 18, 2013 MEETING MINUTES**

1. CALL TO ORDER

The meeting was called to order at 4:00 p.m. in the Newport Coast Conference Room, Bay 2E, 100 Civic Center Drive, Newport Beach, California 92660.

2. ROLL CALL

Present: Council Member Mike Henn (Chair), Mayor Keith Curry and Council Member Tony Petros

Staff present: City Manager Dave Kiff, Deputy City Manager Terri Cassidy, Finance Director Dan Matusiewicz, Deputy Finance Director Steve Montano, Budget Manager Susan Giangrande and Administrative Coordinator Tammie Frederickson

Members of the public: Jim Mosher, Carl Cassidy

3. PUBLIC COMMENTS

Mr. Jim Mosher inquired on the status of the Finance Committee work plan for the coming year; commented on possible public interest in the two reports posted by Finance staff about development fees showing what fees have been collected and how the fees were used during the last fiscal year; and he expressed that he has no intention of pursuing an appeal to the courts on the alleged Brown Act violations which was the subject of the last Finance Committee meeting. He reminded the Committee that the City Attorney stated discussions with the majority of elected officials of a legislative body must take place only at noticed meetings and there are no exceptions.

Mr. Mosher commented on the trash contract and noted the financial decision whether or not to outsource was based on savings. He believed it was unfair to have placed the burden on the trash collectors of demonstrating that insourcing was economical and feasible. He questioned the accuracy of recycling figures provided by CR&R and noted some members of the public may feel misled by information from CR&R regarding sending green waste to the landfill. This is because that may not be possible in the future and would then require implementation of a more expensive program.

4. APPROVAL OF MINUTES

Mayor Curry instructed a correction to his statement on page 2 from "...a waste of taxpayer time and effort" to "...a waste of taxpayer money." Mayor Curry moved, Council Member Petros seconded to approve the minutes of the October 15, 2013, Finance Committee meeting with the above correction. The Committee voted all ayes to approve the minutes.

**All documents distributed for this meeting are available in the
administration office of the Finance Department**

5. CURRENT BUSINESS

A. Review of Public Employees Retirement System (PERS) Valuations

Finance Director Dan Matusiewicz reviewed a presentation on the June 30, 2012, CalPERS Actuarial Valuations used to determine the 2014-15 contribution rates for safety and miscellaneous employees. The slideshow illustrated pension fundamentals; pension risks; retirement contributions; historical components of pension funding; the relationship between investment return and pension cost; CalPERS historic investment returns; plan cost variables such as mortality, investment returns, industrial disability retirements and workforce size; and a CalPERS timeline of historical decisions that affected actuarial assumptions.

Mr. Matusiewicz reviewed the new CalPERS asset smoothing methodology which will impact contribution rates starting in fiscal year 2016 and will result in a better funded plan with more stability. The previous actuarial value approach for the determination of rates is being eliminated. The difference between the actuarial value basis and market value basis is \$88.9 million which will be added to the unfunded liability and phased into rates over 5 years. Council Member Henn questioned whether the smoothing of the \$88.9 million is readjusted every year during the 5-year period if the asset value changes. Mr. Matusiewicz responded that a successive trapezoid-shaped amortization base is added to the schedule each year. The amortization base can be positive or negative depending on whether there is a net actuarial gain or loss for the year.

Mr. Matusiewicz went on to discuss projected PERS rates and pension costs. He noted that under the old methodology the unfunded liability continued to creep upwards each year and he illustrated an analogy of a homeowner refinancing a 30-year mortgage every year. He stated that under the new methodology the unfunded liability over a period of time will look very different than the old methodology. Referring to the mortgage analogy, this smoothing methodology will result in truly paying down the mortgage instead of refinancing every year. Mayor Curry added that under the new methodology the unfunded liability gets recalculated every year and is affected by factors such as mortality rates and investment assumptions. Council Member Henn commented there will be new deficits created over time but it will be paid off at the end of the 30-year amortization period. Council Member Petros agreed that the City has taken a responsible approach with steps already made to reduce our costs but he believed the unfunded liability will never go away. He suggested that the Council should express support for the efforts San Jose Mayor Reed is undertaking on a potential pension reform ballot measure.

Mr. Matusiewicz spoke on the projected pension cost increases and noted in six years the employer contribution will increase \$10 million. Council Member Henn remarked we should find a way to message the good things the City is doing such as the advance payments that were made, the shift to a fully amortizing methodology the City elected ahead of CalPERS, the reductions in employment

levels, and the fact that employees are paying a portion of the employer costs. Mayor Curry commented that by the end of the next fiscal year, employees will have gone from paying \$0 to \$7 million a year in costs; that is substantial progress and there is the possibility of employees picking up a portion of the increased cost, particularly safety employees. Council Member Henn advised against using percentages in discussions and to stick with using dollar amounts.

Mr. Matusiewicz noted in terms of the unfunded liability, the City was fully funded in 2007 on a market value basis. He commented that 60% of the pension benefit obligation is associated with separated employees and 40% is associated with active members. Mayor Curry remarked the footnote on that slide should be corrected because it was not in sync with the percentages shown in the pie chart.

More actuarial changes on the horizon will likely impact 2015-16 rates, including a possible 0.25% reduction to the discount rate, a new experience study looking at mortality and disability retirement assumptions, a review of the investments strategy and GASB Statement No. 68 requirement to report unfunded pension liability on the balance sheet. This reporting requirement this will not change our means of funding the pension liability.

As previously noted by members of the Finance Committee, the latest actuarial valuation does not reflect steps taken by the City Council toward pension reform. Council Member Henn insisted that it is important to find a way to express the fact in dollars. It is important to reflect the fiscal impact of decisions that have a substantive benefit in reducing the liability beyond what it otherwise would have been. Mr. Matusiewicz concluded the presentation with his recommendations to continue with maintaining reasonable employee contributions, seeking opportunities for staffing efficiencies to keep payroll in check, and consider the use of reserves to accelerate payments on the unfunded liability so as to avoid the interest that accrues to the City from the liability. Mayor Curry further recommended an increase to employee contributions, especially safety employees. He added another key element is to constrain compensation growth. Council Member Henn commented that as contract negotiations begin it is important in terms of policy direction to understand compensation distinctions and how to control payroll cost growth. Deputy City Manager Terri Cassidy noted that some agencies have made a policy decision to only hire new hires as opposed to laterals. City Manager Kiff remarked that would result in possibly replacing top executives with someone from the private sector who has never been in PERS but it is something for the Council to consider.

Council Member Henn stated the recommendations are not ready to go forward and that Council needs to have a thoughtful discussion about the recommendations and establish the policy direction Council wants to take. He directed staff to bring back an expanded list of aggressive policy options and include a dollar value expressed for the steps already taken toward reducing the cost through negotiated increases in employee contributions. Mayor Curry

added it should be explained that the \$89 million increase in the liability is the result of CalPERS changing the assumptions and calculations in a way that states the number in a much different way than it was a year ago.

Mr. Mosher commented it would be useful to the public to understand how the various formulas work for calculating employee pensions. Mr. Kiff remarked the CalPERS website provides information on pension formulas.

B. Quarterly Financial Review Q4 FY 2012-13 and Q1 FY 2013-14

Deputy Finance Director Steve Montano went over the financial results for the fourth quarter of fiscal year 2012-13, the period between April 1 and June 30. Newport Beach continues to be a prosperous and financially secure municipality due to the strong underlying tax base, strong governance and disciplined fiscal decisions. He reviewed the "Top 3" revenue sources which are property tax, sales tax and transient occupancy tax (TOT), and he reported increases higher from the prior fiscal year for each of the three sources. In response to Council Member Petros' question regarding why the sales tax year-to-date actual is lower than the amended budget, Mr. Matusiewicz explained the State Board of Equalization made a large adjustment for some funds that were misallocated to the City.

Mr. Montano concluded that overall in FY 2013-13, the net increase to the City's General Fund reserve was \$2.6 million. Council Member Henn asserted there was a positive \$7.4 million revenue variance and a \$5 million positive expenditure variance, which amounts to a \$12.4 million positive variance on an operating basis. He pointed out the policy decision made to transfer \$11.6 million out of the General Fund to reserves. Mayor Curry commented it is important to get the message out that the \$12.4 million operating variance was achieved through reduced expenditures and higher revenue growth to finish the fiscal year with a budget surplus over the adopted budget. Putting the number in perspective, Mayor Curry stated the surplus is 150% higher than the \$8 million debt service cost for City Hall, or from another perspective the surplus would cover six years of the \$2 million yearly pension cost increase. He emphasized the City continues to be in strong shape and will continue stringent efforts to reduce pension liability costs.

Council Member Henn remarked that achieving the budget surplus is a mark of distinction to those who operate the City and a view of the operating performance should be isolated and highlighted.

In response to a question raised by Mayor Curry, Mr. Montano replied the aggregate total reserves, which include discretionary and committed reserves, total \$130 million. Mr. Matusiewicz noted the Facilities Reserve currently includes committed money that has not yet been set aside for a couple of capital projects, namely Marina Park and Sunset Ridge. Council Member Henn asked staff to find a consistent methodology for expressing the amount of available reserves. Mayor Curry declared the City's reserves are at their highest level in the 108 year history of the City. He stated it is important for the taxpayers to know that in terms of how we're being good stewards of the City finances. Council Member Petros pointed out that for policy making, it is vitally important to report

consistently and correctly the reserve amount and how you arrive at that amount.

Mr. Montano went on to report on the first quarter for fiscal year 2014-15, the period between July 1 and September 30. As is typically the case, much of the revenue lags during the first quarter, such as property tax and sales tax. He noted the TOT which reflects 26% of revenue covers the summer months. Council Member Petros questioned whether the housing market is keeping pace with the fourth quarter as reported. Mr. Montano responded it is too early to offer any projected increase over what was conservatively budgeted.

In response to a question raised by Council Member Petros, Mr. Kiff said the information on CalPERS was included in the draft Quarterly Financial Report because PERS released the actuarial reports and this is an opportunity to help educate the public on the issue. Council Member Henn expressed that the CalPERS discussion is not relevant to the financial report and the conclusion for the first quarter should be a positive indication that the budget is on track. Mr. Henn preferred a separate PERS primer document that addresses some of the pension issues.

Mr. Mosher inquired about the charts and suggested a revision for clarification to the column heading "Percent of 2012/13 Budget Realized." He also questioned whether the Top 3 components are consistent with the Performance Plan that shows a large amount of funds coming from fees for services yet there is no mention of these funds or the tidelands fund in the financial report. Mr. Matusiewicz responded that this is the first year a separate tidelands report was published to address issues raised by the State Lands Commission. Agreement was expressed to include some verbiage in the quarterly financial report on the expanded tidelands financial report.

C. Budget Process Strategy and Roadmap

Budget Manager Susan Giangrande discussed the fiscal year 2014-15 budget process. The budget will be compiled using new budgeting software technology that will bring more structure and efficiency to the budgeting process. Ms. Giangrande spoke about the improved reporting and expanded capability features of the software, City Vision. She reviewed highlights and a timeline for the new Enterprise Resource Planning (ERP) program selection and implementation process with modules phased in over time through mid-2017.

Ms. Giangrande gave an overview of the 2014-15 budget calendar. Council Member Petros stated that during the budget review process, he is interested in addressing staffing and project management oversight which appears to constrain the capacity to execute capital projects.

Council Member Henn commented the revenue assumptions included in the roadmap are conservative and the Committee Members did not express any concerns with the conservative nature of the assumptions. The discussion moved on to expenditures wherein Mr. Kiff suggested that at the January Council goal

setting session there could be further discussion on the Council priorities for completing capital projects faster. He commented that operationally the next year will include changes to trash collection service, a consultant's study on fire and emergency medical services that may result in a change, the class and compensation study as well as the new ERP will result in operational changes, and maintenance and operation of higher technology buildings including OASIS and the Civic Center.

Mr. Kiff spoke on citizen engagement in the budget process and said he is open to suggestions on how to achieve a dialogue with the public to help them better understand various aspects of putting together the City's budget.

Mr. Cassidy encouraged promoting the work of this Committee to members of the public. He stated his belief that the public would benefit from the opportunity to listen to the discussion and interaction with staff. Mr. Cassidy thanked the Committee Members and staff for the breaking down the information and he requested there always be monthly meetings of the Finance Committee.

Mr. Mosher asked about how performance based budgeting fits in with the changes to the new budgeting software and the ERP. Council Member Henn explained performance based budgeting does not automatically tie in to a new ERP system. He stated the ERP will help facilitate steps towards performance based budgeting which he articulated as activities of the City defined and prioritized through its programs and an assignment of revenues and costs associated with the programs. The City Vision software is an enhanced reporting tool that is revenue and expenditure oriented.

Ms. Giangrande commented that one new feature of City Vision will be the ability to report the full pension obligation and employee contribution in the fiscal year 2014-15 detail budget.

On the topic of citizen engagement, Mr. Mosher commented it is disappointing in many areas and we have a long way to go to get the public actively engaged in financial matters.

6. FINANCE COMMITTEE ANNOUNCEMENTS OR MATTERS WHICH MEMBERS WOULD LIKE PLACED ON A FUTURE AGENDA FOR DISCUSSION, ACTION OR REPORT (NON-DISCUSSION ITEM)

Council Member directed staff to return with a pension summary and a 2014 work plan.

7. ADJOURNMENT

The Finance Committee adjourned at 5:54 p.m.

Filed with these minutes are copies of all material distributed at the meeting.

Attest:

Mike Henn, Chair
Finance Committee Chair

Date

DRAFT

All documents distributed for this meeting are available in the
administration office of the Finance Department

**CITY OF NEWPORT BEACH
FINANCE COMMITTEE AGENDA ITEM INFORMATION**

Agenda Item No. _____
March 24, 2014

TO: HONORABLE CHAIR AND MEMBERS OF THE COMMITTEE

FROM: Finance Department
Dan Matusiewicz, Finance Director
(949) 644-3123, DanM@newportbeachca.gov

SUBJECT: FISCAL YEAR 2012-13 AUDITOR RECOMMENDATION

SUMMARY:

In connection with the City's financial statement audit, the auditors have certain obligations to communicate the audit results with both City Council and management. The attached letters from the City's auditors, White Nelson Diehl Evans fulfill those obligations for the required communication.

DISCUSSION:

The first audit letter is intended to communicate matters of particular significance that City Council should be aware of including:

- Qualitative Aspects of Accounting Practices
- Difficulties Encountered in Performing the Audit
- Corrected and Uncorrected Adjustments
- Disagreements with Management
- Management Representations
- Management Consultations with Other Independent Accountants
- Other Audit Findings or Issues

We are pleased to report that the auditors reported no instances of significant audit findings; difficulties encountered in connection with the performance of the audit; corrected or uncorrected adjustments; disagreements with management or other audit findings or issues.

The second letter entitled "Independent Auditors' report on Internal Control over Financial Reporting and on Compliance and Other Matters" is intended to communicate deficiencies, significant deficiencies or material weaknesses in internal control and instances of noncompliance or other matters. We are pleased to report that the auditors did not identify any deficiencies in internal control considered to be a material weakness that would result in more than a remote likelihood of a material misstatement of the financial statements or would not otherwise be prevented by the City's internal controls.

They also did not identify any instances of noncompliance or other matters that require specific communication to the governing body as promulgated by Government Auditing Standards.

We are pleased to report that there were no management comments this year.

Prepared by:

Submitted by:

Rukshana Virany
Accounting Manager

Dan Matusiewicz
Finance Director

Attachments:

- A. Auditor's "Audit Committee Letter"
- B. Auditor's "Report on Internal Control over Financial Reporting and on Compliance & Other Matters"

To the Honorable Mayor and
Members of the City Council
of the City of Newport Beach
Newport Beach, California

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Newport Beach (the City) for the year ended June 30, 2013. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards and *Government Auditing Standards*, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our engagement letter dated May 3, 2013 and our meeting on planning matters with the finance committee on June 12, 2013. Professional standards also require that we communicate to you the following information related to our audit.

Significant Audit Findings

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the City are described in Note 1 to the financial statements. As discussed in Note 1d to the financial statements, the City incorporated deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure of net position due to the adoption of Governmental Accounting Standards Board's Statement No. 63, "*Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*". The adoption of this standard also provides a new statement of net position format to report all assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net position. Also discussed in Note 1d to the financial statements, the City has changed its method for accounting and reporting certain items previously reported as assets or liabilities during fiscal year 2012-2013 due to the early adoption of Governmental Accounting Standards Board's Statement No. 65, "*Items Previously Reported as Assets and Liabilities*". The adoption of this standard required retrospective application resulting in a \$1,132,169 reduction of previously reported net position as of the beginning of the year for the governmental activities. No other accounting procedures were adopted and the application of other accounting policies was not changed during the year ended June 30, 2013. We noted no transactions entered into by the City during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected.

Significant Audit Findings (Continued)

Qualitative Aspects of Accounting Practices (Continued)

The most sensitive estimates affecting the City's financial statements are as follows:

- a. Management's estimate of the fair market value of investments, which is based on market values provided by outside sources.
- b. Management's estimate of the value of capital assets (infrastructure assets) is based on industry standards.
- c. The estimated useful lives of capital assets for depreciation purposes are based on industry standards.
- d. The funded status and funding progress of the public defined benefit plans with CalPERS are based on actuarial valuations.
- e. The annual required contribution and actuarial accrued liability for the City's Other Post-Employment Benefit Plan is based on certain actuarial assumptions and methods prepared by an outside consultant.
- f. The total estimated cost to fund the Early Retirement Incentive Program is based on amounts provided by the third-party administrator.
- g. Management's estimate of the claims payable liabilities related to general liability and worker's compensation claims are based on actuarial valuations.

We evaluated the key factors and assumptions used to develop these estimates in determining that they were reasonable in relation to the financial statements taken as a whole.

Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosures affecting the financial statements were reported in Note 8 regarding claims payable, Note 10 regarding the CalPERS defined benefit plans, Note 11 regarding the City's Early Retirement Incentive Program (ERIP), and Note 13 regarding the City's Other Post-Employment Benefit Plan.

The financial statement disclosures are neutral, consistent, and clear.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. Management has corrected all such misstatements. In addition, none of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to each opinion unit's financial statements taken as a whole.

Significant Audit Findings (Continued)

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated December 24, 2013.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the City's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the City's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Other Matters

With respect to the supplementary information accompanying the financial statements, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

This information is intended solely for the use of management, the City Council and others within the City and is not intended to be and should not be used by anyone other than these specified parties.

White Nelson Dick Evans LLP

Irvine, California
December 24, 2013

INDEPENDENT AUDITORS' 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*

The Honorable Mayor and
Members of City Council
City of Newport Beach
Newport Beach, California

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Newport Beach, California (the City), as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the City's basic financial statements and have issued our report thereon dated December 24, 2013.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the City's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the City's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

White Nelson Dick Evans LLP

Irvine, California
December 24, 2013

**CITY OF NEWPORT BEACH
FINANCE COMMITTEE AGENDA ITEM INFORMATION**

Agenda Item No. _____
March 24, 2014

TO: HONORABLE CHAIRMAN AND MEMBERS OF THE COMMITTEE

FROM: Finance Department
Steve Montano, Deputy Finance Director
(949) 644-3240 or Smontano@NewportBeachCA.gov

SUBJECT: Finance Committee 2014 Work Plan

SUMMARY

Staff will present and seek approval of tentative Finance Committee agenda topics scheduled for the year.

Prepared and Submitted by:

Steve Montano
Deputy Finance Director

Attachment: 2014 Finance Committee Work Plan

City of Newport Beach Finance Committee 2014 Work plan

Scheduled Date	Agenda Title	Agenda Description
March 2014		
3/24/2014	Review of June 30, 2013 Audit Results	Review results of the June 30, 2013 Financial Audit and audit of Federal Funds (Single Audit). The auditor may wish to discuss any changes in accounting standards or disclosures that may be relevant for the forthcoming audit year(s). The committee will have an opportunity to discuss any potential areas of audit concern at this time but committee members are also welcome to contact the auditors directly anytime during the course of the year.
	2014 Work Plan Overview	Staff will seek approval of tentative Finance Committee agenda topics scheduled for the year.
	Enterprise Resource Planning (ERP) Update	Review status of ERP selection process and tentative implementation plan if contract is approved by Council.
	Discretionary Reserve Policy Review	City reserves are a critical financial tool used for strategic planning and managing risk. Council Reserve Policy, F-2, establishes the framework and parameters of the City's discretionary reserves. It is important to periodically reevaluate this policy to make sure it remains current with strategic objectives and financial risks faced by the City. Staff will review this policy at a summary level, recommend certain adjustments and seek Committee comment and direction.
April 2014		
4/28/2014	Quarterly Financial Review	Staff will present Q3 financial results prior to the publication of the Quarterly Business Report.
	Facilities Financial Plan Tool (FFPT) Update	Staff will present an updated version of the FFPT that incorporates further refinements of the scope, time and cost of potential projects.
	Review of Proposed Budget	Staff will provide an overview of the 2014-15 Proposed Budget.
	Special Event Funding Recommendations	Staff will present the results of the Special Event Funding Application process and review staff funding recommendations.
July 2014		
7/21/2014	Annual Investment Policy Review	Staff will present its annual review of the City's investment policy and seek approval and guidance from the Finance Committee regarding the scope, objectives, and standards that govern the City's investment portfolio.
	Annual Investment Performance Review	Staff and/or one or more investment advisors will describe the performance of the City's investment portfolio.
	CALPERS Unfunded Liability Review and White Paper	Staff will introduce a white paper that describes the City's pension benefit plan and the City's efforts to manage its financial exposure to rising pension liabilities while at the same time maintaining its support for promised benefits. Staff will provide clarifying information on the CalPERS changes regarding employer contribution rates, how the impact of actuarial studies (e.g. payroll growth, mortality, wage inflation, discount rate, etc.) impact employer rates, and alternatives for selecting the best funding policy going forward.
November 2014		
11/17/2014	Quarterly Financial Review Q1 FY 14/15	Staff will present Q1 financial results prior to the publication of the Quarterly Business Report.
	Preliminary Year-End Results and the Q4 FY 13/14 Financial Report	Staff will present the preliminary year-end closing results for FY 13/14 and the Q4 financial results.
	Overview of CalPERS Actuarial Valuations	Review latest CalPERS Actuarial Valuations setting FY 2015-16 rates.
	Discretionary Reserve Policy Review	This will be a second review of the City's discretionary reserve levels.

**CITY OF NEWPORT BEACH
FINANCE COMMITTEE AGENDA ITEM INFORMATION**

Agenda Item No. _____
March 24, 2014

TO: HONORABLE CHAIRMAN AND MEMBERS OF THE COMMITTEE

FROM: Finance Department
Steve Montano, Deputy Finance Director
(949) 644-3240 or Smontano@NewportBeachCA.gov

SUBJECT: ERP Update

SUMMARY

Staff will discuss the attached staff report.

Prepared and Submitted by:

Steve Montano
Deputy Finance Director

Attachment:

Consideration of Agreement for Integrated Enterprise Resource Planning Software System (ERP) and Implementation Services (Tyler Technologies Inc.)



CITY OF

NEWPORT BEACH

City Council Staff Report

Agenda Item No. 18.

TO: HONORABLE MAYOR AND MEMBERS OF THE CITY COUNCIL

FROM: Dave Kiff, City Manager – (949) 644-3002, dkiff@newportbeachca.gov

PREPARED BY: Sheri Anderson, Rob Houston, Steve Montano

PHONE: (949) 644-3307, (949) 644-3033, (949) 644-3124

TITLE: Consideration of Agreement for Integrated Enterprise Resource Planning Software System (ERP) and Implementation Services (Tyler Technologies Inc.)

ABSTRACT:

This item is the appropriation and selection of a vendor for a new Enterprise Resource Planning (ERP - also referred to as our Financial + Many Other Elements) software. The proposed vendor is Tyler Technologies. The proposed contract amount is \$3.766M.

RECOMMENDATION:

Approve and authorize the Mayor to execute an agreement with Tyler Technologies Inc. for the purchase, installation, and implementation of an Enterprise Resource Planning Software System and related subsystem software in an amount not to exceed \$3,766,697.

FUNDING REQUIREMENTS:

The total ERP project costs over the five-year term of the contract are anticipated to be \$4,543,785 (see attachment titled Proposed Contractual Costs and Project Budget). This amount includes costs for software license, implementation, and maintenance fees; contingency funding; and project oversight and staffing.

Software License, Implementation, and Maintenance Fees

The Tyler Technologies Inc. not to exceed contractual amount is \$3,766,697, which consists of \$2,909,265 in software, hardware and implementation services and \$857,432 in annual maintenance fees over the five-year term. The majority of the annual maintenance fees will be incurred in future years and will be expensed as departmental internal service fund charges.

As the City moves through the phases of this project, its staff and administration will be challenged to rethink current practices and provide the necessary framework for the City to

align administrative processes with current leading practices. To further this goal, the not to exceed contract amount with Tyler Technologies includes resources for business process consulting, a half time project management staffing resource, and change management assistance.

Contingency

In the event that extra work is needed beyond what is indicated in the Statement of Scope of Work, staff has allocated a contingency budget of \$200,000 and a budget of \$15,000 for other miscellaneous items. The City has identified and budgeted contractual cost stated above to include three "customizations" (i.e., functionalities that require changes to the source code in order to be delivered). There are some functional requirements that have been responded to in the Request for Proposals as either requiring additional procedures or modification. While in most cases these requirements can be met with additional configuration, there may be cases where supplemental code may need to be used. A contingency for extra work or third party application licensing will provide for software modifications, additional interface work with 3rd party applications, and any optional components deemed necessary during the discovery phase that were not originally specified in the base project.

Project Oversight and Staffing

Staffing backfill in the amount of \$562,088 for the duration of the project has been identified. This consists of a temporary HR analyst for 18 months and IT overtime staffing of 450 hours over 30 months. The Finance Department will have the largest staffing commitment to the ERP project than any other department and is requesting authorization to add accountant hours to backfill the work of staff that will be impacted by the planning and implementation process. As part of a larger strategic human capital management initiative, the new positions will a) mitigate the impending ERP workload, b) maintain and improve the analytical capacity to serve other departments during and after the ERP implementation, and c) better position Finance Department staff during the business process change that will occur during the ERP implementation.

The ERP implementation is scheduled to take between 25 and 30 months and will consist of 5 major phases (see Project Timing Section below). Each phase has a life-cycle that requires involvement in chart of account development, business process rules discovery and planning, conversion/interface development, configuration, training, and testing. This schedule will span 3 budget and 2 Comprehensive Financial Annual Report (CAFR) preparation cycles, which will place a significant strain on existing staffing resources.

The total FY 2013-14 available budget for the acquisition and implementation of the ERP system is \$3,736,169. The total anticipated first-year expenditures for the project are approximately \$2,926,384. No additional appropriation of funds for the project is necessary.

DISCUSSION:

Background

The City's current financial management system is provided by Sungard and was implemented over 20 years ago. The City has grown since then and has developed operational needs beyond the abilities of the current system. In addition to the current financial system, the City operates multiple stand-alone customized applications and interfaces in various departments.

Under the current system, many items are tracked and managed in Microsoft Excel spreadsheets and Access databases including: Contract Management, Budgeting, Grant

Management, Cash Flow Management, Records Management, HR Background Questionnaire, Livescan Log, DMV Physicals, Intern Log, Temp & Contractor Log, Disability Claims and Workers Compensation Claims, and other items.

Because the City's financial system was not originally designed to integrate with many of the City's more modern business applications, duplicate entry and manual reconciliation are required where IT staff have not developed and maintained customizations. By replacing the current system, the City will gain operational efficiencies by eliminating the need for redundant processes and duplicate data entry, while improving integration between the financial system and other core functions. The benefits that will accrue to the City as the result of this effort will be stronger decision support (better and timelier information), expanded use of web and mobile device applications to improve customer convenience and numerous workflow process improvements that will streamline and enhance workplace efficiency. This improved integration will also greatly enhance the reporting capability the City will have to provide more accurate information for decision making.

Highlights of limitations in the current financial system and other stand-alone systems within the City's operations include the following:

- Antiquated and limited number of cost accounting tools.
- Insufficient flexibility and configurability has required City IT staff to develop and maintain multiple customizations to integrate with desktop applications.
- Lack of online approval or workflow.
- Lack of ability to generate detailed report queries on the General Ledger.
- Inflexible chart-of-account/budget control structures.
- Inability to create flexible ad-hoc reports for management and user purposes.
- Proliferation of independent databases throughout the organization.
- Inability to query databases and have access to on-line/real-time data.
- Limited technical support for existing software.

We concluded that most of these problems can be overcome through a financial system using best business practices as its framework. The goal of this procurement is to obtain an integrated financial and human resource system that provides us with leading-edge software to perform a broad range of functions such as purchasing, payroll, human resources, general accounting, budgeting, and other capabilities.

Selection Process

A Request for Proposals (RFP) solicitation was issued on April 30, 2013, inviting proposals from parties interested in providing the City with an Enterprise Resource Planning (ERP) system. The RFP was distributed directly to known ERP system providers and also posted on the City's website, making it available to the public. The proposal submission deadline passed on June 7, 2013 and the City received a total of five (5) proposals from the following proposers:

CRW Systems
Kinsey – Infor
Phoenix Business, Inc.
SunGard Public Sector, Inc.
Tyler Technologies, Inc.

Although price was a significant factor in selecting a vendor, staff also considered how well the vendors complied with the main selection criteria defined in the RFP. The proposals underwent

a preliminary review based on administrative requirements of the proposers and minimum functional requirements of the proposed systems, as set forth in the RFP solicitation. Of particular note, the RFP solicitation included a 'Functional Requirements Checklist' that contained fields enabling proposers to demonstrate their proposed systems' functionality with respect to the City's requirements. This checklist was a mandatory submittal item, per the instructions in the RFP. The proposal from CRW Systems demonstrated that their proposed system was primarily functional with regard to permits and permitting but lacked functionality in most of the other resource planning requirements mandated by the City. Furthermore, the proposal from SunGard Public Sector, Inc. did not provide a response in any manner to the City's system functionality requirements. As such, both proposals were deemed non-responsive and were not recommended for further evaluation.

The three (3) remaining responsive proposals were subject to a technical review, in which the functionality of each proposed system was compared and evaluated. The evaluation panel consisted of City Manager's Office, Information Technology, Human Resources and Finance staff, as well as a consultant assisting the City on this project. The panel was charged with determining the relative weight of each major system functionality category and then rating the proposed systems against these metrics. The technical review identified the proposed systems from Kinsey-Infor, Phoenix Business, Inc. and Tyler Technologies, Inc. as all satisfactorily meeting the City's functional system requirements.

The evaluation panel then assessed the cost proposals associated with each system. The following table illustrates the estimated system and maintenance costs proposed to the City, as taken directly from each proposal. Please note that these costs include maintenance for a period of five (5) years after system implementation:

Proposer	Estimated System Cost (5 Years)
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Tyler Technologies (Tyler Munis)	\$1,430,897
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Kinsey – Infor (Infor-Lawson)	\$3,941,088
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Phoenix Business, Inc. (SAP)	\$14,614,372
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Due to the significantly higher proposed cost of their proposed system despite the lack of any demonstrated advantages over the other two systems, the proposal from Phoenix Business, Inc. (proposing SAP software) was removed from further consideration in the evaluation process.

The City invited the remaining proposers, Kinsey-Infor and Tyler Technologies, Inc. to participate in live demonstrations encompassing the various areas of functionality offered by their systems. Each proposer was given one week to present to an audience consisting of various department end-users that would potentially use their system. All attendees participated in scoring each of the proposers based on the information and functionality presented. During this process, Tyler Technologies, Inc. outscored Kinsey-Infor among all of the raters and in a force-ranking exercise, the Tyler Technologies, Inc. system was preferred by a count of 29 to 4 raters. Following the evaluation processes described thus far, the decision was made by the City to pursue further evaluation of Tyler Technologies, Inc. and to discontinue the evaluation of Kinsey-Infor, barring any major setbacks with the former.

The City identified two cities as recent ERP system clients of Tyler Technologies whose system requirements mirrored those of the City: Victorville and Culver City. Both agencies agreed to host live site visits to enable City representatives to see the Tyler Technologies, Inc. ERP in a live functional setting. The City dispatched a team consisting of staff end-users of the ERP system to attend these site visits and identify any areas of concern regarding the system. These site visits provided the City with an opportunity to engage current users of the Tyler Technologies, Inc. system and the City representatives took advantage of this opportunity to ask about the advantages and shortcomings of the system encountered by its current users. The site visit team concluded these visits with a list of specific functionality issues which would eventually be negotiated but left largely satisfied with how the system performed in a live-time municipal government setting. In addition to this outreach City staff spoke to representatives from the City of Beverly Hills and the City of Pasadena whom have both selected Tyler during recent ERP RFP processes. Both cities conducted lengthy vendor demonstrations and review and determined that Tyler had the best product to meet the demanding needs of their organizations.

The complexity of the evaluation process, which encompassed a technical review, cost review, live system demonstrations and site visits, reflect the complex nature of the ERP system the City wishes to procure. Following this comprehensive best-value procurement and evaluation process, the City identified Tyler Technologies as the highest-rated proposer of an ERP system to the City.

This contract with Tyler Technologies, Inc. furthers the City's goal to provide high quality public services and increase the efficient management of public resources. The contract also supports the goal to maintain fiscal responsibility and stability by implementing an ERP system that centralizes financial and human resources data for consistency, reliability and accuracy. Additionally, this project supports the IT Department's mission of providing proven state-of-the-art technologies in the most strategic, cost effective and efficient means in furtherance of the projects and initiatives outlined in the IT Strategic Plan. Finally, this project will provide an opportunity for the City to improve customer service and provide users with improved and enhanced access to information, while fostering an efficient and dynamic administrative environment that will be well prepared for the future challenges facing the City.

Project Timing

The planned implementation will occur in five stages as provided in the attachment titled "ERP Implementation Cycle."

Additionally, the project will be organized according to a phased software implementation plan. Phase 1 will include Core Financials and be delivered by October 1, 2015. Phase 2 will include Core Human Resources and Payroll to be delivered to the City by January 1, 2016. Phase 3 will include Utility Billing to be delivered to the City by June 1, 2016. Phase 4 will include Work Orders to be delivered to the City also by June 1, 2016. Phase 5 will include Business Licenses and Performance Based Budgeting to be delivered to the City by October 1, 2016.

ENVIRONMENTAL REVIEW:

Staff recommends the City Council find this action is not subject to the California Environmental Quality Act ("CEQA") pursuant to Sections 15060(c)(2) (the activity will not result in a direct or reasonably foreseeable indirect physical change in the environment) and 15060(c)(3) (the activity is not a project as defined in Section 15378) of the CEQA Guidelines, California Code of Regulations, Title 14, Chapter 3, because it has no potential for resulting in physical change to

the environment, directly or indirectly.

NOTICING:

The agenda item has been noticed according to the Brown Act (72 hours in advance of the meeting at which the City Council considers the item).

ATTACHMENTS:

Description

Proposed Contractual Costs and Project Budget

ERP Implementation Cycle

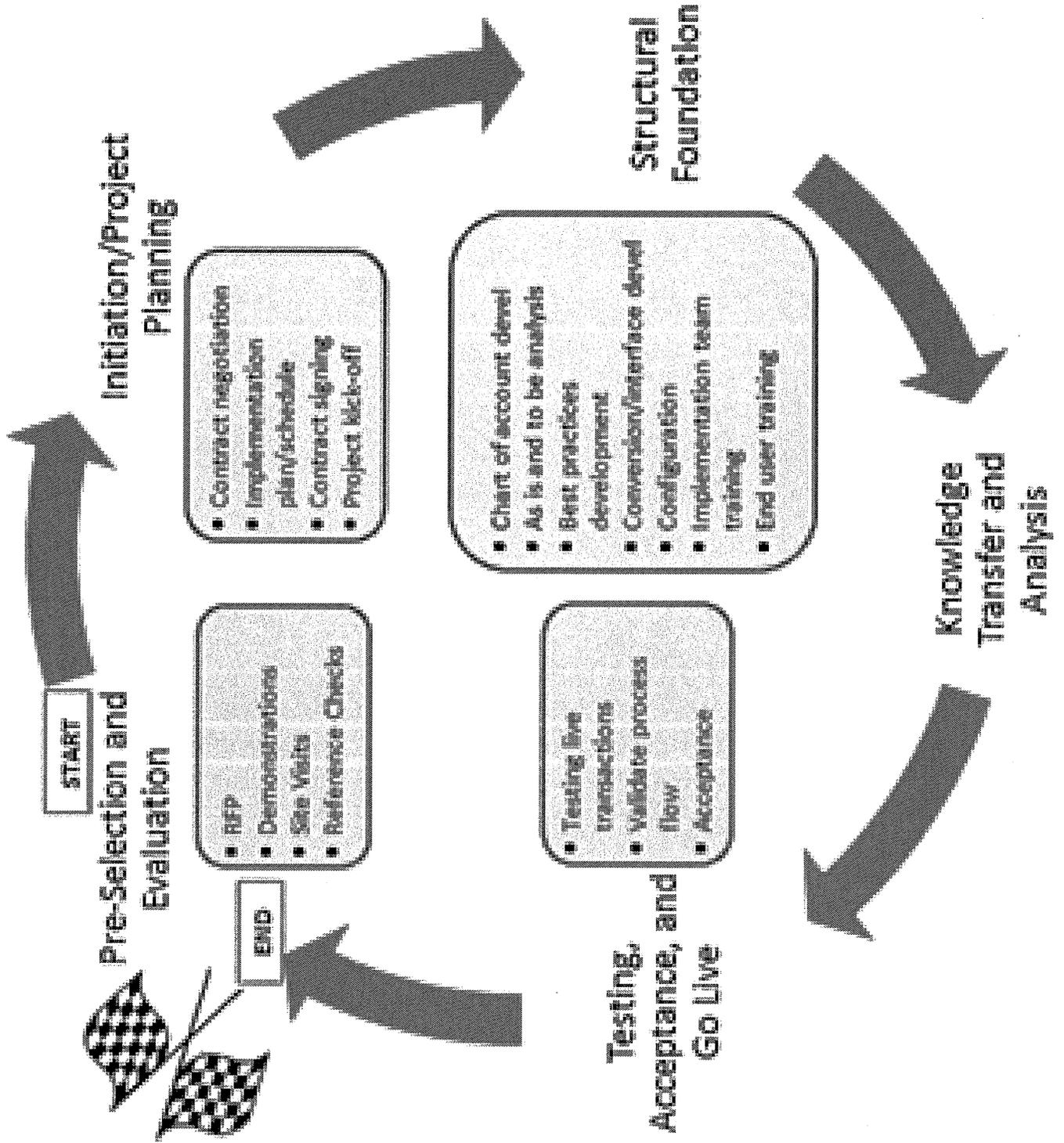
Phased Implementation Schedule

Contract (w/o Exhibits A-J which are available for review in the City Clerk's office and the Finance Department)

Tyler Munis ERP Proposed Contractual Costs and Project Budget

	IT Internal Service Fund (ITSF)	
	ITSF Operating	ITSF Replacement
	Costs to be expensed through existing ERP budget	Costs to be expensed through Internal Service Fund
Total Project Costs		
Software, Hardware and Implementation Services		
Software License Fees	\$859,460	\$859,460
3rd Party Hardware and Software	32,105	32,105
Implementation Services		
Data Conversion	141,500	141,500
Business Process Consulting	444,500	444,500
Project and Change Management	435,000	435,000
Other Services	996,700	996,700
Total Software, Hardware and Implementation Services	\$2,909,265	
Maintenance Fees		
Year 1 FY 13/14	\$31,495	31,495
Year 2 FY 14/15	198,268	
Year 3 FY 15/16	203,347	198,268
Year 4 FY 16/17	208,581	203,347
Year 5 FY 17/18	215,741	208,581
Total Maintenance Fees	\$857,432	215,741
Total Tyler Not To Exceed Cost	\$3,766,697	
Staffing Backfill		
Temp or Limited Term - 1 HR Analyst for 18 months	\$156,000	156,000
Temp or Limited Term - 2 Accountants for 24 months	370,088	370,088
IT Overtime (450 hours over 30 months)	36,000	36,000
Total Backfill	\$562,088	
Additional Costs		
SQL/VMWare licensing	\$15,000	15,000
Contingency	200,000	200,000
Total Additional costs	\$215,000	
ERP PROJECT COST GRAND TOTAL	\$4,543,785	\$825,937

ERP Implementation Life Cycle



ID	Installations/ Implementations	Phases	Start	Finish	Duration	Q2 14		Q3 14			Q4 14			Q1 15			Q2 15			Q3 15			Q4 15			Q1 16			Q2 16			Q3 16			
						Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep
1	Finance	Phase 1	05/01/2014	10/01/2015	371d	▶																													
2	Payroll/Human Resources	Phase 2	01/01/2015	01/01/2016	262d	▶																													
3	Utility Billing	Phase 3	06/01/2015	05/20/2016	255d	▶																													
4	Work Order/Request	Phase 4	10/01/2015	06/01/2016	175d	▶																													
5	Business License/Misc.	Phase 5	01/01/2016	09/30/2016	196d	▶																													

**SOFTWARE LICENSE PURCHASE AND
PROFESSIONAL SERVICES AGREEMENT
WITH TYLER TECHNOLOGIES, INC. FOR
ENTERPRISE RESOURCE PLANNING SYSTEM**

THIS SOFTWARE PURCHASE AND PROFESSIONAL SERVICES AGREEMENT ("Agreement") is made and entered into as of this 26th day of March 26, 2014 ("Effective Date"), by and between the CITY OF NEWPORT BEACH, a California municipal corporation and charter city ("City"), and TYLER TECHNOLOGIES, INC., a Delaware corporation ("Tyler"), whose address is One Tyler Drive, Yarmouth, MA 04096, and is made with reference to the following:

RECITALS

- A. City is a municipal corporation duly organized and validly existing under the laws of the State of California with the power to carry on its business as it is now being conducted under the statutes of the State of California and the Charter of City.
- B. City desires to engage Tyler to furnish, license, deliver, install and maintain Tyler software products in order to implement the Enterprise Resource Planning ("ERP") system ("Project").
- C. Tyler possesses the skill, experience, ability, background, certification and knowledge to provide the professional services described in this Agreement.
- D. City has solicited and received a proposal from Tyler, has reviewed the previous experience and evaluated the expertise of Tyler, and desires to retain Tyler to provide products and render professional services under the terms and conditions set forth in this Agreement.

NOW, THEREFORE, it is mutually agreed by and between the undersigned parties as follows:

1. TERM

The term of this Agreement as it relates to Services, including, but not limited to software maintenance Services, shall commence on the Effective Date, and shall terminate five (5) years from the installation date of the Tyler Software Products, not to exceed December 31, 2019 unless terminated earlier as set forth herein. The parties may elect to extend the term of the Agreement for purposes of maintenance Services by written amendment to the Agreement. However, the license for the software purchased by the City in conjunction with this Agreement is irrevocable in nature (subject to Client's compliance with the license grant in this Agreement) and shall not be subject to the limitations in term as set forth above.

2. SERVICES TO BE PERFORMED

Tyler shall diligently perform all the Services described in the Investment Summary attached hereto as Exhibit B and detailed in the Statement of Work attached hereto as Exhibit A and the Support Call Process attached hereto as Attachment 2 to

Exhibit A, the Software Maintenance Agreement attached hereto as Attachment 3 to Exhibit A ("Services" or "Work"). Any revisions to the scope of Services shall be made by written amendment to the Agreement signed by both parties and approved as to form by the City Attorney.

3. SOFTWARE LICENSES

Tyler agrees to grant to City licenses to use Tyler's software products and associated third party software products as identified in the Investment Summary attached as Exhibit B ("Software Products") in accordance with the terms and conditions of the Software License Agreement attached hereto as Exhibit C, the Third Party Product Agreement attached hereto as Exhibit D and the Adobe End User License Agreement attached hereto as Exhibit E, respectively, and all incorporated herein by reference (the "Licenses").

4. TIME OF PERFORMANCE

4.1 Tyler shall perform the Services in accordance with the mutually agreed project schedule included in Exhibit A. In the absence of a specific schedule, the Services shall be performed to completion in a diligent and timely manner. The failure by Tyler to materially adhere to the schedule set forth in Exhibit A or perform the Services in a diligent and timely manner may result in termination of this Agreement by City.

4.2 Notwithstanding the foregoing, Tyler shall not be responsible for delays due to causes beyond Tyler's reasonable control. However, in the case of any such delay in the Services to be provided for the Project, each party hereby agrees to promptly provide notice (within two (2) business days) of the occurrence causing the delay to the other party so that all delays can be timely addressed.

4.3 Tyler shall submit all requests for extensions of time for performance in writing to the Project Administrator as defined herein not later than ten (10) calendar days after the start of the condition that purportedly causes a delay. The Project Administrator shall review all such requests and may grant reasonable time extensions for unforeseeable delays that are beyond Tyler's control.

4.4 For all time periods not specifically set forth herein, the parties shall respond in the most reasonably expedient and appropriate manner under the circumstances, by hand-delivery or mail.

5. COMPENSATION TO TYLER

5.1 City shall pay Tyler for the Tyler software products, Services and Licenses listed in the Investment Summary (but not including any item in the Optional Section), attached hereto as Exhibit B and incorporated herein by reference, on a not-to-exceed basis for the Term in accordance with the provisions of this Agreement, including, without limitation, the Compensation Schedule included in Attachment 1 to Exhibit B. Tyler's compensation for all Work performed in accordance with this Agreement, including all reimbursable items and subconsultant fees, shall not exceed **Three Million Seven Hundred Sixty Six Thousand Six Hundred Ninety Seven Dollars and 00/100**

(\$3,766,697.00), without prior written authorization from City. No billing rate changes shall be made during the term of this Agreement without the prior written approval of City.

5.2 Taxes: The fees set forth in the Investment Summary and Compensation Schedule included within Exhibit B do not include any taxes, including, without limitation, sales, use or excise tax. City and Tyler specifically agree and designate the point of sale and place of delivery for any and all taxable purposes under this Agreement, including, but not limit to, all Services and Software Products, shall be the City of Newport Beach 100 Civic Center Dr., Newport Beach, CA 92660. Furthermore, under the City's Direct Payment Exemption permit number SR EAA 24-089475 DP, the City will self-accrue its Use Tax obligation to the California State Board of Equalization within thirty (30) days of delivery of the products to the City. If only partial delivery of the taxable items in the Investment Summary included in Exhibit B are received by the City, the City will only pay the California State Board of Equalization the amount of Use Tax due on the value of the items delivered in accordance with the prices set forth in the Investment Summary in Exhibit B. City shall provide Tyler with a copy of the City's Direct Payment Exemption permit within thirty (30) days of the Effective Date.

5.3 Tyler shall submit invoices to City describing the Work performed or Software Products delivered in accordance with the Compensation Schedule included in Attachment 1 to Exhibit B. Tyler's bills shall include the name of the person who performed the Work, a brief description of the Services performed and/or the specific task in the Scope of Services to which it relates and/or Software Product provided, the date the Services were performed, the time spent on all Work billed, and a description of any reimbursable expenditures. City shall pay Tyler no later than sixty (60) calendar days after receipt of the invoice by City staff.

5.4 City shall reimburse Tyler only for those costs or expenses reasonably incurred in connection with the Services and otherwise in conformance with the requirements of this Agreement. Expenses will be incurred in accordance with the then-current Tyler Business Travel Policy. The current Tyler Business Travel Policy is attached hereto as Attachment 2 to Exhibit B.

5.5 In the event City cancels services less than two (2) weeks in advance of the date services are to be performed, and such cancellation is not directly related to Tyler's failure to perform pursuant this Agreement, City is liable to Tyler for (i) all non-refundable expenses incurred by Tyler on City's behalf; and (ii) daily fees associated with the canceled services if Tyler is unable to re-assign its personnel.

5.6 Tyler shall not receive any compensation for Extra Work performed without the prior written authorization of City. As used herein, "Extra Work" means any Work that is determined by the parties to be necessary for the proper completion of the Project, but which is not included within the Scope of Services and which the parties did not reasonably anticipate would be necessary at the execution of this Agreement. Compensation for any authorized Extra Work performed within three (3) years of the Effective Date shall be paid at the rates set forth in the Investment Summary as set forth in Exhibit B unless otherwise agreed to by the parties.

5.7 Electronic Payment. City shall remit payment to Tyler via electronic payments. Tyler's electronic payment information is as follows:

Bank: Wells Fargo Bank, N.A.
420 Montgomery
San Francisco, CA 94104

ABA: 121000248

Account: 4124302472

Beneficiary: Tyler Technologies Inc. – Operating

6. PROJECT MANAGER

6.1 Tyler shall designate a Project Manager, who shall coordinate all phases of the Project. This Project Manager shall be available to City at all reasonable times during the term of Agreement. Tyler shall use commercially reasonable efforts to not remove or reassign the Project Manager.

6.2 Tyler, at the reasonable discretion of City, shall remove from the Project any of its personnel assigned to the performance of Services upon written request of City provided that such request for removal is for cause, and that Tyler shall have a reasonable opportunity to remedy the condition supporting the City's request for removal to avoid removal of personnel from the Project. Tyler warrants that it will furnish the necessary personnel to complete the Project on a timely basis as contemplated by this Agreement.

7. ADMINISTRATION

This Agreement will be administered by the City Manager's Office. The City Manager or designee shall be the Project Administrator and shall have the authority to act for City under this Agreement. The Project Administrator shall represent City in all matters pertaining to the Services to be rendered pursuant to this Agreement.

8. CITY'S RESPONSIBILITIES

To assist Tyler in the execution of its responsibilities under this Agreement, City agrees to provide access to and upon request of Tyler, one copy of all existing relevant information on file at City. City will provide all such materials in a timely manner so as not to cause delays in Tyler's Work schedule.

9. STANDARD OF CARE

9.1 All of the Services shall be performed by Tyler or under Tyler's supervision. Tyler represents that it possesses the professional and technical personnel required to perform the Services required by this Agreement, and that it will perform all Services in a manner commensurate with the highest professional standards. For purposes of this Agreement, the phrase "highest professional

standards" shall mean those standards of practice recognized by one (1) or more comparable firms performing similar work under similar circumstances.

9.2 All Services shall be performed by qualified and experienced personnel who are not employed by City. By delivery of completed Work, Tyler certifies that the Work conforms to the requirements of this Agreement, all applicable federal, state and local laws, and the highest professional standards.

9.3 Tyler represents and warrants to City that it has, shall obtain, and shall keep in full force and effect during the term hereof, at its sole cost and expense, all licenses, permits, qualifications, insurance and approvals of whatsoever nature that is legally required of Tyler to practice its profession. Tyler shall maintain a City of Newport Beach business license during the term of this Agreement.

9.4 Tyler shall not be responsible for delay, nor shall Tyler be responsible for damages or be in default or deemed to be in default by reason of incidents of force majeure (including, without limitation, strikes, lockouts, accidents, and acts of God), or the failure of City to furnish timely information or to approve or disapprove Tyler's Work promptly, or delay or faulty performance by City, contractors, or governmental agencies.

10. HOLD HARMLESS

10.1 To the fullest extent permitted by law, Tyler shall indemnify, defend and hold harmless City, its City Council, boards and commissions, officers, agents, volunteers and employees (collectively, the "Indemnified Parties") from and against any and all claims, demands, obligations, damages, actions, causes of action, suits, losses, judgments, fines, penalties, liabilities, costs and expenses (including, without limitation, attorneys' fees, disbursements and court costs) of every kind and nature whatsoever (individually, a Claim; collectively, "Claims") for bodily injury, death or damage to property which arise from any breach of the terms and conditions of this Agreement resulting from Tyler's negligence, recklessness, and/or willful acts, errors and/or omissions of Tyler, its principals, officers, agents, employees, vendors, suppliers, consultants, subcontractors, anyone employed directly or indirectly by any of them or for whose acts they may be liable, or any or all of them).

10.2 Notwithstanding the foregoing, nothing herein shall be construed to require Tyler to indemnify the Indemnified Parties from any Claim arising from the negligence, recklessness or willful misconduct of the Indemnified Parties.

10.3 Nothing in this indemnity shall be construed as authorizing any award of attorneys' fees in any action on or to enforce the terms of this Agreement. This indemnity shall apply to all claims and liability regardless of whether any insurance policies are applicable. The policy limits do not act as a limitation upon the amount of indemnification to be provided by Tyler.

11. INDEPENDENT CONTRACTOR

It is understood that City retains Tyler on an independent contractor basis and Tyler is not an agent or employee of City. The manner and means of conducting the Work are under the control of Tyler, except to the extent they are limited by statute, rule

or regulation and the expressed terms of this Agreement. No civil service status or other right of employment shall accrue to Tyler or its employees. Nothing in this Agreement shall be deemed to constitute approval for Tyler or any of Tyler's employees or agents, to be the agents or employees of City. Tyler shall have the responsibility for and control over the means of performing the Work, provided that Tyler is in compliance with the terms of this Agreement. Anything in this Agreement that may appear to give City the right to direct Tyler as to the details of the performance of the Work or to exercise a measure of control over Tyler shall mean only that Tyler shall follow the reasonable direction of City with respect to the performance of the Services in accord with requirements of this Agreement.

12. COOPERATION

The parties agree to work closely and cooperate fully with one another, including any appropriate designees.

13. CITY POLICY

Tyler shall discuss and review all matters relating to Project direction with City's Project Administrator in advance of all critical decision points in order to ensure the Project proceeds in a manner consistent with City goals and policies.

14. PROGRESS

Tyler is responsible for keeping the Project Administrator informed on a regular basis regarding the status and progress of the Project, activities performed and planned, and any meetings that have been scheduled or are desired.

15. INSURANCE

Without limiting Tyler's indemnification of City, and prior to commencement of Work, Tyler shall obtain, provide and maintain at its own expense during the term of this Agreement or for other periods as specified in this Agreement, policies of insurance of the type, amounts, terms and conditions described in the Insurance Requirements attached hereto as Exhibit F, and incorporated herein by reference.

16. PROHIBITION AGAINST ASSIGNMENTS AND TRANSFERS

Except as specifically authorized under this Agreement, the Services to be provided under this Agreement shall not be assigned, transferred contracted or subcontracted out without the prior written approval of City. No assignment shall release the original parties or otherwise constitute a novation. Notwithstanding the foregoing, should Tyler be the subject of a merger or consolidation, Tyler may, upon reasonable notice to the City, assign this Agreement in its entirety to the surviving entity and the City's approval to such assignment shall not be unreasonably withheld.

17. SUBCONTRACTING

Except as specifically authorized herein, the Services to be provided under this Agreement shall not be otherwise assigned, transferred, contracted or subcontracted out without the prior written approval of City.

18. OWNERSHIP OF WORK PRODUCT

18.1 Documents and Printouts. All reports, drafts, maps, records, plans, drawings, plans, specifications, and printouts and other documents prepared by Tyler in furtherance of the work shall be the sole property of the City and shall be delivered to City whenever requested. Tyler may make duplicate copies of such materials for its own file or for such other purpose as may be authorized in writing by the City. Notwithstanding anything to the contrary herein, Tyler shall retain ownership of all intellectual property rights in and to the Tyler Software Products and User Guides.

18.2 Documents, including drawings and specifications, prepared by Tyler pursuant to this Agreement are not intended or represented to be suitable for reuse by City or others on any other project. Any use of completed documents for other projects and any use of incomplete documents without specific written authorization from Tyler will be at City's sole risk and without liability to Tyler. Further, any and all liability arising out of changes made to Tyler's deliverables under this Agreement by City or persons other than Tyler is waived against Tyler, and City assumes full responsibility for such changes unless City has given Tyler prior notice and has received from Tyler written consent for such changes.

18.3 All written documents shall be transmitted to City in formats compatible with Microsoft Office and/or viewable with Adobe Acrobat.

19. CONFIDENTIALITY

19.1 All Documents, including drafts, preliminary drawings or plans, notes and communications that result from the Services in this Agreement, shall be kept confidential unless City expressly authorizes in writing the release of information or such release is required by applicable law.

19.2 Both parties recognize that their respective employees and agents, in the course of performance of this Agreement, may be exposed to confidential information and that disclosure of such information could violate rights to private individuals and entities. Each party agrees that it shall not disclose any confidential information of the other party and further agrees to take appropriate action to prevent such disclosure by its employees or agents. The confidentiality covenants contained herein will survive the termination or cancellation of this Agreement for a period of two (2) years. This obligation of confidentiality will not apply to information that: a) At the time of the disclosure is in the public domain; b) After disclosure, becomes part of the public domain by publication or otherwise, except by breach of this Agreement by a party; c) A party can establish by reasonable proof was in that party's possession at the time of disclosure; d) A party receives from a third party who has a right to disclose it to that party; or is subject to requests made under the California Public Records Act or the Freedom of Information Act, only to the extent disclosure is based on the good faith

written opinion of the receiving party's legal counsel that disclosure is required by law; provided, however, that that receiving party shall give prompt notice of the service of process or other documentation that underlies such requirement and use its best efforts to assist the disclosing party if the disclosing party wishes to obtain a protective order or otherwise protect the confidentiality of such confidential information. The disclosing party reserves the right to obtain protective order or otherwise protect the confidentiality of its confidential information.

20. INTELLECTUAL PROPERTY INDEMNITY

Tyler shall defend and indemnify City, its agents, officers, representatives and employees against any and all liability, including costs, for infringement or alleged infringement of any United States' letters patent, trademark, or copyright, including costs, contained in Tyler's Documents provided under this Agreement.

21. RECORDS

Tyler shall keep records and invoices in connection with the Services to be performed under this Agreement. Tyler shall maintain complete and accurate records with respect to the costs incurred under this Agreement and any Services, expenditures and disbursements charged to City, for a minimum period of three (3) years, or for any longer period required by law, from the date of final payment to Tyler under this Agreement. All such records and invoices shall be clearly identifiable. Tyler shall allow a representative of City to examine, audit and make transcripts or copies of such records and invoices during regular business hours. Tyler shall allow inspection of all Work, data, documents, proceedings and activities directly related to the Agreement for a period of three (3) years from the date of final payment to Tyler under this Agreement. Such inspection shall occur after one (1) week advance notice.

22. WITHHOLDINGS

In the event City believes products or services do not conform to warranties in this Agreement, City will provide written notice to Tyler within fifteen (15) calendar days of receipt of the applicable invoice. City is allowed an additional fifteen (15) calendar days to provide written clarification and details. Tyler will provide a written response to City that will include either a justification of the invoice or an adjustment to the invoice. Tyler and City will develop a plan to outline the reasonable steps to be taken by Tyler and City to resolve any issues presented in City's notice to Tyler. City may only withhold payment of the amount actually in dispute until Tyler completes its action items outlined in the plan. Notwithstanding the foregoing, if Tyler is unable to complete its actions outlined in the plan because City has not completed its action items outlined in the plan, City will remit full payment of the invoice. Tyler shall not unreasonably discontinue work while items are disputed in accord with this provision.

23. ERRORS AND OMISSIONS

In the event of errors or omissions that are due to the negligence or professional inexperience of Tyler which result in expense to City greater than what would have resulted if there were not errors or omissions in the Work accomplished by Tyler, the additional design, construction and/or restoration expense shall be borne by Tyler.

Nothing in this Section is intended to limit City's rights under the law or any other sections of this Agreement. Nothing in this section shall be construed to require Tyler to pay the cost of substitute goods or services. This Section is, in all respects, subject to Sections 27.2 (Dispute Resolution Process) and 30 (Limitation of Liability) of this Agreement.

24. CITY'S RIGHT TO EMPLOY OTHER CONSULTANTS

City reserves the right to employ other Consultants in connection with the Project. The foregoing notwithstanding, any Consultant shall be subject to the terms and conditions of this Agreement, including, without limitation, the provisions regarding handling and use of confidential information.

25. CONFLICTS OF INTEREST

25.1 Tyler or its employees may be subject to the provisions of the California Political Reform Act of 1974 (the "Act"), which (1) requires such persons to disclose any financial interest that may foreseeably be materially affected by the Work performed under this Agreement, and (2) prohibits such persons from making, or participating in making, decisions that will foreseeably financially affect such interest.

25.2 If subject to the Act, Tyler shall conform to all requirements of the Act. Failure to do so constitutes a material breach and is grounds for termination of this Agreement by City in accordance with Section 28 below. Tyler shall indemnify and hold harmless City for any and all claims for damages resulting from Tyler's violation of this Section.

26. NOTICES

26.1 All notices, demands, requests or approvals, including any change in mailing address, to be given under the terms of this Agreement shall be given in writing, and conclusively shall be deemed served when delivered personally, or on the third business day after the deposit thereof in the United States mail, postage prepaid, first-class mail, addressed as hereinafter provided.

26.2 All notices, demands, requests or approvals from Tyler to City shall be addressed to City at:

Attn: Rob Houston, Assistant to the City Manager
City Manager's Office
City of Newport Beach
100 Civic Center Drive
PO Box 1768
Newport Beach, CA 92658

26.3 All notices, demands, requests or approvals from City to Tyler shall be addressed to Tyler at:

Attn: Associate General Counsel
Tyler Technologies, Inc.

27. CLAIMS

Unless a shorter time is specified elsewhere in this Agreement, before making its final request for payment under this Agreement, Tyler shall submit to City, in writing, all claims for compensation under or arising out of this Agreement. Tyler's acceptance of the final payment shall constitute a waiver of all claims for compensation under or arising out of this Agreement except those previously made in writing and identified by Tyler in writing as unsettled at the time of its final request for payment.

28. MEET AND CONFER PROCESS

28.1 For all disputes under this Agreement, a party will notify the other party in writing within fifteen (15) days of becoming aware of a dispute. If the parties cannot resolve such dispute within thirty (30) calendar days of receipt of written notice of dispute, the parties will each promptly designate an executive level representative from its organization to meet with its counterpart from the other party to resolve the dispute. Thereafter, either party may assert its other rights and remedies under this Agreement within a court of competent jurisdiction.

28.2 All meetings and discussions during the Meet and Confer Process will be deemed confidential settlement discussions not subject to disclosure under Federal Rule of Civil Procedure 408 or any similar applicable state rule.

28.3 Nothing in this provision will prevent a party from applying to a federal or state court of competent jurisdiction to obtain injunctive relief pending resolution of the dispute through the dispute resolution procedures set forth herein.

29. TERMINATION

29.1 In the event that either party fails or refuses to perform any of the provisions of this Agreement at the time and in the manner required, that party shall be deemed in default in the performance of this Agreement. If such default is not cured within a period of forty-five (45) calendar days of receipt of notice of default from the alleging party, the non-defaulting party may terminate the Agreement forthwith by giving to the defaulting party written notice thereof.

29.2 Notwithstanding the above provisions, City shall have the right, at its sole and absolute discretion and without cause, of terminating this Agreement at any time by giving no less than forty-five (45) calendar days' prior written notice to Tyler.

29.3 In the event of any termination of this Agreement, City shall pay Tyler for non-defective products and Services delivered in accord with the requirements of this Agreement and costs incurred up to the effective date of termination for which Tyler has not been previously paid. On the effective date of termination, Tyler shall deliver to City all non-proprietary and non-confidential reports, documents and other information developed or accumulated in the performance of this Agreement, whether in draft or final form.

29.4 Procedure on Termination. If this Agreement is terminated following the Completion of Services, then the City may retain the copy of the Software in its possession subject to the terms of the Software License Agreement but it shall not be entitled to any additional Licenses, nor will it receive updates of, or modifications to, the Software made by Tyler. Notwithstanding the foregoing, the City will remain subject to the obligations imposed upon it pursuant to this Agreement with respect to the Software, including, but not limited to, such obligations relating to use of the Software and confidentiality.

30. **DISCLAIMER**

THE WARRANTIES SET FORTH IN THIS AGREEMENT, INCLUDING ATTACHMENTS AND EXHIBITS, ARE EXCLUSIVE AND IN LIEU OF ALL OTHER RIGHTS, REMEDIES, AND WARRANTIES EXPRESSED, IMPLIED, OR STATUTORY, INCLUDING, WITHOUT LIMITATION, THE WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, AND SYSTEM INTEGRATION, WHICH ARE HEREBY DISCLAIMED BY TYLER.

31. **LIMITATION OF LIABILITY**

31.1 Professional Services. In no event shall either party be liable for special, indirect, incidental, consequential, or exemplary damages, including, without limitation, any damages resulting from loss of use, loss of data, interruption of business activities, or failure to realize savings arising out of or in connection with the provision or quality of professional services or use of the Tyler Software Products. The parties liability for damages arising out of the professional services (identified as the line item "Tyler Services" in the Investment Summary attached as Exhibit B), whether based on a theory of contract or tort, shall be limited to two (2) times the Tyler Services fees identified in the Investment Summary included in Exhibit B and paid by Client.

31.2 Maintenance Agreement (Exhibit A-Attachment 3). In no event shall Tyler be liable for special, indirect, incidental, consequential, or exemplary damages, including, without limitation, any damages resulting from loss of use, loss of data, interruption of business activities, or failure to realize savings arising out of or in connection with the provision or quality of maintenance services or use of the Tyler Software Products. Tyler's liability for damages and expenses arising out of the Maintenance Agreement, whether based on a theory of contract or tort, shall be limited to two (2) times the Software Maintenance Fees due and paid by City during the twelve (12) month period prior to the claim. The Software Maintenance Fees reflect and are set in reliance upon this limitation of liability.

31.3 Software License Agreement (Exhibit C). In no event shall Tyler be liable for special, indirect, incidental, consequential, or exemplary damages, including, without limitation, any damages resulting from loss of use, loss of data, interruption of business activities, or failure to realize savings arising out of or in connection with the use of the Tyler Software Products. Tyler's liability for damages and expenses arising out of this Software License Agreement, whether based on a theory of contract or tort, shall be limited to two (2) times the Software License Fees set forth in the Investment Summary

included in Exhibit B and paid by Client. Such Software License Fees are set in reliance upon this limitation of liability.

31.4 Third Party Product Agreement (Exhibit D). In no event shall Tyler be liable for special, indirect, incidental, consequential, or exemplary damages, including without limitation, any damages resulting from loss of use, loss of data, interruption of business activities, or failure to realize savings arising out of or in connection with the use of the Third Party Products. Tyler's liability for damages and expense arising out of the Third Party Product Agreement attached as Exhibit D, whether based on a theory of contract or tort, shall be limited to the License fee/purchase price of the Third Party Products as set forth in the Investment Summary included in Exhibit B and paid by Client.

32. STANDARD PROVISIONS

32.1 Recitals. City and Tyler acknowledge that the above Recitals are true and correct and are hereby incorporated by reference into this Agreement.

32.2 Compliance with all Laws. Tyler shall, at its own cost and expense, comply with all applicable statutes, ordinances, regulations and requirements of all governmental entities, including federal, state, county or municipal, whether now in force or hereinafter enacted. In addition, all Work prepared by Tyler shall conform to applicable City, county, state and federal laws, rules, regulations and permit requirements and be subject to approval of the Project Administrator and City.

32.3 Waiver. A waiver by either party of any breach, of any term, covenant or condition contained herein shall not be deemed to be a waiver of any subsequent breach of the same or any other term, covenant or condition contained herein, whether of the same or a different character.

32.4 Integrated Contract. This Agreement represents the full and complete understanding of every kind or nature whatsoever between the parties hereto, and all preliminary negotiations and agreements of whatsoever kind or nature are merged herein. No verbal agreement or implied covenant shall be held to vary the provisions herein.

32.5 Conflicts or Inconsistencies. In the event there are any conflicts or inconsistencies between this Agreement and the attachments attached hereto, the following order of precedence shall apply: the terms of this Agreement and Exhibits A-F, I and J shall govern, followed by Tyler's Proposal attached hereto as Exhibit G and then the City's Request for Proposal attached hereto as Exhibit H.

32.6 Interpretation. The terms of this Agreement shall be construed in accordance with the meaning of the language used and shall not be construed for or against either party by reason of the authorship of the Agreement or any other rule of construction which might otherwise apply.

32.7 Amendments. This Agreement may be modified or amended only by a written document executed by both Tyler and City and approved as to form by the City Attorney.

32.8 Severability. If any term or portion of this Agreement is held to be invalid, illegal, or otherwise unenforceable by a court of competent jurisdiction, the remaining provisions of this Agreement shall continue in full force and effect.

32.9 Controlling Law and Venue. The laws of the State of California shall govern this Agreement and all matters relating to it and any action brought relating to this Agreement shall be adjudicated in a court of competent jurisdiction in the County of Orange, State of California.

32.10 Equal Opportunity Employment. Tyler represents that it is an equal opportunity employer and it shall not discriminate against any subcontractor, employee or applicant for employment because of race, religion, color, national origin, handicap, ancestry, sex, age or any other impermissible basis under law.

32.11 No Attorneys' Fees. In the event of any dispute or legal action arising under this Agreement, the prevailing party shall not be entitled to attorneys' fees.

32.12 Counterparts. This Agreement may be executed in two (2) or more counterparts, each of which shall be deemed an original and all of which together shall constitute one (1) and the same instrument.

[SIGNATURES ON NEXT PAGE]

IN WITNESS WHEREOF, the parties have caused this Agreement to be executed on the dates written below.

**APPROVED AS TO FORM:
CITY ATTORNEY'S OFFICE**

Date: 3/19/14

By: 
Aaron C. Harp
City Attorney 

CITY OF NEWPORT BEACH,
a California municipal corporation

Date: _____

By: _____
Rush N. Hill, II
Mayor

ATTEST:

Date: _____

By: _____
Leilani I. Brown
City Clerk

TYLER: Tyler Technologies, Inc., a
Delaware corporation

Date: _____

By: _____
James J. Hurley, III
Senior VP, Sales & Marketing - ERP

Date: _____

By: _____
Stacey M. Gerard
Assistant Secretary

[END OF SIGNATURES]

Attachments:

- Exhibit A – Statement of Work
 - Exhibit A-Attachment 1: Verification Test
 - Exhibit A-Attachment 2: Support Call Process
 - Exhibit A-Attachment 3: Software Maintenance Agreement
 - Exhibit A-Attachment 4: Acceptance Testing
- Exhibit B – Investment Summary
 - Exhibit B-Attachment 1: Compensation Schedule
 - Exhibit B-Attachment 2: Business Travel Policy
- Exhibit C – Software License Agreement
- Exhibit D – Third Party Product Agreement
- Exhibit E – Adobe End User License Agreement
- Exhibit F – Insurance Requirements
- Exhibit G – Tyler's Proposal submitted in response to Client's RFP
 - Exhibit G – Attachment 1: Requests For Clarification
- Exhibit H – City's Request for Proposal
- Exhibit I – Escrow Agreement
- Exhibit J – Interface and Modification Documents

**CITY OF NEWPORT BEACH
FINANCE COMMITTEE AGENDA ITEM INFORMATION**

Agenda Item No. _____
March 24, 2014

TO: HONORABLE CHAIR AND MEMBERS OF THE COMMITTEE

FROM: Finance Department
Dan Matusiewicz, Finance Director
(949) 644-3123 or danm@newportbeachca.gov

SUBJECT: DISCRETIONARY RESERVE POLICY REVIEW

ABSTRACT:

Several Council members have inquired about the appropriate level and rational behind the reserves we maintain. This agenda item will provide the basis for a discussion on how we look at our reserves and are they too much relative to strategic and risk management objectives.

DISCUSSION:

Reserves are the cornerstone of financial flexibility. They provide our City with options to respond to unexpected issues and afford a buffer against shocks and other forms of risk. They also provide us with the means to address community priorities such as improving community serving facilities, emergency communications infrastructure, information technology, and other strategic initiatives to enhance the long-term financial well being of the City. City reserves, therefore, represent the combination of both strategic savings efforts and risk management measures.

A summary of discretionary reserve parameters are included in Attachment A which outline the parameters in Council Policy F-2 and other reserve policies.

Implemented in 2011, the Governmental Accounting Standards Board (GASB) Statement 54 requires the City to categorize governmental fund balances in a hierarchy according to their level of restrictiveness as illustrated in the following table:

	GASB 54 (Fund Balance Classification)	
Non-Discretionary	1	Non-Spendable (Not Readily convertible to cash)
	2	Restricted (Externally Restricted)
Discretionary	3	Committed (Council Restricted) *
	4	Assigned (City Manager earmarked/intent)
	5	Unassigned (No other level of restriction)

* It is important to note that there is not universally accepted industry practice that “committed” funds are truly *available* to the government in the event of a financial necessity. Examples and a more detailed description of each of the classifications are included in the Reserve Policy F-2 (Attachment B).

How does the City Define Available Reserves?

At the Finance Committee meeting, staff will illustrate how this City determines what reserves would be available in the event of an emergency. Staff will also attempt to address the question “How much is too much?”

Proposed Changes to Discretionary Reserves

Initial staff recommendations include the following amendments to the policy.

I. Increase the Contingency Reserve from 15% of General Fund “Operating Budget” to 25% of General Fund “Operating Budget.”

The City maintains a reserve for contingencies in the spirit of planning for what you cannot foresee. As a minimum balance for this reserve, the City sets aside 15% its operating expenditures for this purpose. The Government Finance Officers Association (GFOA) recommends, at a minimum, that general-purpose governments, regardless of size, maintain unrestricted fund balance in their General Fund of no less than two months regular General Fund operating revenues or expenditures, which is equivalent to a 17% contingency reserve. Credit rating agency Standard and Poors (S&P) considers an adequate level of “fund balance” to be a credit strength because the level of fund balance measures the flexibility of an issuer to meet essential services during transitional periods. S&P considers 15% of annual operating expenditures to be an adequate level. After conducting a survey of cities in California similar to Newport Beach, staff found contingency reserve requirements mostly in excess of 15% and in the range of 20% to 25% of operating budget. Last week S&P affirmed this rating again to the investors noting our, excellent financial management, an outstanding economic base and healthy reserves, in their rationale. In order to maintain an adequate level of creditworthiness among credit rating agencies and considering the current planned spend down of unassigned reserves, staff believes that increasing the contingency reserve to 25% of General Fund operating budget is a prudent action at this time.

City	Target Contingency Reserve
Newport Beach	15% of General Fund Operating Budget excluding CIPs & transfers out
Huntington Beach	Two months (17%) of General Fund adopted expenditure budget
Irvine	20% of General Fund Expenditures
Beverly Hills	25% of operating revenues
Santa Monica	\$9.7M Economic Uncertainty Reserve; 10% Emergency Reserve. 14% total
Santa Barbara	25% of operating budget; 15% for Disaster Reserve + 10% for Contingency Reserve
Carlsbad	40%-50% of General Fund Expenditures with a minimum of 30% (to provide for 3-6 months of operations)
Santa Cruz	Minimum of two months of General Fund adopted expenditure budget (17%).
Coronado	About 6 months of General Fund expenditures and another \$1 Million in Emergency (stabilization reserves)
Mission Viejo	15% of General Fund Revenues

II. Transfer the City’s Contingency Reserve Designation from the “Committed” to the “Unassigned” GASB 54 Classification Category

Because of the importance of unreserved or “unassigned” fund balance to the credit rating agencies’ evaluation of a local government’s creditworthiness, it is appropriate to consider their primary concerns. One important consideration is that governments have an adequate level of financial resources to ensure the timely payment of principal and interest on their outstanding debt. Of particular importance to the credit rating agencies is the size of available (not otherwise committed or restricted) “fund balance.” Because a large portion of the City’s fund balance (an excess of \$22 million) is contained within the “committed” classification, we have learned that rating agencies, without careful investigation, may consider this portion of fund balance as unavailable. Staff proposes the transfer of the City’s Contingency Reserve designation from the “Committed” back to the “Unassigned” GASB 54 classification. Policy restrictions would remain similar but with less specifics in order to be classified as unassigned.

CONCLUSION:

Staff welcomes the Finance Committee’s input on these recommendations. Finance staff will formally bring any approved recommendations back to the Finance Committee and to Council for formal approval.

Prepared by:

Submitted by:

/s/Steve Montano
 Steve Montano
 Deputy Finance Director

/s/Dan Matusiewicz
 Dan Matusiewicz
 Finance Director

Attachments:

- A. Summary of Discretionary Reserve Parameters
- B. Council Policy F-2 Reserve Policy

Summary of Discretionary Reserve Parameters

Reserve Name	Purpose	Minimum	Revenue Set-Aside	Recommendation
Discretionary Reserves				
Strategic Savings				
Facilities Financial Planning Reserve	Facility Replacement	Max. Annual Debt Service + Project Needs	As determined by Facilities Financial Planning Tool (FFPT)	
Facilities Maintenance Plan	Major Facility Maint.	No Policy	As determined by Facilities Maintenance Plan (Vertex)	
Equipment Replacement	Equipment Replacement	50% of Accumulated Depreciation on RV basis	Rates sets annually based on projected replacement needs	
IT Strategic Fund	System Replacement	No Minimum	Rates sets annually based on projected replacement needs	
Public Arts Reserve	Public Arts Facilities	No Minimum	2% of Public Benefit Fees - Developer Agreements	Cross Reference Policy I-13
Oceanfront Encroachment Reserve	Revenue Agreement	No Minimum	100% of Oceanfront Encroachment permit fee revenue	
Sr. Center and Rec. Facility Rental Reserve	Equipment Replacement	No Minimum	10% Facility Rental Services	
Off Street Parking	Neighborhood Parking	No Minimum	50% of parking meter revenues in designated areas	
Paramedic Program	Program Refresh	No Minimum	Hoag Contribution & Program Income	Eliminate when funds are utilized
Recreational Instruction	Equipment Replacement	No Minimum	10% to 20% of specified recreation classes	
Senior Fitness Center Reserve	Equipment Replacement	No Minimum	10% of fitness center membership fees	
In Lieu Parking	Neighborhood Parking	No Minimum	Annual fees to use municipal lot	
Neighborhood Enhancement A	Neighborhood Vitalization	No Minimum	Parking meter revenues in designated areas	
Neighborhood Enhancement B	Neighborhood Vitalization	No Minimum	50% of parking meter revenues in designated areas	
Cable Franchise	Public Access Channel	No Minimum	Cable Franchise	
START Program	Paramedic Triage Video Program	No Minimum	Excess revenues generated by sales of training videos/materials	
Oil and Gas Reserve	Well Improvements	No Minimum	\$40,000 of oil and gas field production revenues annually	
Capital Reappropriations	Reserves Reappropriated CIPs	None	Unspent Capital Projects Reappropriated to the next FY	
Risk Management				
Contingency Reserve	Unexpected or Extraordinary events	15% of Operating Budget		Increase to 25% of Operating Budget
Worker's Compensation	Prefunding Liability	Exceed actuary's "Expected Level"	Rates charged to departments to fund expected liability.	
General Liability	Prefunding Liability	Exceed actuary's "Expected Level"	Rates charged to departments to fund expected liability.	
Retiree Insurance	Prefunding Liability	None	Rates set annually to match expected liability.	
Compensated Absences	Prefunding Liability	3-year average of annual cash flows	3.5% of Employee salaries	
PERS Rate Reserve	Extraordinary Rate Changes	No Minimum	No Policy	
Unassigned	Residual	No Minimum	Residual Fund balance	Reclass Contingency Reserve to Unassigned Fund Balance
Enterprise Fund Reserves				
Water Fund				
Stabilization and Contingency	Rate Stabilization and Contingency	50% of Annual Operating Budget		
Infrastructure Replacement	Infrastructure Replacement	None	Per recommendations from Water Master Plan	
Wastewater Fund				
Stabilization and Contingency	Rate Stabilization and Contingency	50% of Annual Operating Budget		
Infrastructure Replacement	Infrastructure Replacement	None	Per recommendations from Water Master Plan	

RESERVE POLICY

PURPOSE

To establish City Council policy for the administration of Reserves defined as fund balances in governmental funds and net working capital in proprietary funds.

BACKGROUND

Prudent financial management dictates that some portion of the funds available to the City be reserved for future use.

As a general budget principle concerning the use of reserves, the City Council decides whether to appropriate funds from Reserve accounts. Even though a project or other expenditure qualifies as a proper use of Reserves, the Council may decide that it is more beneficial to use current year operating revenues or bond proceeds instead, thereby retaining the Reserve funds for future use. Reserve funds will not be spent for any function other than the specific purpose of the Reserve account from which they are drawn without specific direction in the annual budget; or by a separate City Council action. Information regarding Annual Budget Adoption and Administration is contained in City Council Policy F-3.

GOVERNMENTAL FUNDS AND FUND BALANCE DEFINED

Governmental Funds including the General Fund, Special Revenue Funds, Capital Projects Funds, Debt Service Funds and Permanent Funds have a short-term or current flow of financial resources, measurement focus and basis of accounting and therefore, exclude long-term assets and long-term liabilities. The term Fund Balance, used to describe the resources that accumulate in these funds, is the difference between the fund assets and fund liabilities of these funds. Fund Balance is similar to the measure of net working capital that is used in private sector accounting. By definition, both Fund Balance and Net Working Capital exclude long-term assets and long-term liabilities.

PROPRIETARY FUNDS AND NET WORKING CAPITAL DEFINED

Proprietary Funds including Enterprise Funds and Internal Service Funds have a long-term or economic resources measurement focus and basis of accounting and therefore, include long-term assets and liabilities. This basis of accounting is very similar to that used in private sector. However, instead of Retained Earnings, the term Net Assets is used to describe the difference between fund assets and fund liabilities. Since Net

Assets include both long-term assets and liabilities, the most comparable measure of proprietary fund financial resources to governmental Fund Balance is Net Working Capital, which is the difference between current assets and current liabilities. Net Working Capital, like Fund Balance, excludes long-term assets and long-term liabilities.

GOVERNMENTAL FUND RESERVES (FUND BALANCE)

For Governmental Funds, the Governmental Accounting Standards Board (“GASB”) Statement No. 54 defines five specific classifications of fund balance. The five classifications are intended to identify whether the specific components of fund balance are available for appropriation and are therefore “Spendable.” The classifications also are intended to identify the extent to which fund balance is constrained by special restrictions, if any. Applicable only to governmental funds, the five classifications of fund balance are as follows:

<u>CLASSIFICATIONS</u>	<u>NATURE OF RESTRICTION</u>
Non-spendable	Cannot be readily converted to cash
Restricted	Externally imposed restrictions
Committed	City Council imposed commitment
Assigned	City Manager assigned purpose/intent
Unassigned	Residual balance not otherwise restricted

A. Non-spendable fund balance: That portion of fund balance that includes amounts that are either (a) not in a spendable form, or (b) legally or contractually required to be maintained intact. Examples of Non-spendable fund balance include:

1. Reserve for Inventories: The value of inventories purchased by the City but not yet issued to the operating Departments is reflected in this account.
2. Reserve for Long Term Receivables and Advances: This Reserve is used to identify and segregate that portion of the City’s financial assets which are not due to be received for an extended period, so are not available for appropriation during the budget year.
3. Reserve for Prepaid Assets: This reserve represents resources that have been paid to another entity in advance of the accounting period in which the resource is deducted from fund balance. A common example is an insurance premium, which is typically payable in advance of the coverage period. Although prepaid

assets have yet to be deducted from fund balance, they are no longer available for appropriation.

4. Reserve for Permanent Endowment - Bay Dredging: The endowment specifies that the principal amount will not be depleted and represents the asset amounts to be held in the Bay Dredging Fund.
 5. Reserve for Permanent Endowment - Ackerman Fund: The endowment specifies that the principal amount will not be depleted and represents the asset amount to be held in the Ackerman Fund.
- B. Restricted fund balance: The portion of fund balance that reflects constraints placed on the use of resources (other than non-spendable items) that are either (a) externally imposed by creditors, grantors, contributors, or laws or regulations of other governments; or (b) imposed by law through constitutional provisions or enabling legislation. Examples of restricted fund balance are:
1. Reserve for Debt Service: Funds are placed in this Reserve at the time debt is issued. The provisions governing the Reserve, if established, are in the Bond Indenture and the Reserve itself is typically controlled by the Trustee.
 2. Affordable Housing: A principal provision of the Newport Beach Housing Element requires developers to provide housing units for lower income households, the number of which is to be negotiated for each development project. In lieu of constructing affordable housing, developers have paid into this reserve which is used at the City Council's discretion to provide alternate methods for the delivery of affordable housing for lower income households.
 3. Park In Lieu: Per NBMC 19.52 and California Government Code Section 664777 (The 1975 "Quimby Act"), a dedication of land or payment of fees for park or recreational purposes in conjunction with residential development is required. The fees collected can only be used for specific park or recreation purposes as outlined in NBMC 19.52.030 and 19.52.070.
 4. Upper Newport Bay Restoration Reserve: This reserve is the repository for funds mandated by SB573, as well as special fees charged to permit holders as an alternative to meeting certain specified mitigation criteria. In addition to the mitigation fees, ten percent (10%) of Beacon Bay lease revenue is placed in this Reserve. Funds in the Reserve are restricted for Upper Newport Bay restoration projects.

5. Permanent Endowment for Bay Dredging: The endowment also specifies that the interest earnings on the principal amount can only be used for dredging projects in the Newport Bay.
 6. Permanent Endowment for Ackerman Fund: The endowment also specifies that the interest earnings on the principal amount can only be used for scholarships provided by the City.
- C. Committed fund balance: That portion of a fund balance that includes amounts that can only be used for specific purposes pursuant to constraints imposed by formal action by the government's highest level of decision making authority, and remain binding unless removed in the same manner. The City considers a resolution to constitute a formal action for the purposes of establishing committed fund balance. The action to constrain resources must occur within the fiscal reporting period; however the amount can be determined subsequently. City Council imposed Commitments are as follows:
1. Contingency Reserve: The Contingency Reserve shall have a target balance of fifteen percent (15%) of General Fund "Operating Budget" as originally adopted. Operating Budget for this purpose shall include current expenditure appropriations and shall exclude Capital Improvement Projects and Transfers Out. Appropriation and/or access to these funds are reserved for emergency situations only. The parameters by which the Contingency Reserve could be accessed would include the following circumstances:
 - a. A catastrophic loss of critical infrastructure requiring an expenditure of greater than or equal to five percent (5%) of the General Fund, Operating Budget, as defined above.
 - b. A State or Federally declared state of emergency where the City response or related City loss is greater than or equal to five percent (5%) of the General Fund, Operating Budget.
 - c. Any settlement arising from a claim or judgment where the loss exceeds the City's insured policy coverage by an amount greater than or equal to five percent (5%) of the General Fund, Operating Budget.
 - d. Deviation from budgeted revenue projections in the top three General Fund revenue categories, namely, Property Taxes, Sales Taxes and Transient Occupancy Taxes in a cumulative amount greater than or equal to five percent (5%) of the General Fund, Operating Budget.

- e. Any action by another government that eliminates or shifts revenues from the City amounting to greater than or equal to five percent (5%) of the General Fund, Operating Budget.
- f. Inability of the City to meet its debt service obligations in any given year.
- g. Any combination of factors 1) a.-f. amounting to greater than or equal to five percent (5%) of the General Fund, Operating Budget in any one fiscal year.

Use of the Contingency Reserve must be approved by the City Council. Should the Contingency Reserve commitment be used, the City Manager shall present a plan to City Council to replenish the reserve within five years.

2. Facilities Financial Planning Reserve: In conjunction with the City's Facilities Financial Plan, a sinking fund has been established to amortize the cost of critical City facilities such as, but not limited to, the Civic Center, Police Department buildings, Fire Stations, Library Branches and other Facility Improvement Projects.

The Facilities Financial Planning Program establishes a level charge to the General Fund that will perpetually replenish the cash flows necessary to finance the construction of critical City facilities. This plan will be updated annually as part of the budget process, or as conditions change. The City shall strive to maintain fund balance in the Facilities Financial Planning Reserve at a level equal to or greater than the maximum annual debts of existing obligations.

The eligible uses of this reserve include the cash funding of public facility improvements or the servicing of related debt.

3. Oceanfront Encroachment Reserve: In the early 1990's, it was discovered by survey that improvements to several ocean front parcels were encroaching onto the public beach. The encroachment was relatively minor. The negotiated solution was for the property owners to pay a permit fee each year to the City. Revenue thus generated may only be used for ocean front restoration projects and incidental costs of improvements and maintenance to enhance public access and use of ocean beaches as approved by the City Council. This Reserve is the repository for those funds. City Council Policy L-12 contains additional background and details about the encroachment issue.
4. Senior Center and Recreation Facility Rental Reserve: City Council Policy B-2 requires ten percent (10%) of gross revenues derived from OASIS Senior Center

and Recreation facilities rental fees to be set aside annually for equipment replacement and/or facility refurbishment.

5. Off Street Parking: Per NBMC 12.44.025 fifty percent (50%) of parking meter revenue collected in designated areas is set aside for acquisition, development and improvement of off street parking facilities within those areas.
6. Paramedic Program (Hoag): In addition to the debt issuance agreements with Hoag Hospital which required an original deposit, effective July 1, 2000, any excess revenues generated by this program, after accounting for General City Overhead of fifteen percent (15%), were to be accumulated for future paramedic related purposes. Funds accumulated may be used only for paramedic related purposes as directed by the City Council.
7. Recreational Instruction: City Council Policy B-2 requires ten percent (10%) to twenty percent (20%) of gross annual revenues derived from specified recreational classes to be set aside for the refurbishment of certain recreational facilities, fee-based activity programs and equipment used in connection with fee-based recreation classes.
8. Senior Fitness Center Reserve: City Council Policy B-2 requires ten percent (10%) of the gross annual revenues derived from fitness center membership fees to be set aside and used for new or replacement fitness equipment.
9. In Lieu Parking: Per NBMC 12.44.125 the City requires commercial businesses to provide adequate off-street parking or where this is not possible, businesses are afforded the opportunity to pay an annual fee and use parking spaces in a municipal lot, providing such a lot is located within specified proximity to the business. These funds can only be used to provide additional parking.
10. Neighborhood Enhancement - A: NBMC 12.44.027 directs revenues from parking meters in Zone 9 shall be apportioned to this Neighborhood Enhancement A. Funds accumulated will only be used for the purpose of enhancing and supplementing services to the West Newport area. Both the nature of the supplemental services and the definition of the area served are set forth in the Code Section above.
11. Neighborhood Enhancement - B: NBMC 12.44.027 directs that fifty percent (50%) of revenues from parking meters in the Balboa Peninsula be apportioned to this Neighborhood Enhancement B. Funds accumulated will only be used for the purpose of enhancing and supplementing services in the Balboa Peninsula. Specific details are contained in the Code Section.

12. Cable Franchise: Pursuant to the provisions of the Newport Beach Municipal Code, Title 5, Business Licenses & Regulations, Chapter 5.44, in return for the use of the City's streets and public ways for the purpose of installing, operating, maintaining, or reconstructing a cable system to provide cable service, fees are collected by the City from cable providers. Those fees are to be used by the City for support of Public, Education, and Government access programming only.
 13. START Program: The Fire Department's START Program developed by the Fire Department and Hoag Hospital helps prepare emergency personnel to quickly organize their resources to handle multi-casualty emergencies. Training video and training materials are sold to other agencies. Any excess revenues generated by this program shall only be used for production expenses related to future START training materials and to enhance paramedic, EMT, and MICN pre-hospital education as directed by the City Council.
 14. Oil and Gas Reserve: The annual \$40,000 which is being set aside from the oil and gas field production revenues is to be used to fund abandoned wells and facilities as they go out of service.
- D. Assigned fund balance: That portion of a fund balance that includes amounts that are constrained by the City's intent to be used for specific purposes but that are not restricted or committed. This policy hereby delegates the authority to the City Manager or designee to modify or create new assignments of fund balance. Constraints imposed on the use of assigned amounts may be changed by the City Manager or his designee. Appropriations of balances are subject to Council Policy F-3 concerning budget adoption and administration. Examples of assigned fund balance may include but are not limited to:
1. Appropriations Reserves: This is a temporary repository for funds not yet fully appropriated in the annual budget. It is normally used during the budget process to set aside funds for known or strongly anticipated expenses that will need to be addressed by budget amendment during the budget year. Sometimes the dollar amount and/or appropriate account breakdown for such expenses cannot be specifically identified at the time the budget is adopted, even though the funds will be needed. In such cases, the funds will normally be budgeted to the Reserve for Appropriations.
 2. Change in Fair Market Value of Investments: As dictated by GASB 31, the City is required to record investments at their fair value (market value). This accounting practice is necessary to insure that the City's investment assets are shown at their true value as of the balance sheet. However, in a fluctuating

interest rate environment, this practice records market value gains or losses which may never be actually realized. The City Manager may elect to reserve a portion of fund balance associated with an unrealized market value gain. However, it is impractical to assign a portion of fund balance associated with an unrealized market value loss.

3. PERS Rate Reserve: This Reserve may be established for the specific purpose of helping to smooth out the year-to-year fluctuations in PERS rates.

When the City Manager or his designee authorizes a change in General Fund, Assigned Fund Balance, City Council shall be notified quarterly.

- E. Unassigned fund balance: The residual portion of available fund balance that is not otherwise restricted, committed or assigned.

PROPRIETARY FUND RESERVES (NET WORKING CAPITAL)

In the case of Proprietary Funds (Enterprise and Internal Service Funds), Generally Accepted Accounting Principles (“GAAP”) does not permit the reporting of reserves on the face of City financial statements. However, this does not preclude the City from setting policies to accumulate financial resources for prudent financial management of its proprietary fund operations. Since proprietary funds may include both long-term capital assets and long-term liabilities, the most comparable measure of liquid financial resources that is similar to fund balance in proprietary funds is net working capital which is the difference between current assets and current liabilities. For all further references to reserves in Proprietary Funds, Net Working Capital is the intended meaning.

A. Water Enterprise Fund

1. Stabilization and Contingency Reserve: This Reserve is used to provide sufficient funds to support seasonal variations in cash flows and in more extreme conditions, to maintain operations for a reasonable period of time so the City may reorganize in an orderly manner or effectuate a rate increase to offset sustained cost increases. The intent of the Reserve is to provide funds to offset cost increases that are projected to be short-lived, thereby partially eliminating the volatility in annual rate adjustments. It is not intended to offset ongoing, long-term pricing structure changes. The target level of this reserve is fifty percent (50%) of the annual operating budget. This reserve level is intended to provide a reorganization period of 6 months with zero income or 24 months at a twenty-five percent (25%) loss rate. The City Council must approve the use of these funds, based on City Manager recommendation. Funds collected in excess

of the Stabilization reserve target would be available to offset future rate adjustments, while extended reserve shortfalls would be recovered from future rate increases. Should catastrophic losses to the infrastructure system occur, the Stabilization and Contingency Reserve may be called upon to avoid disruption to water distribution.

2. Infrastructure Replacement Funding Policy: This funding policy is intended to be a temporary repository for cash flows associated with the funding of infrastructure replacement projects provided by the Water Master Plan. The contribution rate is intended to level-amortize the cost of infrastructure replacement projects over a long period. The annual funding rate of the Water Master Plan is targeted at an amount that, when combined with prior or future year contributions, is sufficient to provide for the eventual replacement of assets as scheduled in the plan. This contribution policy is based on the funding requirements of the most current Water Master Plan. There are no minimum or maximum balances contemplated by this funding policy. However, the contributions level should be reviewed periodically or as major updates to the Water Master Plan occur. Annual funding is contingent on many factors and may ultimately involve a combined strategy of cash funding and debt issuance with the intent to normalize the burden on Water customer rates.

B. Wastewater Enterprise Fund

1. Stabilization and Contingency Reserve: This Reserve is used to provide sufficient funds to support seasonal variations in cash flows and in more extreme conditions, to maintain operations for a reasonable period of time so the City may reorganize in an orderly manner or effectuate a rate increase to offset sustained cost increases. The intent of the Reserve is to provide funds to offset cost increases that are projected to be short-lived, thereby partially eliminating the volatility in annual rate adjustments. It is not intended to offset ongoing, long-term pricing structure changes. The target level of this reserve is fifty percent (50%) of the annual operating budget. This reserve level is intended to provide a reorganization period of 6 months with zero income or 24 months at a twenty-five percent (25%) loss rate. The City Council must approve use of these funds, based on City Manager recommendation. Funds collected in excess of the Stabilization reserve target would be available to offset future rate adjustments, while extended reserve shortfalls would be recovered from future rate increases. Should catastrophic losses to the infrastructure system occur, the Stabilization and Contingency Reserve may be called upon to avoid disruption to wastewater service.

2. Infrastructure Replacement Funding Policy: This funding policy is intended to be a temporary repository for cash flows associated with the funding of infrastructure replacement projects provided by the Wastewater Master Plan. The contribution rate is intended to level-amortize the cost of infrastructure replacement projects over a long period of time. The annual funding rate of the Wastewater Master Plan is targeted at an amount that, when combined with prior or future year contributions, is sufficient to provide for the eventual replacement of assets as scheduled in the plan. This contribution policy should be updated periodically based on the most current Wastewater Master Plan. There are no minimum or maximum balances contemplated by this funding policy. However, the contributions level should be reviewed periodically or as major updates to the Wastewater Master Plan occur. Annual funding is contingent on many factors and may ultimately involve a combined strategy of cash funding and debt issuance with the intent to normalize the burden on Wastewater customer rates.

C. Internal Service Funds

Background.

Internal Service Funds are used to centrally manage and account for specific program activity in a centralized cost center. Their revenue generally comes from internal charges to departmental operating budgets rather than direct appropriations. They have several functions.

--They work well in normalizing departmental budgeting for programs that have life-cycles greater than one year; thereby facilitating level budgeting for expenditures that will, by their nature, be erratic from year to year. This also facilitates easier identification of long term trends.

--They act as a strategic savings plan for long-term assets and liabilities.

--From an analytical standpoint, they enable appropriate distribution of city-wide costs to individual departments, thereby more readily establishing true costs of various operations.

Since departmental charges to the internal service fund duplicate the ultimate expenditure from the internal service fund, they are eliminated when consolidating entity-wide totals.

The measurement criteria, cash flow patterns, funding horizon and acceptable funding levels are unique to each program being funded. Policy regarding target

balance and/or contribution policy, gain/loss amortization assumption, source data, and governance for each of the City's Internal Service Funds is set forth as follows:

1. For all Internal Service Funds: The Finance Director may transfer part or all of any unencumbered fund balance between the Internal Service Funds provided that the withdrawal of funds from the transferred fund would not cause insufficient reserve levels or insufficient resources to carry out its intended purpose. This action is appropriate when the decline in cash balance in any fund is precipitated by an off-trend non-recurring event. The Finance Director will make such recommendations as part of the annual budget adoption or through separate Council action.
2. Equipment Maintenance Fund and Equipment Replacement Fund: The Equipment Maintenance and Replacement Funds receive operating money from the Departments to provide equipment maintenance and to fund the regular replacement of major pieces of equipment (mostly vehicles) at their economic obsolescence.
 - a. Equipment Maintenance Fund: The Equipment Maintenance Fund acts solely as a cost allocation center (vs. a pre-funding center) and is funded on a pay-as-you-go basis by departmental maintenance charges by vehicle type and usage requirement. Because of this limited function, the target year-end balance is zero.

Contribution rates (departmental charges) are set to include the direct costs associated with maintaining the City vehicle fleet, including fleet maintenance employee salary and benefits, operating expenses and maintenance related capital outlay. Administrative overhead and maintenance facility improvements and replacement costs are to be provided outside of this cost unit.

Because of the limited purpose of this fund, a gain/loss assumption is not needed.

Source data is ongoing city fleet inventory and maintenance cost information.

Governance is achieved through annual management adjustment of contribution rates on the basis of maintenance cost by vehicle and distribution of costs based on fleet use by department.

- b. Equipment Replacement Fund: Operating Departments are charged annual amounts sufficient to accumulate funds for the replacement of vehicles,

communications equipment, parking equipment and other equipment replacement determined appropriate by the Finance Director. The City Manager recommends annual rate adjustments as part of the budget preparation process. These adjustments are based on pricing, future replacement schedules and other variables.

The age and needs of the equipment inventory vary from year to year. Therefore the year-end fund balance will fluctuate in direct correlation to accumulated depreciation. In general, it will increase in the years preceding the scheduled replacement of relatively large percentage of the equipment, on a dollar value basis. However, rising equipment costs, dissimilar future needs, replacing equipment faster than their expected life or maintaining equipment longer than their expected life all contribute to variation from the projected schedule.

In light of the above, the target funding level is not established in terms of a flat dollar figure or even a percentage of the overall value of the equipment inventory. It is established at fifty percent (50%) of the current accumulated depreciation value of the equipment inventory, calculated on a replacement value basis. This will be reconciled annually as part of the year-end close out process by the Finance Department. If departmental replacement charges for equipment prove to be excessive or insufficient with regard to this target funding level, new rates established during the next budget cycle will be adjusted with a view toward bringing the balance back to the target level over a three-year period.

3. Insurance Reserve Funds: The Insurance Reserve funds account for the activities of general liability and workers' compensation claims.

Background.

The City employs an actuary to estimate the liabilities associated with the general liability and workers compensation activities. The costs typically associated with these programs include: claims administration, legal defense, insurance premiums, self insured retention and the establishment of appropriate loss reserves including "incurred-but-not reported" (IBNR) claims. In a prescribed measurement methodology, the Actuary estimates the liabilities in conformity with Generally Accepted Accounting Principles (GAAP).

The Actuary refers to this measurement level in his report as the "Expected Level." However, because actuarial estimates are subject to significant uncertainties, actuaries typically recommend that a target funding level be set at

an amount in excess of expected liability as a margin to cover contingencies. A typical target funding level would be set to obtain a specified confidence level (the percent chance that resources set-aside will be sufficient to cover existing claims).

Full funding of the Actuary's "Target Funding Level" establishes a seventy-five percent (75%) confidence there will be sufficient resources (including projected interest) to pay the full amount of existing claims without future contributions. Funding at the "Expected Level" produces a confidence level of only fifty percent to sixty-five percent (50%-65%). Therefore, the target funding of insurance reserves should exceed the "Expected Level" to account for adverse estimate deviation.

Policy & Practice.

The City should target funding of its risk management obligations at not less than the Expected Level, described above; and not more than an amount sufficient to establish a seventy-five percent (75%) Confidence Level. Actuarial losses should be recovered over a rolling 3-year basis while actuarial gains should be amortized over a rolling 5-year basis. As part of the operating budget, each department will be charged a rate equal to its proportionate share of the total "revenue" required to fund the Insurance Reserve Fund at this level.

To lessen the impact of short-term annual rate change fluctuation, City management may implement one-time fund transfers (rather than department rate increases) when funding shortfalls appear to be due to unusually sharp and non-recurring factors. Excess reserves in other areas may be transferred to the internal service fund in these instances but such transfers should not exceed the funding necessary to reach a seventy-five (75%) confidence level interval.

4. Compensated Absences Fund:

Background.

The primary purpose of flex leave, vacation leave and sick leave is to provide compensated time off as appropriate and approved. However, under certain circumstances, typically at separation from service, some employees have the option of receiving cash-out payments for some accumulated leave balances. The Compensated Absences Fund is utilized primarily as a budget smoothing technique for any such leave bank liquidations. The primary purpose of the Compensated Absences Fund is to maintain a balance sufficient to facilitate this smoothing.

Policy and Practice.

The contribution rate will be set to cover estimated annual cash flows based on a three-year trailing average.

The minimum cash reserve should not fall below that three-year average. The maximum cash reserve should not exceed fifty percent (50%) of the long term liability. The target cash reserve shall be the median difference between the minimum and maximum figures.

Each department will make contributions to the Compensated Absences Fund through its operating budget as a specified percentage of salary. The Finance Director will review and recommend adjustments to the percentage of salary required during the annual budget development process. This percentage will be set so as to maintain the reserve within the parameters established above.

5. Post Retirement Funding Policies:

a. Pension Funding:

- (i) California Public Employees Retirement System (CalPERS): The City's principal Defined Benefit Pension program is provided through contract with CalPERS. The City's contributions to the plan include a fixed employer paid member contribution and an actuarially determined employer contribution that fluctuates each year based on an annual actuarial plan valuation. This variable rate employer contribution includes the normal cost of providing the contracted benefits plus or minus an amortization of plan changes and net actuarial gains and losses since the last valuation period.

It is the City's policy to make contributions to the plan equaling at least one hundred percent (100%) of the actuarially required contribution (annual pension cost). Because the City pays the entire actuarially required contribution each year, by definition, its net pension obligation at the end of each year is \$0. Any unfunded actuarial liability (UAL) is amortized and paid in accordance with the actuary's funding recommendations. The City will strive to maintain its UAL within a range that is considered acceptable to actuarial standards. The City Council shall consider increasing the annual CalPERS contribution should the UAL status fall below acceptable actuarial standards.

(ii) Laborer's International Union of North America (LIUNA): The City provides funds to support a supplemental pension plan for some employee associations through contract with LIUNA. This is funded at a fixed percentage of total compensation on a pay-as-you-go basis. The City is not contractually required to guarantee the level of the ultimate LIUNA benefit to retirees, nor does it do so. Therefore the City's liability for this program is full funded each year.

b. Other Post Employment Benefits (OPEB Funding):

Background.

The City's OPEB funding obligations consists of two retiree medical plans.

New Plan. Effective January 2006, the City and its employee associations agreed to major changes to the Post Employment Healthcare Plan. New employees and all current employees participate in a program that requires certain defined employee and employer contributions while the employee is in active service. However, once the contributions have been made to the employee's account, the City has transferred a substantial portion of the funding risk to the employee.

Old Plan. Eligible employees who retired prior to the "New Plan" and certain active employees were eligible to continue to receive post-retirement medical benefits (a defined benefit plan). The cost was divided among the City, current employees and retirees. In the past, this program was largely funded on a pay-as-you-go basis, so there was a significant unfunded liability. Recognizing this problem, the City began contributing to this obligation in 2001. In 2008, these assets were placed in a pre-funding trust. The City's intention is to amortize the remaining unfunded liability within 20 years.

Policy & Practice.

New Plan. Consistent with agreements between the City and Employee Associations, the new defined contribution plan will be one hundred percent (100%) funded, on an ongoing basis, as part of the annual budget process. Funds to cover this expenditure will be contained within the salary section of each department's annual operating budget.

Old Plan. The City's policy is to pre fund the explicit (cash subsidy) portion of the Actuarial Accrued Liability (AAL) of the remnants of the old plan over a 20-year amortization period, or less. This amount will be based on the Annual Required Contribution (ARC) determined by a biennial actuarial review; subject to review and analysis by the City. The City will strive to maintain a funded status that will be within a range that is considered acceptable to actuarial standards. The City Council shall consider increasing the annual OPEB contribution should the funded status fall below acceptable actuarial standards.

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