



**BUSINESS OF THE CITY COUNCIL
CITY OF MERCER ISLAND**

**AB 6474
May 21, 2024
Regular Business**

AGENDA BILL INFORMATION

TITLE:	AB 6474: Financial Status Update for the First Quarter 2024 and Budget Amending Ordinance	<input type="checkbox"/> Discussion Only <input checked="" type="checkbox"/> Action Needed: <input type="checkbox"/> Motion <input checked="" type="checkbox"/> Ordinance <input type="checkbox"/> Resolution
RECOMMENDED ACTION:	Receive the FY 2024 First Quarter Financial Status Update and adopt Ordinance No. 24-11, amending the 2023-2024 Biennial Budget.	

DEPARTMENT:	Finance
STAFF:	Matt Mornick, Finance Director LaJuan Tuttle, Deputy Finance Director Ben Schumacher, Financial Analyst
COUNCIL LIAISON:	n/a
EXHIBITS:	1. Financial Status Update – First Quarter FY 2024 2. Ordinance No. 24-11 2023-2024 Budget Amendments
CITY COUNCIL PRIORITY:	4. Focus efforts and actions to be an environmentally and fiscally sustainable, connected, and diverse community.

EXECUTIVE SUMMARY

The purpose of this agenda bill is to provide the City Council with a financial status update for the first quarter of fiscal year (FY) 2024.

- As of January 1, 2024, the City transitioned its accounting procedures from Generally Accepted Accounting Practices (GAAP) full accrual reporting to the cash basis method as defined by the Washington State Auditor’s Office (SAO). A key impact resulting from this change is the timing of revenues.
- The change from accrual to cash basis does not affect total revenues, only the timing of when those revenues are recognized as received. This impacts year-over-year comparisons in the financial status update during the 2024 transition year.
- All funds are performing as expected through the first three months of the year.
- Analysis across all funds is provided in the FY 2024 First Quarter Financial Status Update (Exhibit 1).
- Budget amending Ordinance No. 24-11 (Exhibit 2) outlines changes to the 2023-2024 biennial budget since May 7, 2024.
- Budget appropriation requests for the Firefighters Pension Fund and multiple facilities projects are also included for City Council consideration.

ISSUE/DISCUSSION

Change to Cash Basis Reporting

The Finance departments 2023-2024 workplan includes the objective to change the City's annual financial report from Generally Accepted Accounting Practices (GAAP) full accrual financial statements to the cash basis method as defined by the Washington State Auditor's Office (SAO).

Cash basis reporting as prescribed in the Budgeting, Accounting, and Reporting System (BARS) manual offers several advantages for cities in Washington state, particularly smaller ones. Cash basis reporting focuses on what money is received and spent in real time, making it easier to understand and manage. Because cash basis is more straightforward, it requires less staff time to administer compared to full accrual accounting. Cash basis reporting provides a clearer picture of how well the City is adhering to its long-term financial plans, with the same accountability, oversight, and control achieved with reporting under GAAP.

The primary reporting impact of this change in accounting practice is the timing of when cash flows are considered revenues or expenditures. Under accrual-based accounting, the process the City used through the end of 2023, revenues are recorded in the period earned regardless of when payment is received. Similarly with full accrual accounting, an expenditure is recognized when the liability for goods or services is incurred. For example, a revenue that is received 2024 for a grant reimbursing 2023 expenditures would be recognized and earned in 2023.

Cash basis accounting requires revenues to be recognized when the cash is received. Expenditures are recognized when payment is issued. Using the same example, a payment received today for a grant reimbursing 2023 expenditures will be recognized as revenue in 2024.

The result in the transition to cash basis accounting is financial reports that are easier to understand and more closely align with budgets. Staff anticipates the change will also significantly reduce staff time, particularly related to the preparation and audit of annual financial statements.

Impact of Transition to Cash Basis Reporting

Beginning January 1, 2024, Finance staff implemented changes in accounting procedures to align with cash basis reporting as defined by the SAO. In 2024, certain revenues that were previously reported on an accrual basis with each quarterly Financial Status Update have switched to a true cash basis. Staff expects the transition to cash basis reporting to have minor impacts throughout the year and will attempt to highlight the related changes with each quarterly financial update in 2024.

The year-end 2023 financial status update presented to Council on May 7 reported ending fund balances using the modified accrual basis of accounting. Modified accrual accounting requires certain cash receipts in January 2024 be reported as revenue for year-end 2023.

Most notable impacts to the first quarter of 2024 are State shared revenues (sales tax, fuel taxes), Real Estate Excise Taxes, and limited external utility taxes. Distributions of these taxes received in January 2024 were accounted for as revenue that was earned and reported in December 2023.

These receipts are not being reported again in the 2024 Financial Status Update. This will impact year-to-year comparisons throughout the 2024 transition year.

Financial Status Update Q1 2024

The Financial Status Update (Exhibit 1) includes detailed analysis on the City’s revenue and expenditure actuals from January 1 through March 31, 2024. The budget reflected in the update includes budget amendments adopted by ordinance through May 7, 2024 (see [Ordinance No. 24-04](#)).

General Fund revenues ended the quarter at \$6.0 million, which are within budget expectations but below the same period of the prior year due to the change in accounting procedures. General sales tax revenues are consistent with FY 2023 numbers when comparing month-to-month returns due to higher-than-expected production across most business sectors, especially revenues related to the construction sector. Sales tax increases are tied to construction activity on the island, lingering effects of inflation, and the strength of the regional economy at this point in time.

Interest earnings in the first quarter of 2024 amount to \$557,534, markedly exceeding budget expectations. The Local Government Investment Pool (LGIP) saw a consistent increase in yields throughout 2023 and the higher yields have maintained in the first quarter of 2024 ending March at 5.43%, which represents a 0.66% increase compared to March 2023.

Expenditures in the General Fund were \$9.8 million at the end of the first quarter, on par with budget expectations as outlined in figure 1. Expenditures are up \$0.6 million from the prior year. “Salaries & Benefits” appear lower than the prior year due to the new partnership with Eastside Fire & Rescue (EFR) and how expenditures for fire service personnel are now recorded as costs relating to a contract instead of salary and benefit costs. The increase in expenditures over the prior year can be attributed to one-time transition costs for services provided by EFR in "Other Services & Charges."

GENERAL FUND EXPENDITURES <i>(\$ in millions)</i>	FY 2024 AMENDED BUDGET	% of AMENDED BUDGET	FY 2023 QUARTER 1 ACTUALS	FY 2024 QUARTER 1 ACTUALS	YTD as % of AMENDED BUDGET
Salaries & Benefits	26.40	68%	5.77	4.55	17%
Supplies	0.79	2%	0.19	0.13	17%
Contract Services	3.52	9%	0.57	0.40	11%
Other Services & Charges	7.99	20%	2.45	4.74	59%
Interfund Transfers Out	0.35	1%	0.22	0.03	7%
TOTAL EXPENDITURES	\$39.05	100%	\$9.19	\$9.85	25%

Figure 1

The Water, Sewer, and Stormwater Utility Funds are operating within budget expectations. Capital project expenditures in the beginning of the year are traditionally low, given much of the capital work occurs in late spring through the early fall. Work is well underway on projects such as the Meter Replacement Implementation and Water System Improvements.

All other operating and capital funds throughout the City are within budget expectations, and there are no significant variances to either revenues or expenditures unless otherwise stated with the transition in accounting procedure.

Budget Amending Ordinance

The Firefighters Pension Fund requires additional budget authority to meet 2024 pension obligations. The excess pension benefit for pre-LEOFF 1 firefighters is tied to the cost-of-living-adjustments (COLA) provided to current active fire positions.

With the 8.6% COLA and 3.75% additional adjustment tied to the transition to Eastside Fire & Rescue in 2023, the resulting COLA for pre-LEOFF 1 excess pension benefits exceeded original budget expectations. The Pension Fund needs additional budget authority of \$39,100 to meet the 2024 pension obligations, as outlined in Exhibit 2. This budget adjustment is needed to increase budget authority using existing Pension Fund resources and has no impact on the General Fund.

Furthermore, multiple facility projects require additional funding of \$565,200 to meet anticipated future costs. This additional funding need will come entirely from ARPA funds and is outlined in Exhibit 2. A summarized list is provided below:

- **City Hall Facilities:** Additional funds are required to manage the closure of City Hall, including supplies for displaced staff teams, additional portable bathrooms, and continued work moving City materials out of City Hall.
- **Police Interim Workspace:** Additional funds are required related to the installation and lease payments for the modular buildings located on the former City Hall parking lot. Costs in 2024 include water and power utility modifications and connections to the three police modular buildings, installation fees, furnishings, and lease costs through the end of the year.
- **Slater Room:** Additional investments in the Slater room including audio visual upgrades, window shading, and furniture to better facilitate City Council and Board & Commission meetings.
- **Northwest Studio Pre-Design:** Contract costs with the City architectural consultant Northwest Studio for the pre-design and early cost estimates for the new Public Safety & Maintenance building.
- **OAC Consulting:** Consulting contract with the construction management firm OAC for advisement on potentially pursuing alternative Public Works contracting methods for the Public Safety & Maintenance building and other City capital projects.

RECOMMENDED ACTION

Adopt Ordinance No. 24-11, amending the 2023-2024 Biennial Budget.