



**TOWN OF LOS GATOS**  
**FINANCE COMMISSION**  
**SUBCOMMITTEE REPORT**

MEETING DATE: 07/29/2021

ITEM NO: 2

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DATE: July 21, 2021  
TO: Finance Commission Subcommittee  
FROM: Laurel Prevetti, Town Manager  
SUBJECT: Receive Information on Town Financial Policies, Procedures, and Processes

**RECOMMENDATION:**

Receive Information on Town Financial Policies, Procedures, and Processes.

**BACKGROUND:**

On June 30, 2021, the Finance Commission Subcommittee requested information regarding the process steps to prepare the Town's primary financial documents. Staff volunteered to prepare process flow diagrams and associated narrative for the next meeting. In addition, Subcommittee members also asked staff to identify other relevant existing financial policies, procedures, and processes.

The Town has a wide variety of financial policies, processes, practices, and procedures which can be segregated between Council adopted policies and internal procedures and processes. This report provides information related to both areas.

This report is organized as follows:

- Overview of the Relationship between the Comprehensive Annual Financial Report and the Annual Budget Process
- Operating Budget Preparation
- Capital Budget Process
- Overview of Internal Accounting and Financial Reporting
- Accounting Activities
- Financial Reporting and Comprehensive Annual Financial Report Process
- Council Adopted Financial Policies

**PREPARED BY:** Arn Andrews  
Assistant Town Manager

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Reviewed by: Town Manager, Town Attorney, and Finance Director

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If the Subcommittee wishes to have any elements of the report broken out in greater detail, staff can provide this at subsequent meetings.

DISCUSSION:

Overview of the Relationship Between the Comprehensive Annual Financial Report and the Annual Operating and Capital Budget Processes

As previously noted at Finance Commission and Subcommittee meetings, the Town follows a financial rhythm which starts with the adoption of the completed Comprehensive Annual Financial Report (Annual Report) and the identification of any surpluses or deficits resulting at year end of the prior fiscal year. This year end information is integrated into Council's annual discussion of Strategic Priorities to provide budget direction for the potential use(s) of any surpluses in the next fiscal year's budget.

Subsequently, the Council considers the Mid-Year Budget Review for the current fiscal year, evaluating revenue and expenditure trends for the first six months against the adopted Budget. Typically, at the same evening as the Mid-Year Review, the Council receives an updated Five-Year Forecast with sensitivity analysis for major revenue and expenditure assumptions. The Council is provided the opportunity to give budget direction based on the forecast.

All of these discussions inform the development of the following year's Proposed Operating and Capital Budgets. The illustration in Attachment 1 summarizes the annual year end closure and how it relates to development of Operating and Capital Budgets.

Operating Budget Preparation

As illustrated on the following pages, the development of the Operating Budget is a compilation of yearlong endeavors. While not represented in the flow chart, the evaluation of the Mid-year Budget becomes the basis of the Five-Year Forecast (Attachment 2) because it contains the most current data on revenues and expenditures. The Forecast enables the Town to evaluate the Town's longer-term fiscal condition to help guide policy, programmatic planning, and budget decisions. Its purpose is to identify financial trends, potential shortfalls, and other issues so the Town can proactively address them and budget accordingly.

The Forecast contains detailed information that contributes to the preparation of the annual Operating Budget, including the Town's "Base Case" Five Year Forecast, its data sources, and budget assumptions. In addition, the Forecast utilizes empirical data from our hoteliers/AirBNB, County Tax Assessor, Sales Tax consultant, and CalPERS (on the expense side) among other sources. The assumptions utilized in developing the most recent Forecast can be found starting on page A-21 of the FY 2021/22 Proposed Operating Budget.

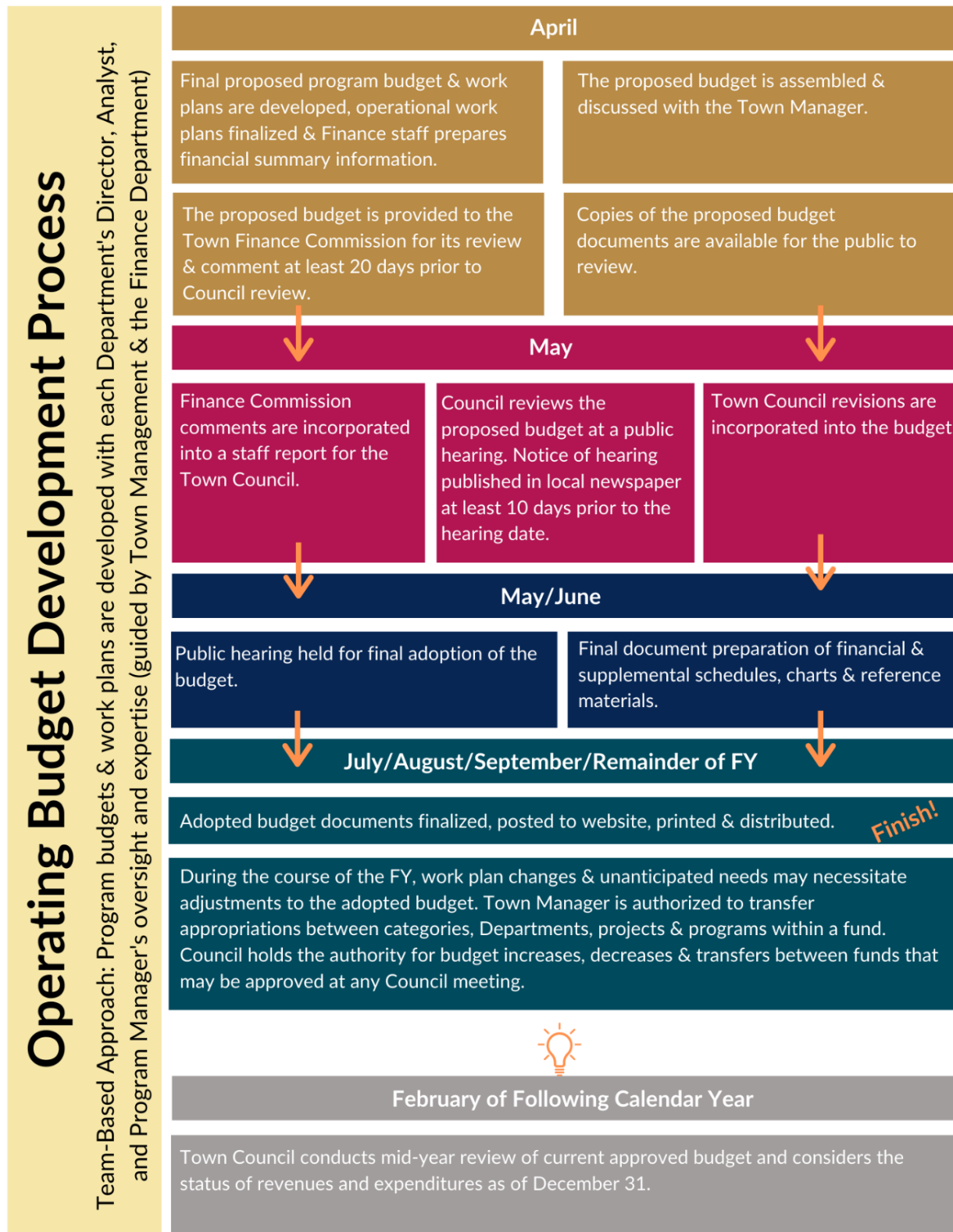
DISCUSSION (continued):

# Operating Budget Development Process

Team-Based Approach: Program budgets & work plans are developed with each Department's Director, Analyst, and Program Manager's oversight and expertise (guided by Town Management & the Finance Department)



DISCUSSION (continued):



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DISCUSSION (continued):

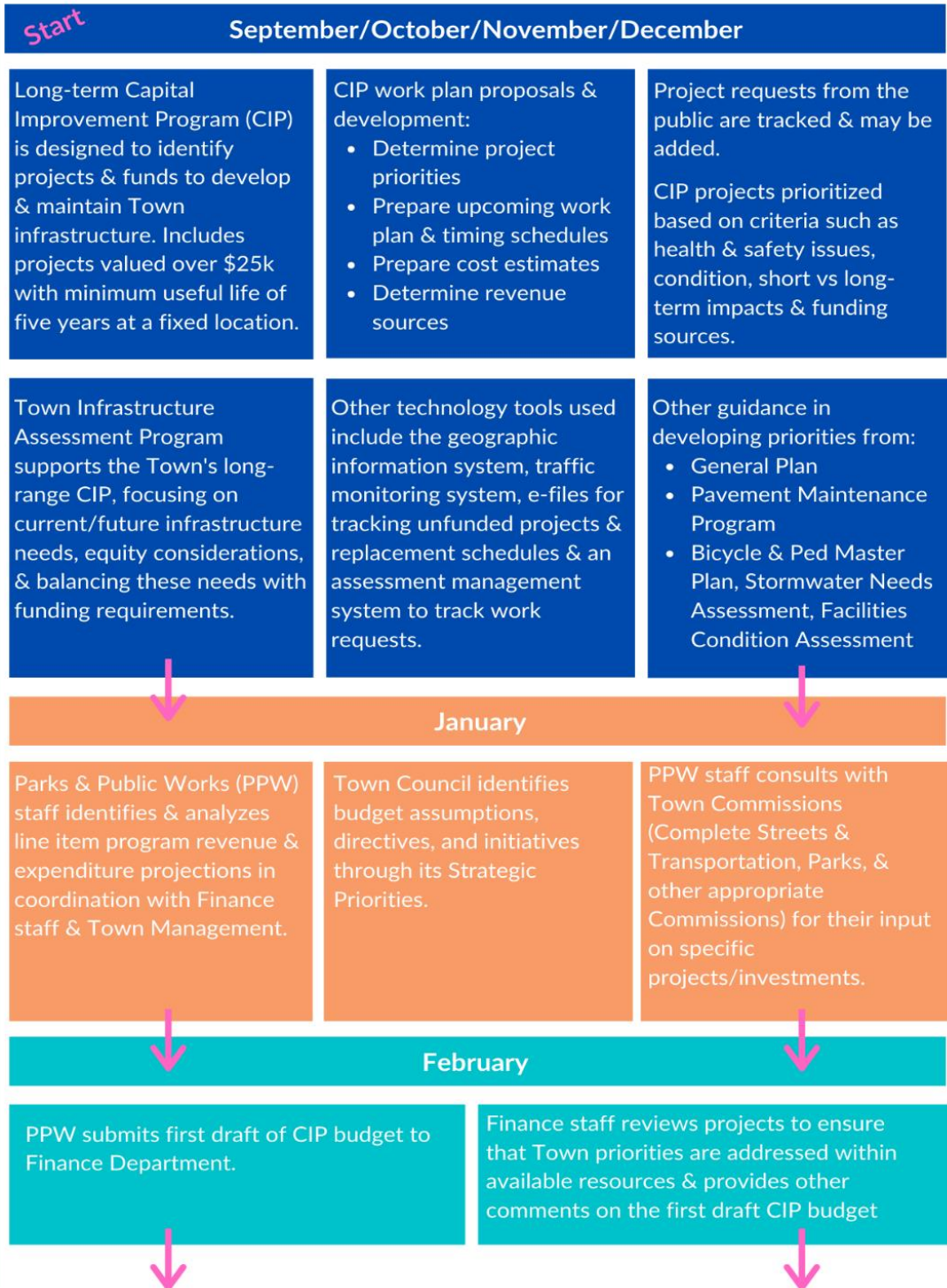
Capital Budget Preparation

The Capital Improvement Program (CIP) is a comprehensive five-year plan designed to identify projects to develop and maintain the Town's infrastructure, consistent with the Town Council Core Goals of high quality infrastructure, community character, public safety, fiscal stability, good governance, and civic enrichment. The CIP development process is illustrated on the following pages.

DISCUSSION (continued):

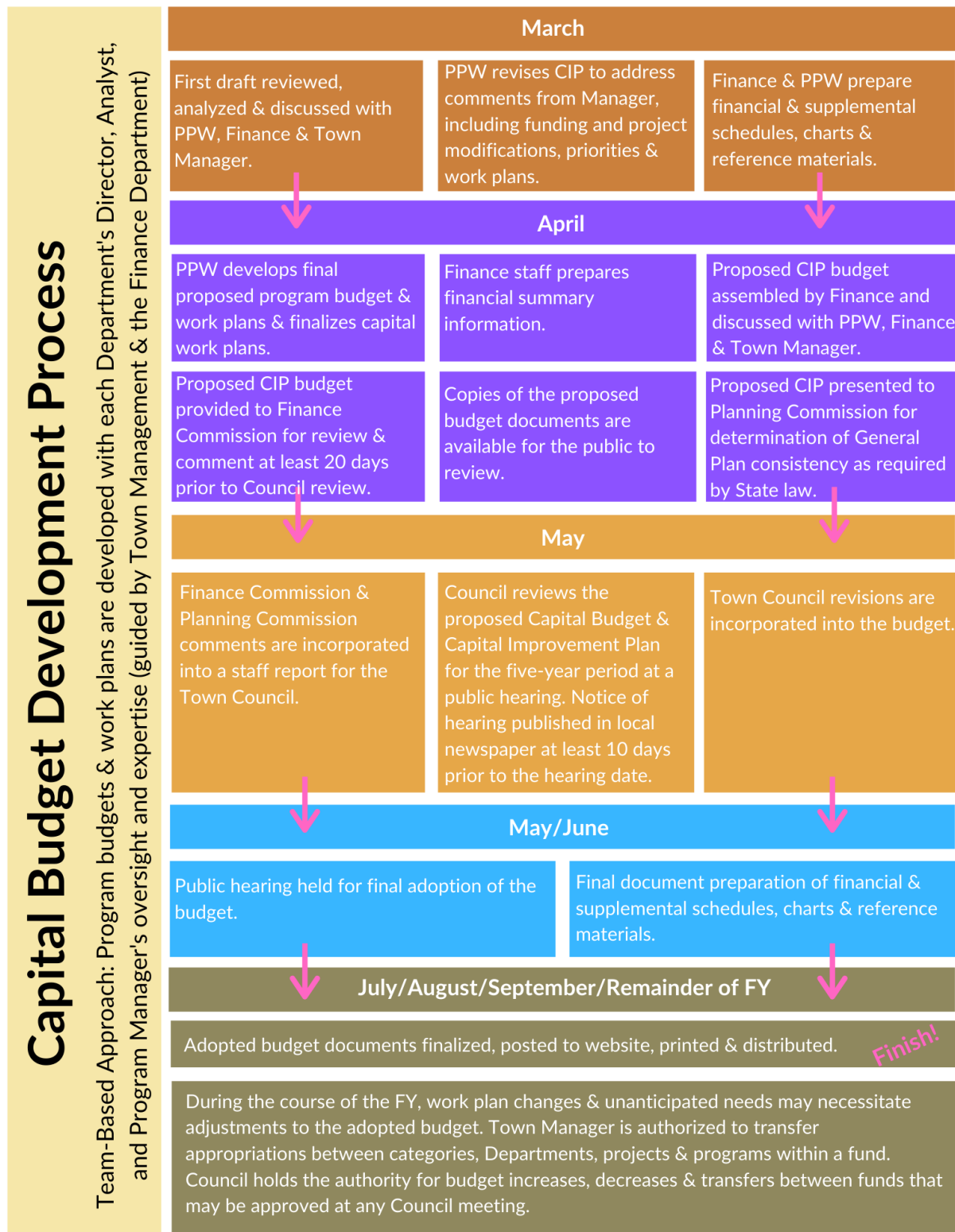
# Capital Budget Development Process

Team-Based Approach: Program budgets & work plans are developed with each Department's Director, Analyst, and Program Manager's oversight and expertise (guided by Town Management & the Finance Department)





DISCUSSION (continued):



DISCUSSION (continued):

Overview of Internal Accounting and Financial Reporting

The Town's finance accounting activities center around the process of assembling, analyzing, classifying, and recording data relevant to financial transactions and events that affect the government's financial position. The Finance Department also publishes financial reports including annual budgets, capital improvement plans, and audited annual financial reports which utilize the financial information thus assembled and provided to the Los Gatos residents as required by State law. Accounting and financial reporting activities are complementary rather than identical endeavors.

The audit is conducted in two phases, interim and final audit. The interim audit is conducted in late spring prior to the fiscal year end, testing internal controls and processes. The final audit is conducted after the close of the fiscal year in the fall after all financial transactions of the year audited are completed and entered to the Town's financial system.

Accounting Activities

During each fiscal year, Finance staff enters all financial transactions on a monthly basis to the Town's financial system/general ledger. These entries include recurrent postings from all of the Town's financial system modules such as payroll, accounts payable, cash receipts, and accounts receivable; and monthly journal entries as per the normal monthly accounting cycle. Provided below are high level discussions of Town revenue and expense financial activities and volumes of selected transaction activity to better describe the overall Town financial activity typically encountered in a fiscal year.

*Revenues*

Revenues are typically recorded from the following major sources. Cash receipts recorded through Departmental public counter cash registers, checks received by mail to the Finance Department, online charges by the use of credit cards, and wire transfers received by the Town. The majority of wire transfers are from the County of Santa Clara or the State of California. Five Departments have cash registers at locations where services are delivered to the public.

The Finance Department also creates invoices for miscellaneous services and receivables to assist the Departments who need to bill their customers for services provided. Internal controls required for cash receipts include the daily cashing out of all cash registers with Departmental deposits reconciled against the register reports generated by the Town's financial system. The Finance Department verifies the Departmental deposits as a redundant check to ensure accuracy of the deposit. Once deposits are verified, a combined deposit package is prepared for submittal to the bank.



DISCUSSION (continued):

Presented below is a table of revenues by type and descriptions of the typical sources of this revenue paid to the Town.

Type of Revenues				
Wire Transfers	Checks (Receivables or Other Items)	Credit Card Received at public counters	Online Payments	Cash
SCC County-Property Tax State of CA-Sales Tax	Services to the public including building, planning, public works, library and police and business licenses/hotel tax	Services to the public including building, planning, public works, library police, and business license tax.	Park reservations and some building and planning permits.	Services to the public including building, planning, public works, library and police

To provide some insight into the transactions recorded through the cash receipts received through the Town’s cash registers, below are tables depicting cash receipts volume activity for the past two fiscal years ending June 30, 2020 and June 30, 2021. FY 2019/20 volumes indicate a partial fiscal year impact by the COVID pandemic and Town offices were closed for many public counter transactions during FY 2020/21.

FY 2019/20							
Cash Registers	Cash	Check	Credit Card	Online Building & Planning	Online School Bus/Library Fine	Total	Daily Avg - 260 Working Day
Finance Department	\$ 2,209	\$ 11,934,848	\$ -	\$ -	\$ -	\$ 11,937,057	\$ 45,912
Building/Planning Department	\$ 13,279	\$ 2,721,884	\$ 682,462	\$ 418,609	\$ -	\$ 3,836,234	\$ 14,755
Engineering Department	\$ 1,030	\$ 654,108	\$ 82,373	\$ -	\$ 13,479	\$ 750,990	\$ 2,888
Library Department	\$ 7,254	\$ 97	\$ 3,543	\$ -	\$ 688	\$ 11,583	\$ 45
Police Department	\$ 6,558	\$ 65,786	\$ 21,077	\$ -	\$ -	\$ 93,420	\$ 359
Parks & Public Works Department	\$ 9,694	\$ 42,224	\$ 4,210	\$ -	\$ -	\$ 56,128	\$ 216

FY 2020/21							
Cash Registers	Cash	Check	Credit Card	Online Building & Planning	Online School Bus/Library Fine (Discontinued)	Total	Daily Avg - 260 Working Day
Finance Department	\$ 2,748	\$ 11,877,804	\$ -	\$ -		\$ 11,880,552	\$ 45,694
Building/Planning Department	\$ 0	\$ 883,654	\$ -	\$ 3,032,599		\$ 3,916,253	\$ 15,063
Engineering Department	\$ -	\$ 444,672	\$ -	\$ -		\$ 444,672	\$ 1,710
Library Department	\$ -	\$ -	\$ -	\$ -		\$ -	\$ -
Police Department	\$ 3,884	\$ 38,387	\$ 6,711	\$ -		\$ 48,982	\$ 188
Parks & Public Works Department	\$ -	\$ 14,501	\$ -	\$ -		\$ 14,501	\$ 56

DISCUSSION (continued):

*Expenditure Activities*

Town expenditures and disbursements typically originate from four primary sources: payroll direct deposits, accounts payable for approved purchase orders and agreements, credit cards for approved card holder dollar limits, and wires out for disbursements (such as bi-weekly pension payments due to CalPERS, debt service payments to trustees to make debt service payment to bondholders, and pre-funding deposits made to CalPERS for OPEB and pension liabilities). All disbursement requests (invoices, use of Town credit cards, timesheets) are reviewed and approved by the Departments' management and are forwarded to the Finance Department for final approval and processing. Additional nonrecurring miscellaneous wires require three levels of approval including the approval by the Town Manager. Provided below is a table illustrating approximate transaction volume for each disbursement method.

Type of Disbursements				
Descriptions	Credit Card	Wire Transfers	Direct Deposit	Checks
Approximate Annual Volume	Approximately 1,700 annual transactions (average transaction amount was \$66 for FY 20/21)	Approximately 250 transactions In FY 20/21.	4,836 payroll direct deposit slips issued In FY 20/21	Approximately 7,000 annual accounts payable entries entered 3,120 checks issued

Financial Reporting and Comprehensive Annual Financial Report Process

Subsequent to June 30 of each Fiscal Year (FY), staff opens period 13 of the prior fiscal year. Period 13 is utilized in the Town's financial system to make accrual journal entries affecting the general ledger of the prior fiscal year. Entries are typically generated from the actions necessary to complete the close of the Town's fiscal year as delineated by Finance Department staff's use of the Town's fiscal year closing checklist. The checklist specifies the required closing entries necessary to be generated for all general ledger account balances at the close of each FY. This checklist is reviewed and updated by all Finance staff each year before commencement of the fiscal year closing activities. Typical closing entries include the accrual of expenditures made in the new fiscal year for expenses that per the invoices were actually incurred in the prior fiscal year.

Revenues received early in the new fiscal year are carefully reviewed to record them as prior fiscal year revenues if they were actually earned the prior fiscal. Changes to accrued liabilities and receivables are also journalized and adjusted at fiscal year-end. Additionally, the Town

DISCUSSION (continued):

calculates and records changes to its fixed assets and infrastructure including additions and deletions of infrastructure and calculation of annual depreciation.

Upon completion of all required journal entries to period 13, a preliminary final general ledger trial balance is prepared that is provided to the Town's independent Auditor. This trial balance is used by the Auditor typically in late September or early October each fiscal year as they conduct the final phase of their audit.

Finance Department staff uses the same trial balance provided to the Auditor to prepare the Town's preliminary financial statements. These statements are prepared using a trial balance downloaded from the Town's financial system. The financial report model is a custom staff-developed Excel model. This is typical for most smaller governments who have the skill and knowledge to prepare their own financial statements but not necessary more costly financial management systems.

Upon completion of the final audit, the Town's independent Auditor use the final trial balance to prepare the draft financial statements on their own proprietary system. The draft financial reports that were independently prepared by the Auditor are delivered to Town Finance Department staff for review. Staff's review of the Auditor's draft financials has been made more effective through the ability of staff to compare the Auditor's draft financial statements to staff's draft financial statements derived using its Excel based model. This redundant parallel procedure has proven to be an effective double check of the draft financials prepared by the Auditor. Any differences in the draft financials are identified and then resolved between the Auditors and the Finance Department staff.

Simultaneously to the development of the draft financials, Finance Department staff prepares the draft Introductory section of the Comprehensive Annual Financial Report (Annual Financial Report or Annual Report) which includes the Town Manager's Transmittal Letter. Finance Department staff also prepares the entire Statistical Section of the Annual Report. Concurrently, Finance Department staff utilizes its internal financials to initiate preparing the Management's Discussion and Analysis (MD&A) section of the financial statements. The MD&A provides the financial statement reader more in-depth analysis of the Town's financial reports and includes comparisons to balances reported in the prior fiscal year.

The Auditor then assists staff in developing draft footnotes that provide additional information relating to the balances reported on the draft financials and other pertinent information regarding the Town's financial position. Finance Department staff assists in this effort by providing updates to the notes and reviewing all notes with any edits and or additions or deletions agreed upon between staff and the Auditor. The Town Manager's Office reviews and provides comments/edits on the administrative draft of the entire Annual Report.

DISCUSSION (continued):

Upon completion of the three primary sections of the Annual Report (Introduction, Financial, and Statistical sections) and review by the Town Manager's Office, a final draft is prepared by the Auditor for review by the Town's Finance Commission. Once the document is ready for the Finance Commission, it is publicly available for the entire community. Upon completion of the Commission's review, any edits are made by the Auditor prior to submittal to the Town Council.

Beginning in 2021, the Town will be following the additional requirements of Measure A which provides for the Finance Commission to identify specific recommendations and comments. The Town Manager is required to respond in writing to the Commission's recommendations and comments. As needed, the Auditor may need to participate in these responses. These comments and responses are provided to the Commission.

The Commission's comments and recommendations and the Manager's responses are provided to the Town Council in its consideration to receive the Annual Report. This Council meeting is typically the last meeting in December. The Final Annual Report is archived to the Town's Financial Transparency website along with past Annual Reports, Budgets, and other related information.

Council Adopted Policies

All of the following Policies are available on the Town's website. In addition, several are published annually with the Proposed Operating Budget to provide additional transparency on the direction that is followed for the Town's financial matters. The page numbers for those listed below correlate to the FY 2021/22 Proposed Operating Budget.

*GASB 54 Fund Balance Policy* – This Policy ensures the correct identification and classification of fund balances in accordance with Government Accounting Standards Board (GASB) Statement No. 54.

<https://www.losgatosca.gov/DocumentCenter/View/13771/GASB-54-Fund-Balance-Policy?bidId=>

*General Fund Reserve Policy (A-35)* – This Policy establishes minimum levels of designated reserves within the General Fund.

<https://www.losgatosca.gov/DocumentCenter/View/18897/4-03-General-Fund-Reserve-Policy?bidId=>

*Investment Policy/Operating Portfolio (A-45)* – This Policy ensures that residual operating funds are invested in accordance with applicable sections of the California Government Code and

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DISCUSSION (continued):

other elements of the Policy. The Finance Commission reviews it annually and provides recommendations to the Town Council.

<https://www.losgatosca.gov/DocumentCenter/View/17859/4-02-Investment-Policy?bidId=>

*IRS Section 115 Pension Trust and OPEB Investment Policy (A-55)* – This Policy ensures appropriate fiduciary oversight and investment of the Town’s pension and Other Post-Employment Benefits assets domiciled in IRS Section 115 Trusts.

<https://www.losgatosca.gov/DocumentCenter/View/20141/4-04-IRS-Section-115-Pension-Trust-and-California-Employers-Retiree-Benefit-Trust-CERBT-Investment-Policy?bidId=>

*Long Term Debt Policy (A-41)* – This Policy sets forth debt management objectives and parameters for issuing and administering Town-issued debt.

<https://www.losgatosca.gov/DocumentCenter/View/17858/4-01-Long-Term-Debt-Policy?bidId=>

Attachments:

1. Annual Report and Budget Cycle
2. Five-Year Forecast