Memorandum

August 28, 2017

To: East Contra Costa Fire Protection District Board of Directors
   East Contra Costa Fire Protection District Finance Committee

From: Interim Fire Chief Brian Helmick

Subj: Correction of Previously Underreported Operating Funds Starting Balance Identified through External Audit and Budgeting Process

As you will see in the proposed Final Budget for Fiscal Year (FY2017-18) being presented to the Finance Committee today, the District's General Fund starting balance is $10.13 million, which is approximately $6.2 million above the starting balance shown in the Preliminary Budget approved by the Board of Directors on June 5.

When and how was the mistake found?
The first indication of a problem was when the District began reviewing a draft working version of the routine annual financial audit for FY 2014-15 in mid-May, 2017. Director Joe Young brought to staff's attention that the draft audit showed a higher Unrestricted General Fund balance than he recalled being reflected in historical budgets. At around the same time, in connection with Chief's Brian Helmick's assumption of the Interim Fire Chief position, staff was compiling a list of questions regarding the District's financial operations. Director Young and Chief Helmick set a meeting with County Auditor-Controller Robert Campbell to seek information about both the District's general fund balance and answers to staff's financial operations questions.

1 Local government agencies such as the District are required by law and/or best practice to contract with an external auditor to conduct annual financial audits.
At this meeting, which was held on June 7, 2017, Director Young, Chief Helmick and the Auditor-Controller explored various operational and financial processes, with a focus on the transition of funds and financial operations from the County Treasury to the District. Staff from the City of Brentwood joined Director Young and Chief Helmick for a second meeting with the Auditor-Controller and his staff on July 27, 2017. These discussions revealed that:

- Staff from the District and the County had a misunderstanding of how the district's finances and budget were being managed;
- Most of the District's funds remained in the County's Treasury accounts despite the understanding that only two accounting funds would remain for the purpose of receiving Property Tax revenues. The remaining accounting funds were to be closed and balances transferred to the District; however, this transfer did not occur.

Subsequently, upon further review of the District's past-year budgets and information analyzed in the District past and upcoming financial audits, the District concluded:

- Over the last 3-4 years, as staffing levels fell due to attrition, and stations closed earlier than budgeted, additional savings accumulated in the District account held in the County Treasury;
- These savings were not reflected in the District's financial records used by the District for budgeting purposes;
- When the budgets were developed each year, the actual general fund balance was not fully included in the budgetary starting fund balance. In essence, the District used the projected end-of-year fund balance from the FY 2014-15 Budget as the starting carry-over amount for the FY 2015-16 Budget, rather than the actual starting fund balance held by the District. Then the projected end-of-year balance from FY 2015-16 was used as the starting carry-over balance for FY 2016-17, and so on.
- This error has compounded each year, resulting in an understatement of approximately $6.2 million in the starting fund balance as of the beginning of the FY 2017-18 budget year.

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2 From when the District was formed, through 2014, the County provided numerous administrative and financial services for the District, and all District funds were held in accounts banked with the County. Effective January 1, 2015, the District entered into a contract with the City of Brentwood to provide transaction type services such as payroll and accounts payable processing. As part of that transition, the District opened its own accounts with Bank of the West.

3 This number has been reviewed by the Auditor-Controller and the District's auditor Maze & Associates, but it will be finally confirmed through the District's FY 2015-16 and 16-17 audits.
In sum, the District has determined the following:

a) the source of most of the District's questions and concerns resulted from an incomplete transition of the District's funds from the County to the District by January 1, 2016; and

b) this resulted in compounding understatements of the starting fund balance in the District's budgets for FY 2015-16 and FY 2016-17, and in the Preliminary Budget for FY 2017-18.

What does this mean for the District's budget?

In light of the new information obtained by the District, the District recalculated its carry-over funds going back to early 2015. In conjunction with the completion of the FY 15-16 and FY 16-17 audits, the District will meet with County and City staff to (a) verify the recalculated General Fund balance (with the County), and (b) reconfirm transaction processes and roles (with both the County and City).

The District's external auditor (Maze & Associates) cannot definitively certify the magnitude of the understatement and the new carry-over amount before completing the District's FY 2015-16 and 2016-17 audits. However, their preliminary FY 15-16 and FY 16-17 findings confirm the District's findings and calculations, based on the information provided.

Based on this work, the proposed Final Budget includes the additional carry-over amount as set forth in this memo. If the District's FY 2015-16 and 2016-17 external audits, which should be delivered for acceptance by the Board of Directors within the next six months, reveal further errors, a budget amendment may be required.

Finally, once the two remaining external audits are complete, staff will work with the Finance Committee and Board of Directors to evaluate options for allocation of available one-time funds to reduce various historically unfunded obligations of the District. These could include equipment replacement, facility maintenance, financial liabilities associated with the future cost of post-employment benefits (commonly referred to as "Other Post-Employment Benefits" or "OPEB") and other expenses.

It will be important to remember that these funds are available only one time; they will not be available on an ongoing basis. As such, they are most properly used for one-time expenses rather than for making changes that will increase the District's future operational costs, such as
altering the District's staffing model or opening new stations, without the prospect of future sustainable funding to offset the related future costs.

**How did this mistake happen?**
There was no single point of failure that is responsible for the error. The District has had insufficient administrative staffing for years, relying on just one Fire Chief and one Administrative Assistant, both of whom were dramatically overworked, which meant that many administrative duties either could not be done or were based on incomplete information. As a result, though many individuals have "touched" the District's budget during each cycle since 2014, no one was aware of the fact that they had incomplete information. Finally, based on the complexities of the financial system's transition, and the understaffing in the District's administrative functions, the District's external auditor did not receive the information needed to complete timely audits.

**What are the District's immediate next steps in dealing with this problem?**
All parties involved now have an accounting of all District funds held in the County Treasury. Based on this information, the County is working to close out all non-required District accounts and transfer remaining funds to District accounts at Bank of the West by the end of 2017. This will allow all District funds to be properly tracked by the District. The County will retain only two District accounts that are required to receive property taxes and Community Facilities District levies, which funds will then regularly be transferred to District bank accounts for ongoing use in accordance with District budgets.

In addition, District staff, City staff and Maze & Associates are proceeding as swiftly as possible to accelerate the FY 2015-16 and 2016-17 external audit processes.

Finally, the District is analyzing whether the financial mistakes require mitigation or correction with outside agencies, including the District SAFER grant from 2012, the Multi-Jurisdictional Taskforce Memorandum of Understanding, and a regional grant for the purchase of new self-contained breathing apparatus.

**What other steps will the District take to guard against similar problems in the future?**
The District has asked Maze & Associates to review its financial procedures in conjunction with completion of the FY 15-16 and FY 16-17 audits. Depending on Maze's recommendations, staff
anticipates that some Board-level policies and staff-level practices may need to be updated and strengthened.

More immediately, the District has entered into a contract for temporary administrative assistance to strengthen our organizational capacity. Funding for a permanent position is being requested in the proposed Final Budget. Additionally, the District will be working more closely with the City's finance department to enable the City to take a more active role in reconciling general and special fund balances and cash flows. This arrangement also is expected to be more effective now that all parties have a more complete understanding of the District's and County's roles.

**In Conclusion**

Although this is an unfortunate situation, the District has taken immediate and transparent actions to address it. While there is additional one-time funding available which will provide a firmer foundation for the District, this one-time funding does not resolve the ongoing revenue shortage which prevents the District from permanently funding a fourth station or providing an adequate number of stations to serve the population. We will continue to work diligently to improve the immediate financial practices highlighted by this situation and address the greater ongoing funding issue facing the District.