Subject: Building an Honest Budget

From: Rick Tinsley <rnt97@yahoo.com>
Sent: Monday, May 11, 2020 2:13 PM
To: Marcia Jensen <MJensen@losgatosca.gov>; BSpector <BSpector@losgatosca.gov>; Rob Rennie <RRennie@losgatosca.gov>; Marico Sayoc <MSayoc@losgatosca.gov>
Cc: Richard Tinsley <ricktinsley1@gmail.com>
Subject: Building an Honest Budget

Los Gatos Town Council Members,

In preparation for the annual budget process please remember the following GFOA best practices as pointed out in prior Finance Committee and Town Council meetings:

1. Compare proposed budgets to previous ACTUAL results to clearly understand proposed increases or decreases in spending. Future budgets are necessarily estimates since none of us possess a crystal ball. On the other hand as time passes, prior period budgets (fiction) are replaced with actual results (facts). Comparing a proposed budget to a known fictional prior budget is obfuscation at its worst and violates all measures of common sense and transparency. It is intentionally misleading as it compares a proposed budget to historical numbers that are already known to be false.

2. Budgets should use ACTUAL salaries for all active employees, not falsely inflated top step pay levels for all employees.

3. Budgets should list ACTUAL headcounts by department clearly delineating both active and vacant positions projected by month. Budgets should be based on honest estimates of active employees actually drawing a paycheck, not falsely inflated headcounts assuming every possible job is filled 365 days per year with top step pay which is knowingly inaccurate. Currently the Town web site shows at least nine paid job openings and there may be more. In three recent fiscal years this intentionally inflated headcount added $1.7M - $1.9M per year to the budget which in turn removed these same amounts from the Town Council's authority to allocate resources(as detailed in my Jan 22, 2020 email to the Town Council).

As fiduciaries of the Town's finances, the Town Council must require the Staff to follow these widely recognized best practices for honest and transparent budgeting.

As always, let me know if you have any questions.

Thank you,

Rick Tinsley

ATTACHMENT 4

Subject: Please provide the FY 21 5 Year model in the same format as FY 2016
Attachments: 5 Yr Model - FY 2016 plan year.pdf; 5 Yr Model - FY 2021 plan year.pdf

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From: Phil Koen <pkoen@intermedia.net>
Sent: Tuesday, May 12, 2020 3:32 PM
To: Laurel Prevetti
Cc: Marcia Jensen; BSpector; Marico Sayoc; Rob Rennie; jvannada@gmail.com; Rick Tinsley; Terry Duryea; Ron Dickel; Lee Fagot; Rick Van Hoesen (rick.vanhoesen@gmail.com); Lee Quintana; Maria Ristow; Heidi Owens; Catherine Somers
Subject: Please provide the FY 21 5 Year model in the same format as FY 2016

Dear Laurel,

Would you be so kind as to re-publish the Five Year model in your transmittal letter, adopting the same format that was used in FY 2016. I have attached the FY 2016 version for your review. The current format is of limited value since there is no history reflected in the schedule. How is the reader able to judge the soundness of the model if actuals (or estimates) for prior years are not shown? Reflecting the adopted budget for FY 20 in addition to actuals (or estimates) for FY 2018, FY 2019 and FY 2020 would be very useful to the reader and to the Council. It looks like the public use to get this information, so I am unsure as to why the Staff changed the format. This information hopefully should not be very difficult to add.

Also, you can see that the FY 2016 version provided additional information regarding overtime, other salary and temporary employees salary. Can you expand the current template to include this information? Hopefully, this is not very difficult to do as well.

It would also be very useful if you disclosed your assumption regarding staff vacancy rates over the five-year forecast. The FY 21 budget is reflecting a $3m increase in salary and benefits expense over the estimated number of FY 2020. The salary number is increasing $2.6m (15%) and the total benefits are increasing $400k (4%). There is no explanation given for the significant increase for salaries from the prior year actual. Also, there is no explanation as to why the GASB 45 medical actuarial number decreased by $500k from the prior year estimate.

Hopefully, you will be able to publish an expanded version quickly so we could make timely comments on the budget.

Marico and Rob, I sent you an email on this subject yesterday but did not include FY 2016 as an example. Thus, I am copying you again today.

Thank you.

Phil Koen
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J.D. Power certifies Intermedia for providing an "Outstanding Customer Service Experience" in Assisted Technical Support 4 years running – a first among cloud communications providers.

Reflective of the positive economy, the Five-Year Forecast identified over $400,000 in additional General Fund monies in FY 2015/16 which have been allocated to fund contractually obligated increases, including salary increases, contractual increases and unfunded mandates as previously discussed.

Provided below is a recap of the most recent Five-Year Financial Plan prepared in early May 2015. The updated Five-Year Financial Plan spans FY 2015/16 - 2019/2020:

Town of Los Gatos General Fund

Updated Five-Year Financial Plan

($ millions)

Account	Revenue Category	2012/13 Actuals	2013/14 Adopted	2013/14 Actuals	2014/15 Budget	2014/15 Estimated	FY 1 2015/16 Forecast	FY 2 2016/17 Forecast	FY 3 2017/18 Forecast	FY 4 2018/19 Forecast	FY 5 2019/20 Forecast
4100	Property Tax	$ 8.3	$ 7.8	$ 9.1	$ 8.2	$ 8.4	$ 9.1	$ 9.4	$ 9.7	$ 10.0	$ 10.3
4110	VLF Backfill Property Tax	2.4	2.4	2.7	2.7	2.8	2.8	2.9	2.9	2.9	2.9
4200	Sales & Use Tax	8.8	7.8	8.0	8.3	8.1	8.3	8.8	9.2	9.6	9.5
4250	Franchise Fees	2.0	2.0	2.1	2.1	2.1	2.1	2.2	2.3	2.3	2.4
4251	Transient Occupancy Tax	1.3	1.0	1.5	1.3	1.5	1.5	1.5	1.6	1.6	1.7
4400	Business License Tax	1.2	1.4	1.1	1.4	1.7	1.3	1.3	1.3	1.3	1.3
4400	Licenses & Permits	3.1	2.6	3.2	2.9	2.9	3.0	3.1	3.1	3.2	3.3
4500	Intergovernmental	0.9	0.7	0.8	0.7	0.7	0.8	0.7	0.7	0.7	0.8
4600	Charge for Services	3.1	2.5	2.7	2.5	2.4	2.4	2.7	2.7	2.8	2.9
4700	Fines & Forfeitures	0.6	0.7	0.8	0.7	0.7	0.7	0.7	0.7	0.7	0.7
4800	Interest	(0.2)	0.5	1.1	0.3	0.5	0.3	0.3	0.3	0.4	0.4
4850	Other Sources	3.6	3.4	4.7	4.5	4.9	4.7	3.5	3.3	3.3	3.4
4900	Fund Transfers In	0.6	0.8	0.3	0.6	0.4	0.5	0.4	0.4	0.4	0.4
	TOTAL REVENUES	35.7	33.6	38.1	36.2	37.1	37.5	37.5	38.2	39.2	40.0
	Use of Reserves/Deposits	1.9	2.7	3.4	7.7	7.3	0.4	0.4	0.4	0.4	0.4
TOTAL REVENUES & TRANSFERS		$ 37.6	$ 36.3	$ 41.5	$ 43.9	$ 44.4	$ 37.9	$ 37.9	$ 38.6	$ 39.6	$ 40.4

Account	Expenditure Category	2012/13 Actuals	2013/14 Proposed	2013/14 Actual	2014/15 Budget	2014/15 Estimated	2015/16 Forecast	2016/17 Forecast	2017/18 Forecast	2018/19 Forecast	2019/20 Forecast
5110	Salary	$ 12.6	$ 13.0	$ 12.4	$ 13.7	$ 13.1	$ 14.3	$ 14.3	$ 14.4	$ 14.4	$ 14.4
5130	Temporary Employees	0.9	0.6	0.8	0.6	0.7	0.8	0.7	0.7	0.7	0.7
5140	Overtime	0.6	0.4	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4
5170	Other Salary	0.3	0.4	0.4	0.4	0.2	0.4	0.4	0.4	0.4	0.4
5200	Benefits	6.3	6.7	6.6	8.4	6.0	7.3	7.9	8.4	8.9	9.4
6000	Supplies, Materials, & Services	5.6	5.3	5.6	5.3	5.6	5.5	5.6	5.6	5.8	5.9
6000	Pass Through Expenditures			0.8	0.8	1.1	1.1				
7200	Grants & Awards	0.2	0.2	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2
7400	Utilities	0.4	0.4	0.4	0.4	0.5	0.4	0.5	0.5	0.5	0.5
7700	Fixed Assets	-	-	0.1	-	-	-	-	-	-	-
8060	Internal Service Charges	3.3	3.4	3.4	3.4	3.3	3.6	3.8	3.9	4.0	4.1
8900	Debt Service	2.0	1.9	1.9	1.9	1.9	1.9	2.0	2.0	2.0	2.0
	TOTAL EXPENDITURES	$ 32.2	$ 32.3	$ 33.0	$ 35.5	$ 33.0	$ 35.9	$ 35.8	$ 36.5	$ 37.3	$ 38.0
9900	RDA Trust Fund		0.1	0.1	-		-	-	-	-	-
9900	Operating Transfers Out				-		0.1	-	-	-	-
9900	Capital Transfers Out to GFAR	1.9	2.7	2.6	7.0	7.3	0.4	0.4	0.4	0.4	0.4
9900	GASB 45 Retiree Medical Actuarial	1.2	1.3	5.8	1.3	1.3	1.5	1.6	1.6	1.6	1.6
	EXPENDITURES	35.3	36.4	41.5	43.8	41.6	37.9	37.8	38.5	39.3	40.0
9900	Allocation										
9900	Projects Reserve	-			0.1	0.1	-	-	-	-	-
9900	Transfer to Stabilization Reserve	-			-		-	-	-	-	-
TOTAL EXPENDITURES & ALLOCATIONS		$ 35.3	$ 36.4	$ 41.5	$ 43.9	$ 41.7	$ 37.9	$ 37.8	$ 38.5	$ 39.3	$ 40.0
REVENUES LESS EXPENDITURES		$ 2.3	$ (0.1)	$ -	$ -	$ 2.7	$ -	$ 0.1	$ 0.1	$ 0.3	$ 0.4
ONGOING SHORTFALL MITIGATION		$ -			$ -		$ -	$ -	$ -	$ -	$ -
NET REVENUES LESS EXPENDITURES		$ 2.3	$ (0.1)	$ -	$ -	$ 2.7	$ -	$ 0.1	$ 0.1	$ 0.3	$ 0.4

*FY 2014/15 $7.4 million in use of Reserves/Deposit is for capital projects funding, inclusive of 44.2 million for Phase 1 of the Almond Grove Street Rehabilitation Project.

Notably, in the Five-Year Forecast FY 2014/15 year-end estimates indicate excess revenues over expenditures in the amount of $2.7 million. This $2.7 million is inclusive of the Town's savings related to the payoff of the Town's CalPERS side fund liability. The side fund payoff was approved in June 2014 along with adoption of the proposed FY 2014/15 Operating Budget. Because the FY 2014/15 was adopted prior to the side fund pay-off, the $700,000 in savings was moved to non-departmental so it would not be spent. In addition, approximately $1.3 million of this year end savings resulted from an unusual number of separations and vacancies throughout the fiscal year.

Town of Los Gatos General Fund 5-Year Forecast
(in $ million)

Account	Revenue Category	2020/21 Budget	2021/22 Forecast	2022/23 Forecast	2023/24 Forecast	2024/25 Forecast	2025/26 Forecast
4100	Property Tax	$ 14.7	$ 15.1	$ 15.8	$ 16.2	$ 16.7	$ 16.5
4110	VLF Backfill Property Tax	4.0	4.0	4.1	4.2	4.3	4.3
4200	Sales & Use Tax	8.0	8.1	8.2	8.4	8.5	8.6
4250	Franchise Fees	2.5	2.6	2.7	2.8	2.9	2.9
4251	Transient Occupancy Tax	2.3	2.2	2.2	2.2	2.2	2.2
4400	Business License Tax	1.3	1.3	1.3	1.4	1.4	1.4
4400	Licenses & Permits	3.1	2.9	3.0	3.0	3.1	3.1
4500	Intergovernmental	1.0	0.7	0.8	0.8	0.9	0.9
4600	Business License Tax	4.0	4.1	4.2	4.2	4.2	4.3
4700	Fines & Forfeitures	0.4	0.4	0.4	0.5	0.5	0.5
4800	Interest	0.6	0.8	0.2	0.7	0.2	0.2
4850	Other Sources	2.3	2.2	2.2	2.2	2.2	2.2
4900	Fund Transfers In	0.6	0.5	0.5	0.5	0.5	0.5
TOTAL OPERATING REVENUES & TRANSFERS*		$ 44.8	$ 44.9	$ 45.6	$ 47.1	$ 47.6	$ 47.6
	Use of Capital/Special Project Reserve - Capital	3.4	0.6	0.6	0.6	0.6	0.6
	Use of Pension/OPEB Reserve	4.2	0	0	0	0	0
	Use of Capital/Special Project Reserve - Other	0.8	0	0	0	0	0
TOTAL REVENUES, TRANSFERS, AND USE OF RESERVES		$ 53.2	$ 45.5	$ 46.2	$ 47.7	$ 48.2	$ 48.2

Account	Expenditure Category	2020/21 Budget	2021/22 Forecast	2022/23 Forecast	2023/24 Forecast	2024/25 Forecast	2025/26 Forecast
5110	Salary	20.2	19.9	19.9	20.0	20.1	20.1
5120	CalPERS Benefits	7.3	7.3	8.2	8.7	9.0	9.0
5200	All Other Benefits	4.1	4.1	4.2	4.3	4.4	4.5
6211	OPEB Pay as You Go	1.3	1.4	1.4	1.5	1.7	1.8
6000	Operating Expenditures	6.6	5.8	6.1	6.2	6.5	6.5
7200	Grants & Awards	0.2	0.2	0.3	0.3	0.3	0.3
7400	Utilities	0.6	0.6	0.6	0.7	0.7	0.7
8060	Internal Service Charges	2.4	2.7	2.8	3.0	3.2	3.4
8900	Debt Service	1.9	1.9	1.9	1.9	1.9	1.9
TOTAL OPERATING EXPENDITURES		$ 44.6	$ 44.0	$ 45.4	$ 46.5	$ 47.7	$ 48.1
	GASB 45 Retiree Medical Actuarial	0.6	0.5	0.4	0.3	0.2	0.2
	Additional Discretionary Payment - Pension	4.6	0.4	0.4	0.4	0.4	0.4
TOTAL OPERATING & DISCRETIONARY EXPENDITURES		$ 49.8	$ 44.9	$ 46.2	$ 47.2	$ 48.3	$ 48.7
	Capital Transfers Out to GFAR	3.4	0.6	0.6	0.6	0.6	0.6
	Transfer to Internal Service Funds	0	0	0	0	0	0
	Pension/OPEB Transfer to Pension Trust Fund	0	0	0	0	0	0
	Allocate to Compensated Absences	0	0	0	0	0	0
	Surplus	0	0	0	0	0	0
	Allocate to Property Surplus Reserve	0	0	0	0	0	0
TOTAL EXPENDITURES & RESERVE ALLOCATIONS		$ 53.2	$ 45.5	$ 46.8	$ 47.8	$ 48.9	$ 49.3
NET REVENUES RESERVE TRANSFERS LESS EXPENDITURES & RESERVE ALLOCATIONS		$ -	$ -	$ (0.6)	$ (0.1)	$ (0.7)	$ (1.1)

* Due to rounding of individual categories FY 2020/21 Total Expenditures and Reserve Allocations omits $0.1 million.

Subject: Comments and Questions regarding FY 20/21 Proposed Budget

Arn Andrews • Assistant Town Manager
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From: Rick Tinsley <rnt97@yahoo.com>
Sent: Sunday, May 17, 2020 12:03 PM
To: Marcia Jensen <MJensen@losgatosca.gov>; BSpector <BSpector@losgatosca.gov>; Rob Rennie <RRennie@losgatosca.gov>; Marico Sayoc <MSayoc@losgatosca.gov>
Cc: Laurel Prevetti <LPrevetti@losgatosca.gov>; Arn Andrews <aandrews@losgatosca.gov>; Stephen Conway <sconway@losgatosca.gov>
Subject: Comments and Questions regarding FY 20/21 Proposed Budget

Town Council Members,

The proposed budget assumes relative modest revenue falloff of less than $1.8M or 2.6% for the upcoming fiscal year. Compared to the state of California's proposed budget and indications from other local governments, that seems incredibly optimistic. While we can all hope that the drop off is this small, it would be prudent to consider more substantial revenue drops and make contingency plans accordingly. Better to do this NOW to avoid disruptive midyear budget revisions.

1. **Budgets versus Actual** -- Pages A1-A7 outline the five year forecast with no ACTUAL historical financial data for context. One of the most important ways to evaluate any plan for the next five years is to compare with what ACTUALLY happened the past five years. Yes you can scroll down several dozen pages to piece together the historical data but it would be much more transparent to show it on the same tables. Page A-4 does show 18 years of historical headcount data and it would be very instructive to show the corresponding financial information. For example, spending on Salary and Benefits (page C-8) has increased from $21.9M to $31.6M or 44% over the past 5 years while headcount (page A-4) has increased by only 6 heads or about 4%. That seems rather important to understand. Showing one without the other is misleading.

2. **Accurate Salary Info** -- It is nice to see some improvement in this area. Page A-5 indicates a departure from past practice by using actual plus one step increase rather than top step for all. To be clear, this is just more accurate budgeting, closer to reality, not savings as the report claims.

3. **Active versus vacant positions** -- This budget still assumes 100% of the jobs will be filled for all 365 days of the year. Page A-23 indicates the Town has nine vacant positions and is actively recruiting eight. Pages C-45 through C47 show lots of historical headcount data but it is all "Funded" or "Proposed" headcount, not ACTUAL headcount and therefore does not correlate to ACTUAL financials. Why not show ACTUAL headcount? Page D-50 shows ACTUAL vacancy rates of 9% for FY 2018/19, Estimated vacancies of 13% for FY2019/20, and a planned vacancy rate of 10% for FY 2020/21. Clearly these HR projections do not match up to the budget projections. The Town Council should ask the Staff: "Do we really expect (or need) to have all nine vacant positions filled as of July

1 and keep them all filled for the next 365 days?" Obviously the recruiting environment has improved tremendously, but the Town Council like any responsible governing body should consider whether it makes sense in the current circumstances to fill all these positions.

4. **Actual Operating Expense Growth** - Page A-12 indicates the GF OpEx for FY 2020/21 is projected to increase slightly by $0.4M compared to the prior year's adopted budget. This is intentionally misleading as we are 10.5 months into the current fiscal year so we have much more accurate estimates with which to compare the proposed budget. Compared to the current FY2020 estimate on Page C-8, the proposed budget increases GF Salary and Benefit expenditures by $3.1M. The Town Council should direct the Staff to cease these intentionally misleading comparisons to prior out-of-date budget projections. Regardless of whether the Town should or even can fill all those vacancies in order to spend that additional $3.1M, the comparison to such a padded number conceals actual spending trends. Why do we have to scroll down to the 88th page in the budget document to see this? Why not put this in Section A which will be as far as most people will ever get in this 498 page document?

Thank you,

Rick Tinsley

Subject: Town's proposed Agenda: Item 6, the Budget,

From: Lee Fagot <leefagot@gmail.com>
Sent: Monday, May 18, 2020 9:59 AM
To: Marcia Jensen <marcia.jensen@gmail.com>; BSpector <BSpector@losgatosca.gov>; Rob Rennie <RRennie@losgatosca.gov>; Marico Sayoc <MSayoc@losgatosca.gov>
Cc: Robert Schultz <RSchultz@losgatosca.gov>; Laurel Prevetti <LPrevetti@losgatosca.gov>; Stephen Conway <sconway@losgatosca.gov>
Subject: Town's proposed Agenda: Item 6, the Budget,

Madam Mayor and Council Members,
Rather than ruminating thru almost 500 pages of the Town's proposed Budget, please spend time at the Council meeting to discuss instead the real **analysis** of our Town's finances, develop **strategies** to deal with both the new **challenges** due to COVID, and to put in place a desperately needed ***process*** for MORE transparency, and only then put those agreed numbers into a reasonable budget plan. The contradictions in the document submitted, comparing prior budgets to this one, and future years, instead of comparing ACTUAL revenues and expenditures is like comparing wishful thinking in the past to wishful thinking in the future. Lets use FACTS that are presented in a more concise fashion. For example page C8 shows General Funds salaries and benefits increase almost $10M the last 5 years, and 6 new employees, while page C14 (218 actual pages into the document), which shows a $6.4M salary/benefits increase paid from all funds, since 2016/17 with a projected (actual? Can't tell) head count increase of only 4. And, we do not know if these positions were actually filled for the full fiscal years in the past.

The revenue decline projected for 2020/21 does not seem reasonable nor reflect what other government agencies in our area anticipate. Rather, both steeper declines in sales taxes, TOT and fees could be for both the near and intermediate term, as well as possible expenditure increases due to COVID's impact on our community with both preventive and remedial action needed. Yes, we have reserves, and we have shuffled them around in the past. But, lets be more forthright going forward with open discussions to how to conserve resources and still deliver the quality services our Town has provided in the past.

Our Town has good folks who could help volunteer, the Finance Committee for example, to help with analysis, and work with staff and your selves to put together a more meaningful budget and not to rush the approval. A new process has to be implemented, NOW.

Please openly discuss this budget at Tuesday's meeting and better define an improved PROCESS before making final decisions. Get community input.
Thanks, and lets all be safe.
Lee Fagot
845 Lilac Way
95032

Subject: FW: LGCA's comments regarding Agenda Item #6 - Council Meeting May 19, 2020
Attachments: FY 21 Budget letter -final.docx; Budget Development Flier 3.04.19 Balloon First (2).pdf; Budgeting Salary.pdf; structurally balanced budgets.pdf

From: Phil Koen <pkoen@monteropartners.com>
Sent: Monday, May 18, 2020 10:34 AM
To: Marcia Jensen <MJensen@losgatosca.gov>; Marico Sayoc <MSayoc@losgatosca.gov>; BSpector <BSpector@losgatosca.gov>; Rob Rennie <RRennie@losgatosca.gov>
Cc: Laurel Prevetti <LPrevetti@losgatosca.gov>; Terry Duryea <tduryea@aol.com>; Tom Tinsley <ttinsley@ttinsley.com>; Ron Dickel <rondickel@gmail.com>; Lee Fagot <leefagot@gmail.com>; Catherine Somers <Catherine@losgatoschamber.com>; Rick Van Hoesen (rick.vanhoesen@gmail.com) <rick.vanhoesen@gmail.com>; jvannada@gmail.com; Lee Quintana <leeandpaul@earthlink.net>; Maria Ristow <ristows@comcast.net>; phertan@alum.mit.edu; Heidi Owens <heidi.timmons.owens@gmail.com>
Subject: LGCA's comments regarding Agenda Item #6 - Council Meeting May 19, 2020

Dear Honorable Mayor and Council Members,

We have attached a letter which details our thoughts on both the proposed FY 21 operating budget and capital budget. We have also attached two GFOA best practice reports which discuss achieving a structurally balanced budget and effective budgeting of salary and wages. We would encourage the Council to instruct the staff to comply wherever possible with these best practices.

We have also attached a budget development cycle diagram which was prepared by the City of Irvine. This shows how the City of Irvine prepares their annual budget . Please note the numerous, community out-reach meetings that were held in advance of preparing a draft budget and the departmental budget presentations that were made to the Finance Committee prior to submission to the City Council. By comparison, the Town's budget, which is over 750 pages, was first published this past Monday. There were no community budget meetings held prior to releasing the budget, other than the January Council meeting which had the FY 21 budget has an agenda item. Additionally, the Finance Committee has been prohibited from reviewing the budget and therefore the Council does not have the benefit of their expertise and insight. The first time the public has a chance to provide any meaningful input will be at this coming Tuesday Council "Zoom" meeting, where verbal comments will be limited to 3 minutes.

This does not strike us as an open and transparent process where the Council seriously wants public input. And what ever happened with the MonkeySurvey that was to provide public input on how the Town should spend an incremental $1m if the Town had a surplus? We didn't see on the public's wish list salary increases for the Staff, but that is what the Council chose to do. We believe it is time to have a transparent and full- throated, community based discussion about how the annual budget of this Town is developed which will allow for thoughtful input from residents and expert guidance from the Finance Committee. The current process can be improved. This is a good thing and should viewed as such.

We also want to respectively let you know that we are not planning on attending Tuesday's virtual council meeting. Since we have spent many hours preparing our written remarks, there is nothing that can be added by attending a Zoom meeting and speaking for 3 minutes. Rather, we would prefer to let others use that precious, limited time to voice their comments to the Council. Please do not view this as a "lack of commitment" on our part. Our letter should stand on its own merit.

Thank you.

Phil Koen
Rick Van Hoesen
Jak VanNada

Los Gatos Community Alliance

Dear Honorable Mayor and Council Members,

We are writing to share our thoughts and observations regarding the proposed FY 21 Operating and Capital Plans. Our intent is to provide you with additional analysis, which will help inform you as to the risks of the plan. At the end of the day, it is the Council's responsibility to pass a fiscally prudent operating and capital budget.

Background

As you are certainly aware, the impact of COVID 19 on the Town's financials is still unfolding and unprecedented. The Town has never seen a SIP order which has effectively shut down the Town, now approaching 90 days. We have reviewed preliminary budgets of several cities (Menlo Park, Campbell, Palo Alto, Los Altos) to better understand the planning philosophy each is employing in developing their FY 21 Operating Budgets. We think the City of Menlo Park Staff has captured their planning orientation extremely well in this communication to their Council:

"City Staff want to emphasize that there is no historical analog in the modern economy to the COVID 19 pandemic and the prolonged stay-at-home order. It is highly likely that additional revenue impacts either positive or negative, will be known at the end of the 2020 calendar year. Further, the impacts of the COVID 19 pandemic on financial markets will likely impact CALPERS investment returns resulting in increased pension costs in years following fiscal year 2021. City staff recommends **extraordinary prudence** in creation of new on-going programs or services considering uncertain impacts of the COVID 19 pandemic on city revenues and expenditures".

All the cities we reviewed built their preliminary budgets taking a "moderate" downside view of the impact of COVID 19 on their local economies. To frame this, the percentage decrease in total general fund operating revenues from the FY 20 adopted budget range from a 6% decline to approximately a 20% decline. Additionally, all cities modeled various scenarios ranging from a low impact, moderate impact, to a severe impact in developing their budgets. Based on Council feedback, the respective staffs then built the "preliminary budgets" based on a specific set of planning assumptions selected from the scenario analyses.

1. **General Fund Budget anticipates a "surplus" of 11,905 but shows expenditures exceeding revenues by $7,429,224 (C-8). What does "surplus" mean given this context?**

In the Town Manager's transmittal letter, the statement is made, "the budget currently anticipates a slight **surplus of $11,905**". However, when we look at schedule C-8, we find that general fund expenditures exceed revenues by $7,429,224. In other words, this schedule is showing an operating deficit of over $7.4 million, not a surplus.

It is important to understand how Staff is using the word "surplus". Since budgets by law must be balanced, a "balanced budget" exists when "**all sources** of funds" are equal to "**all uses** of funds". When the "sources of funds" exceeds the "uses of funds", there is a surplus. This is a statutory definition of a "balanced budget", but such budget may not in fact be financially sustainable. For example, a budget that is balanced by including the use of **non-recurring revenue sources,** such as the use of capital project reserves or one-time pension trust transfers, to fund on-going expenditures is not "structurally balanced". A true structurally balanced budget is one that supports financial sustainability for multiple years into the future. The Council needs to be aware of the distinction between satisfying a statutory definition and achieving a true structurally balanced budget.

The FY 21 budget "surplus" presented by Staff has been artificially created by drawing down general fund reserves as shown below:

Operating deficit on schedule C-8	**$(7,429,224)**
Plus: Draw Down of Reserves	
Use of Pension Reserve	$3,270,342
Use of Capital Projects Reserve	$3,401,479
Use of Capital Projects – one-time	$769,308
"Surplus"	**$11,905**

This schedule shows that the operating deficit on schedule C-8 is "funded" by drawing down existing general fund reserves. There is nothing wrong with this because, this is how the budget must legally be balanced. Remember by law the Town must have a "balanced budget".

If the Town wanted to show an even greater "surplus", they could achieve this by increasing the draw-down of the capital project reserve. Essentially you can manufacture whatever "surplus" you want by drawing down even more general fund reserves.

While the statement that there is a "surplus" is technically correct, it does not answer the more important question, namely, is the FY 21 budget "structurally balanced"? To determine that we need to adjust out all one-time revenue sources and one-time expenditures to get to a "structural" view of the FY 21 budget.

2. The FY 21 General Fund budget has a "structural deficit" of ($1,374,237).

The structural deficit can be computed by (A) "adjusted" operating revenues **MINUS** (B) "adjusted operating expenses." This will eliminate one-time sources and uses of funds to arrive at a true "run-rate" view of operating revenues and expenditures.

Operating Revenues – C-8	**$45,751,230**
Less: One Time Sources	
Fund Transfers in	$616,834
Pass Through revenues	$532,500
Debt reimbursement	$1,908,494
Pension trust transfer	$962,158
Adjusted Operating Revenues	**$41,731,244**

Operating Expenditures – C-8	**$53,180,454**
Less: One Time Uses	
Transfers out	$3,401,479
Debt reimbursement	$1,908,494
Pension ADP	$4,232,500
Pass Through expenses	$532,500
Adjusted Operating Expenditures	**$43,105,481**
Structural operating Deficit	**$(1,374,237)**

Once one-time revenue and expenditure items are eliminated, the budget does not appear to be sustainable since "on going" spending levels exceed "on-going" revenue sources. Council should review all expenditures to determine if reductions can be made and thereby reduce the structural deficit.

3. The budget for salary and benefit expenditures is materially over-stated

Staff has historically overstated the expenditure budget for salary and benefits to create a "budget cushion" for unplanned revenue shortfalls. This was achieved by budgeting each staff position at the top step of the respective salary range, regardless of the actual pay rate, and neglecting to factor in a vacancy rate. In FY 20, the Staff is projecting a vacancy rate of 13%. Taken together, these budgeting practices have created a "budget cushion" annually in the range of $2m to $3m.

This practice is not in accordance with GFOA best practices. We highly recommend this should be immediately eliminated so that the Town conforms with GFOA best practices. **The budget should accurately reflect the Staff's best estimate of the expenditures for salary and benefits, not some inflated number.** We have attached for the Council's review the GFOA Best Practice Advisory entitled "Effective Budgeting of Salary and Wages.

You can see the impact of the Staff's current practice by comparing the estimated salary and benefit expenditure for FY 20 of $28,505,727 to the FY 21 budget of $31,579,000. This computes to an 11% increase, which Council (and Staff) may know is not correct. While a portion of this can be attributed to increasing benefit costs, we estimate that at least $2m of the $3.1m increase is due to inflated salary expenditures. The primary source of this "cushion" is failing to include a vacancy factor in the salary budget. Staff has forecasted a vacancy rate of 10% for FY 21 (D-50) but has not factored that into the salary budget. This needs to be corrected to give Council and the public more transparency, as well as clarity regarding our future financial status.

It should also be pointed out the FY 21 budget does not include any increase arising from the POA since negotiations have not concluded and the Staff has chosen not to reflect any estimate as to what that increase may be. We continue to believe that this could add an additional $500,000 to salary expenditures to FY 21.

4. **The General Fund Revenue forecast is optimistic when compared to other cities outlook and there is no scenario analysis**

Our review of the preliminary FY 21 budgets for several cities indicates that many are planning revenue declines ranging from 5% to 20% from the **prior year adopted budget**. We have found no cities that are planning the extremely modest decrease reflected in the FY 21 proposed general fund revenue budget. **To be specific, the proposed budget is reflecting only a $571,358 reduction in total revenues compared to the adopted FY 20 budget**. Frankly, this does not pass the credulity test. The Council will be assuming significant risk adopting a budget with the currently proposed level of expenditure based on the assumption that the Town will only experience a 1.3% decrease in total revenue.

It is also important for the Council to "stress test" the proposed revenue plan. If for instance, we were to assume that the revenues were to decrease just 7.5% (near the low end of the range other cities are expecting), this would result in an incremental revenue decline of $2.7m. Without any offsetting expense reductions, the structural deficit for FY 21 would increase to approximately $4m ($1.3m plus the $2.7m). The danger here is that this would be the "run-rate" deficit the Town would be facing entering into FY 22 not the breakeven scenario shown on schedule A-7.

The Los Gatos FY 21 plan is a point forecast and does not provide any scenarios for revenues and expenditures other than what has been modeled. The Staff references a sensitivity analysis that was performed in January with respect to revenues and expenditures which was used to help establish a "base" case. This base case was constructed prior to COVID 19 and the SIP order, and is of little use in trying to understand the impact of significant decrease in revenues from sales and use tax, TOT tax, licenses and permits and charges for Town Services in a post COVID 19 environment. Given the high degree of uncertainty, the Council should consider requesting the Staff to model 2 additional scenarios to "stress test" the Town's ability to withstand additional downside pressure on these specific revenue sources because of COVID 19.

One last caution, the Council should be skeptical of the sales and use tax forecasts provided by MuniServices. The FY 20 adopted budget for sales and use tax, which was based on MuniServices models, projected $8.1m in revenues. The Town has been under a SIP order now approaching 90 days, which has resulted in the shut-down of almost all retail transactions. This has had a material impact on Town's sales and use tax revenues. And yet the Staff is forecasting the Sales and Use tax revenue for FY 20 to be exactly "on plan" of $8.1m and is forecasting FY 21 to be flat to FY 20. It seems safe to say that the modeling of sales and use tax appears questionable.

5. **The GFAR total project (new plus carryforward programs) has increased over 45% from FY 2016 budget levels. Is this a reasonable level of capital improvement programs? Is there capacity to effectively manage this large number of capital programs?**

The combination of high carryforward amounts for previously approved capital projects ($13,461,002) coupled with new projects requests ($5,487,220) has pushed the GFAR total dollars programed to $18,948,222, a level that is 45% higher than FY 2016 capital improvement budget. The GFAR list contains 54 projects in all and excludes the Almond Grove project, which has been completed and removed from the project list.

However, at this point it is not known which of these projects, if any, have missed the original project completion date AND/OR have exceeded the original project authorization level. Council should review each project to determine if the project should be continued or scaled back and should request explanations for any project behind schedule and/or over budget.

Once a project is approved, the money is transferred to the GFAR where it resides until spent. Historically after the initial project approval review, very little if any time is spent by the Council re-evaluating the priority of these carryforward projects in subsequent years. This leads to an accumulation of dollars that are "reserved" by the GFAR and are not readily visible to the public for inspection and may not be consistent with the Town's current priorities.

For example, in FY 2016 the **third largest project** in dollar terms was a project to acquire the parking lot at 224 W Main (parking lot 6). At the time this was probably a worthy project. Every year the project was "carryforward" with incremental budget dollars added to the original request, but no action was taken. Finally, after four years, the decision was made to withdraw the project and make the $1,460,210 available for other uses. **We recommend these funds be immediately released by the GFAR and returned to the general fund where they can be reprogrammed for other uses.**

The Council needs to appreciate that there is an "opportunity" cost of holding excess funds in a capital program account that is no longer needed. If you think about how these funds could have been used vs. being held in a low interest account, the "opportunity cost" could be material. If for example the Town had withdrawn this project 2 years ago and redirected the funds to make an additional ADP to CALPERS, the Town could have saved over $200k in interest charges. The efficient allocation of our capital funds is critical and needs to be improved.

6. Is the GFAR CIP truly aligned with the Town's Strategic Priorities and provide transparency?

The top 5 capital programs for the FY 21 capital budget capture 55% of the requested $18.9m CIP budget. Two of those projects, Downtown revitalization for $1,972,384 and shed replacement in corporation yard for $977,613 do not appear to be aligned with the strategic priorities.

The downtown revitalization project is a massive undertaking which currently has no written plan that fully describes what exactly is going to be done and how this project aligns with the strategic priorities. There are no milestones associated with the proposed project and no cost details. The project background description provides no additional information other than "progress and expenditures on this project will occur only following ongoing discussions and direction from the Town Council". This is an excellent example of how dollars can be sequestered from public view. These dollars should have never been allocated to the GFAR but rather should remain in an assigned General Fund reserve where the dollars would be clearly visible to all. This would improve transparency and accountability. Only when the project was completely developed, including detailed project timelines, cost estimates and benefit analysis should the funds be transferred to the GFAR. This project is an excellent example of how not to use the GFAR.

By comparison, the GFAR CIP has only $250,000 programmed for roadside fire fuel reduction, which is directly tied to the strategic priority of fire safety. This program, while a step in the right direction, only begins to address the removal of many years of accumulated fuel load along hillside roadways. This is a real danger that if not fixed, will cost lives in the event of a hillside fire. The Council needs to look at these large dollar projects and make sure that they are really required and are consistent with the strategic priorities. **It is hard to reconcile setting aside $1.9m for the "beautification of the Town" and only $250k to "save the Town".**

The fifth largest project on a dollar basis in the FY 21 capital plan is the replacement of a shed on the corporation yard. This project (#2302) has been included in every GFAR CIP list since FY 2016. The original project was for $420k and was to be completed in the fall of 2016. The project description is essentially the same today as it was when first approved in FY 2016.

Each budget cycle the budget dollars fluctuated and finally have reached a total of $977,613, over 2 times the original project cost. The project completion date is now Spring 2021. This is another example of where projects seem to take on a life of their own once initially approved. If this was such an important project to be approved in FY 2016 but nothing was done to complete the project for over 4 years, why do we still need to spend the dollars? Why is this the fifth largest project this year and how does it tie to the Town's strategic priorities? These are reasonable questions for the Council to have answered.

While I am sure that there is a valid explanation, the point is that these "carryforward" projects have very little inspection and once approved, will sit in the CIP budget. Therefore, the carryforward dollars for the GFAR have materially grown since FY 2016.

Conclusion

It is our recommendation that the Council send the current draft of the FY 21 operating budget back to Staff with the direction to fine tune the revenue forecast and salary expenditure forecast and address the issues that have been pointed out. Once this is done, the Council will have a better understanding of the size of the structural deficit we are facing in FY21. Frankly, we are not surprised we are facing structural deficits given the magnitude of the impact of COVID 19.

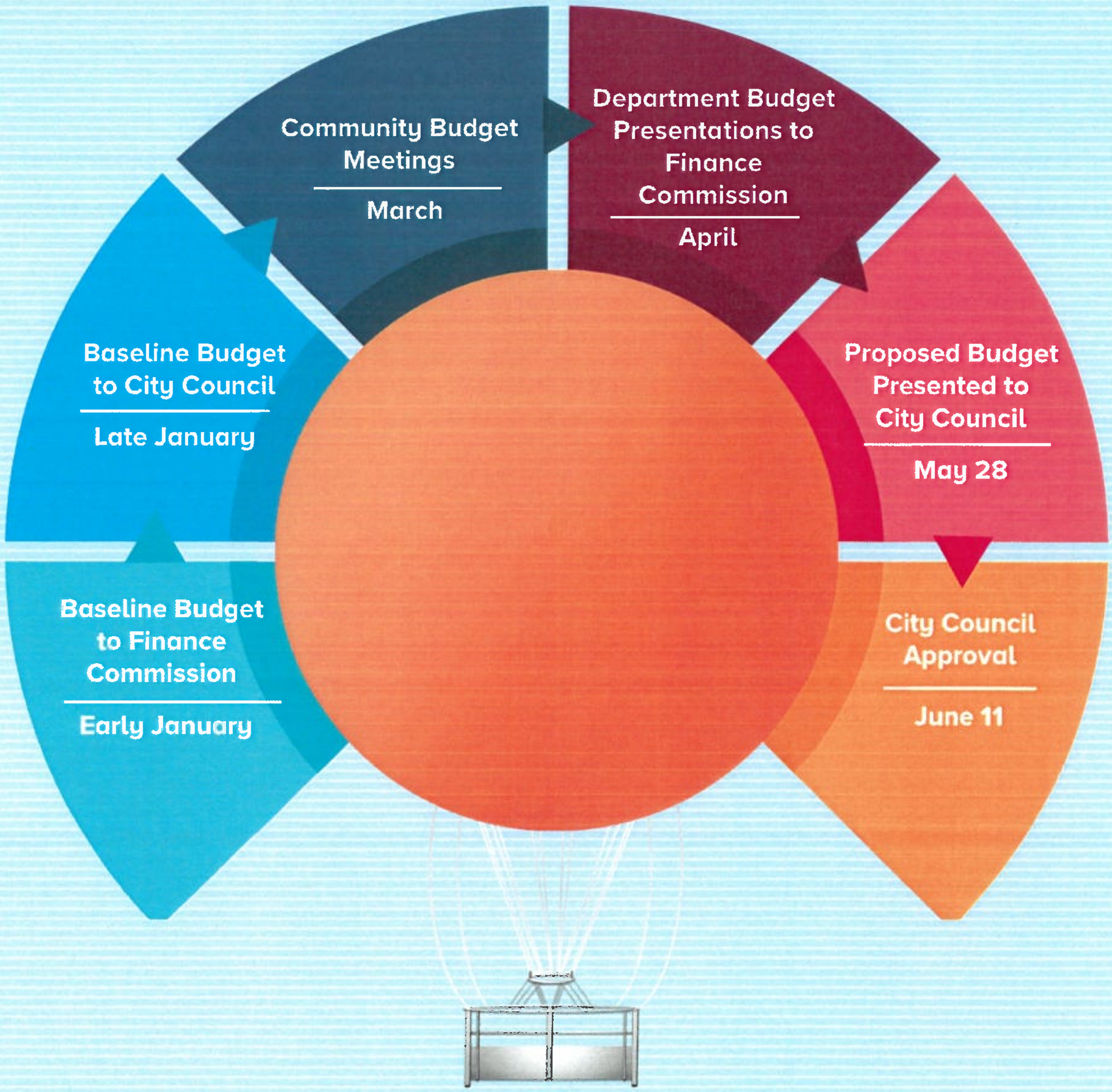
The good news is the Town has sufficient reserves to navigate through this challenging time, and if necessary, the Council should tap these "rainy day" reserves to backfill the current revenue shortfall. Of course, if we do use these reserves, future budgets must address how to restore the reserves to their proper level.

Please let us know if you have any questions on this memo.

Thank you.

Los Gatos Community Alliance

Budget Development Cycle



For more information about the City's budget, join us at Community Budget Meetings.

Community Budget Meetings		
March 5	Lakeview Senior Center	4–5 p.m.
March 6	Orange County Great Park Artist Studios	6–7 p.m.
March 13	Quail Hill Community Center	6–7 p.m.
March 20	Portola Springs Community Center	6–7 p.m.

Visit cityofirvine.org/budget for additional details and to view our budget video.

Irvine Transitions to a Two-Year Budget

Developed in the Context of a Five-Year Plan

Join the City of Irvine in 2019 on its journey to enhance long-term financial planning by transitioning to a two-year budget developed in the context of a comprehensive five-year financial plan.

Why Change the Budget Cycle?

Multi-year financial planning, ongoing monitoring, frequent reporting, and prompt corrective actions when necessary are central elements of sound financial management.

The two-year budget process allows for a more stringent approach to analyzing data, tracking trends and potential problems, and calling for corrective budget action much earlier than in years past. This new enhanced financial planning approach will improve the City's long-term financial management, while also strengthening community engagement.

How Will It Work?

The City currently utilizes a multi-year forecast through the preparation of the five-year Strategic Business Plan and updates the forecast annually as part of the City's budget process. The forecast will be enhanced with greater department details and will continue to provide a long-term look at the City's financial condition and guidance for the two-year budget.

The two-year budget will be developed within the longer-term context of the five-year Strategic Business Plan. During the first year of the two-year cycle, the City Council will receive quarterly revenue and expenditure updates, bringing forward any areas of concern. At the conclusion of the first year of the two-year cycle, the City Council will receive a mid-cycle review of year-end financials. The mid-cycle review process will provide the mechanism to:

1. Ensure that revenue and expenses forecasted at the beginning of the first year remain accurate;
2. Amend the budget to address any significant revenue shortages and/or unknown and unforeseeable expenses; and
3. Allow departments to carryover first-year balances from discretionary savings.

Who Will Review the Budget?

The creation of the City's two-year budget will begin with the Finance Commission reviewing the initial baseline budget in January, followed by the City Council. After receiving input from the community, departments will present detailed and balanced budgets, along with longer-term plans to the Finance Commission in April. Following Commission input, the citywide two-year budget and five-year plan will be presented to the City Council in May for adoption in June 2019.

How Can I Get Involved?

1. Engage with us at a Community Budget Meeting. Please view the back page.
2. Visit cityofirvine.org/budget to view additional materials, including an informational budget development video.
3. Contact the Budget Office with questions at budget@cityofirvine.org.
4. Learn more about the City's continued efforts of fiscal responsibility at our Transparency Portal, cityofirvine.org/transparency.

Resources
- Best Practices/Advisories
- Public Policy Statements
- E-Books
- Publications
- Other Products
- Government Finance Review
- Research Reports
- Resource Centers
- Federal Government Relations
- Canadian Finance
- News and Newsletters

Consulting
- Consulting Services
- Custom Research

Education
- Search for Classes
- CPE Guide
- Guide for Instructors
- Leadership Academy
- Education Policies

Effective Budgeting of Salary and Wages

Printer-friendly version

Type: Best Practice

Background:

Given the funding constraints governments are facing, accurate expenditure projections are more important than ever. Since salaries make up the greatest portion of the expenditure budget, it is logical to apply forecasting techniques that can provide a true picture of where payroll dollars are headed. Another consequence of slowing revenues is the need for greater control over expenditures. Governments can use various mechanisms to manage headcount levels in light of cost constraints.

Recommendation:

GFOA encourages every government to consider forecasting procedures that would result in more accurate expenditure projections, especially as they relate to personnel. The items shown below provide governments with the areas in which they should consider adopting practices to more effectively budget salary and wages. Additionally, in order to analyze total compensation, benefits need to be considered.

Personnel Tracking System. Budget payroll projections are based on the estimate of budgeted positions for the year, so providing the correct number of budgeted positions is important. The system to track budgeted positions may reside in the human resources department rather than the budget department, so it is vital that the departments work together to be consistent in reporting. The system should be able to track all types of employees, not just full-time.

Vacancy Adjustments. Not all positions will be filled 52 weeks per year, so expected vacancies need to be addressed in the salary budget. In doing so, however, governments should consider developing policies on how to treat these vacancies. If the government fully funds salaries associated with vacancies, it is building some potential cushion into the budget. Items to consider:

- **Start Dates.** Expected start dates for open positions may vary. Keeping track of those assumptions is important because a large dollar variance may result when an actual start date differs from the budgeted date.
- **Trends.** Since most governments experience some vacancies during the year, it may be prudent to include a hiring lag in the budget. One way to determine the dollar impact of this lag is to review trends (average filled positions per year versus average vacant positions). This analysis can be conducted at the department level or broken out by individual position. In forecasting open positions, organizations should keep in mind that technical or higher level positions are usually harder to fill.
- **Frozen or Eliminated Positions.** Many open positions are intentionally being left vacant. While some of these positions may be eliminated before the start of the fiscal year, other positions may be temporarily frozen once the fiscal year begins. The dollars saved by not filling these positions should be quantified. If the positions being eliminated are currently filled, then the government might also need to include severance payouts in the budget. Governments are also using furloughs as a means to reduce expenditures. Those cost savings should be identified as well.
- **Funded Versus Unfunded Positions.** Not every position that is requested gets approved. Approved, or funded, positions along with the money to pay for them are included in the budget. Unfunded positions, or those that were requested but not approved, should be noted, especially if management decides at some point to reconsider some of those denied position requests. Departments often include new positions in their budget requests, typically in the departmental request stage. In detailing new positions in the final budget presentation, it is useful to categorize them as funded or unfunded. This way, budget decision makers can clearly identify those unfilled positions that do not have budget dollars available. The budgetary implications of not funding those positions could also be shown.
- **Attrition (Planned Retirements).** Budget consideration should be given for those positions where employees have indicated specific retirement dates. Payouts need to be budgeted. Also, if governments use retirement incentives, the potential loss in quality of service should be considered.

Collective Bargaining Units. When the personnel budget is being developed, the positions that are covered under collective bargaining should be noted. The group name and representation should be identified, along with the beginning and end date of the contract. Also, the government should use consistent terminology when referring to union and non-union payroll items.

- **Contract Settlements.** Be aware of key dates in contract provisions. It may be prudent to set aside reserves for contact settlements, especially if the new terms are expected to be less favorable than those in the existing contracts.
- **Other Considerations.** Some union agreements include items such as overtime, holiday premiums, shift differentials, uniform allowances, and license/certification pay. These should also be accounted for in the budget, as failure to do so could lead to significant cost overruns.

Impact of Inflation. Inflation can have a significant impact on payroll forecasting. Cost-of-living adjustments often are used when forecasting personnel costs. The Consumer Price Index (CPI), a broad measure of consumer inflation, is the cost-of-living index used most often for determining salary increases. The U.S. Bureau of Labor Statistics Employment Cost Index might be a better index for this purpose, as it measures the change in the cost of labor, free from the influence of employment shifts among occupations and industries.

Optimal Staffing Level. One of the biggest challenges a government will face is determining the optimal level of staff needed to meet the organizations goals and objectives.

- **Comparison to Other Governments.** Some governments use a population-to-employee ratio to indicate proper staffing levels. Jurisdictions can compare themselves with surrounding communities and even specific departments, although the effects of privatization can skew such a comparison.
- **Staffing Guidelines.** The organization might have specific policy guidelines that serve as a basis for determining hiring levels. For example, some school districts set up support staffing sheets to specify what personnel can be hired. Hiring levels might be based on such factors as the number of schools in a district, the size of an individual school in square feet, or a schools enrollment.
- **Classifying Positions by Goal.** Hiring decisions should be made to fulfill strategic initiatives, based on clear goals and specific action plans that have been established to help accomplish those goals. Most governments budget personnel by department. A number of governments have moved beyond this traditional approach, however, and started to classify positions in other ways.
- **Use of Volunteers.** It is becoming increasingly common to encourage the use of volunteers in certain programs and services. Fire department staffing provides a classic example of volunteer usage.
- **Seasonal and Temporary Positions.** Some divisions or jurisdictions use part-time or seasonal employees. Park districts, for example, often adjust staffing levels by season.
- **Other Considerations.** Some governments make more use of overtime as an option instead of hiring fulltime workers. The use of retired employees for contractual services is another alternative to adding headcount.

Compensation Approaches. When analyzing budgeted position compensation, the following items should be considered:

- **Step and Grade Systems.** Many governments use a salary range or grade structure for budgeting individual positions. Others, however, have begun to transition away from longevity-based systems in favor of pay for performance systems.
- **Pay for Performance.** Pay for performance is intended to foster workplace productivity. The anticipated impact comes from the ability to reward performance and thereby attract and retain quality employees. A onetime bonus is an option to reward productivity and is sometimes used in lieu of a pay increase. Pay for performance faces a number of challenges, including the cost of monitoring employee performance and the design of a useful appraisal system.
- **Wage Surveys.** Monitoring the average wage increases in other jurisdictions can help a government determine the appropriate level and validity of salary range or grade structures for its own annual salary increases. This information can be obtained by subscribing to government- or industry-specific journals, engaging a consultant, reviewing peer government budget documents, or contacting other governments directly to ask questions.

Personnel Categorization. A traditional way of approaching the personnel budget is the view that each position directly affects the operating budget. This may not always be true, however.

- **Capital versus Operating Classification.** Consideration should be given to the percentage of time that an individual may be working on capital versus operating projects.
- **Cost Allocation.** A similar approach to moving personnel expenses out of the operating budget is the use of a well-developed cost allocation plan. Such a plan allows the government to shift costs to specific activities.
- **Funding Sources.** If a new position is created based on an outside funding source, care should be taken to ensure that the source is not a one-time occurrence.
- **Privatization or Shared Services.** To save money or improve services, many governments have turned to the private sector or to other governments as alternatives to in-house service delivery or staffing. The services most often provided collaboratively include health and human services, transit systems, airports, sewage collection, disposal of hazardous wastes, libraries, tax assessing, and title records.

Monitoring. Governments need to monitor the salary and wages budget through the year, not just when the budget is being put together. Should actual results deviate from the budget in a significant fashion, then djustments need to be made.

Committee: Governmental Budgeting and Fiscal Policy **(BUDGET)**

References:
- GFOA Best Practice: *Examining the Benefits of Managed Competition*, 2006.
- GFOA Best Practice: *Budgeting for Results and Outcomes*, 2007.
- GFOA Best Practice: *Alternative Service Delivery: Examining the Benefits of Shared Services*, 2008.

Approved by GFOA's Executive Board: March 2010

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Achieving a Structurally Balanced Budget

Printer-friendly version

Type: Best Practice

Background:

Most state and local governments are subject to a requirement to pass a balanced budget. However, a budget that may fit the statutory definition of a balanced budget may not, in fact, be financially sustainable. For example, a budget that is balanced by such standards could include the use of non-recurring resources, such as asset sales or reserves, to fund ongoing expenditures, and thus not be in structural balance. A true structurally balanced budget is one that supports financial sustainability for multiple years into the future. A government needs to make sure that it is aware of the distinction between satisfying the statutory definition and achieving a true structurally balanced budget.

Recommendation:

GFOA recommends that governments adopt rigorous policies, for all operating funds,[1] aimed at achieving and maintaining a structurally balanced budget. The policy should include parameters for achieving and maintaining structural balance where recurring revenues are equal to recurring expenditures in the adopted budget.

As a first step, the government should identify key items related to structural balance. These include: *recurring and non-recurring revenues, recurring and non-recurring expenditures, and reserves.*

Recurring revenues are the portion of a governments revenues that can reasonably be expected to continue year to year, with some degree of predictability. Property taxes are an example of recurring revenue. A settlement from a lawsuit is a good example of non-recurring revenue.

Some revenue sources may have both non-recurring and recurring components. These sources require finance officials to exercise judgment in determining how much of the source is truly recurring. For instance, a government may regularly receive sales tax revenues, but a large part of its base may be made up of retailers with highly volatile sales. In this case, it may be prudent to regard unusually high revenue yields as a non-recurring revenue under the assumption that such revenues are unlikely to continue, making it imprudent to use them for recurring expenditures. Another example might be building permit revenues in a period of high growth in the community. Governments should review their revenue portfolio to identify non-recurring revenues and revenues with potentially volatile components, such as the examples above.

Recurring expenditures appear in the budget each year. Salaries, benefits, materials and services, and asset maintenance costs are common examples of recurring expenditures. Capital asset acquisitions are typically not thought of as recurring because although some capital assets may be acquired every year, they are not the same assets year after year. In general, recurring expenditures should be those that you expect to fund every year in order to maintain current/status quo service levels. In general, a government has a greater degree of flexibility to defer non-recurring expenditures than recurring ones.

Reserves are the portion of fund balance that is set aside as hedge against risk. The government should define a minimum amount of funds it will hold in reserve.[2] This serves as a bottom line measure to help determine the extent to which structural balance goals are being achieved. If reserves are maintained at their desired levels, it is an indication that the organization is maintaining a structurally balanced budget. If reserves are declining, it may indicate an imbalance in the budget (e.g., if reserves are being used to fund on-going expenditures). It should be noted that reserves levels are not a perfect measure of structural balance, but are a good and readily available measure.

With the forgoing terms defined, a government should adopt a formal policy calling for structural balance of the budget. The policy should call for the budget to be structurally balanced, where recurring revenues equal or exceed recurring expenditures. The policy should also call for the budget presentation to identify how recurring revenues are aligned with or not aligned with recurring expenditures.[3]

For a variety of reasons, true structural balance may not be possible for a government at a given time. In such a case, using reserves to balance the budget may be considered but only in the context of a plan to return to structural balance, replenish fund balance, and ultimately remediate the negative impacts of any other short-term balancing actions that may be taken. Further, the plan should be clear about the time period over which returning to structural balance, replenishing reserves, and remediating the negative impacts of balancing actions are to occur.[4]

Committee: Governmental Budgeting and Fiscal Policy **(BUDGET)**

Notes:

[1] Note that this Best Practice excludes non-operating funds like capital and debt funds. While governments should ensure that these funds are financially sustainable as well, the specific recommendations found in this Best Practice may not always be a match to the circumstances of non-operating funds.

[2] See GFOA Best Practice Determining the Appropriate Level of Unrestricted Fund Balance in the General Fund (2002 and 2009). 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 of regular general fund operating revenues or regular general fund operating expenditures

[3] Please note that the best practice is not advocating that recurring revenues be formally allocated or earmarked to recurring expenditures, but rather is advocating that the budget presentation provide transparency as to whether recurring revenues and recurring expenditures are balanced.

[4] See GFOA Best Practice Replenishing Fund Balance in the General Fund. (2011).

The County of San Diego, CA was awarded the GFOA Award for Excellence for outsanding use of GFOA's Best Practice on Public Achieving a Structurally Balanced Budget. To learn more about the County's implementation process, please visit their award page.

Approved by GFOA's Executive Board: February 2012

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