Comments and questions on the FY 2023/24 Draft Annual Comprehensive Financial Report

The following are comments, questions, and recommendations made by members of the Finance Commission. In accordance with Section 2.50.225 (a)(3), the Finance Commission is to review the [Annual Comprehensive Financial Report] and the Town Manager is to respond in writing regarding their rationale for accepting or rejecting each comment and recommendation. The following responses as well as the changes proposed in Attachment 1 represent the Town Manager's written response.

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1. The transmittal letter doesn't call out the change in Town Manager - I know Chris wasn't there for the reported fiscal year but he is issuing the transmittal - within the letter the listed officials for the fiscal year (appropriately) has Laurel. It might be helpful to mention the change in the body of the letter to avoid confusion.

    Added. See Footnote on page 8 of the ACFR. There is also a correction to change the Human Resources Director to the appropriate reference.

2. It is mentioned that the assumed vacancy rate for staffing/salaries of 4.6% was exceeded? Was that avg across the town departments? What was the actual vacancy rate (by dept?). Do we need to consider updating the budget assumption?

    Not added. The discussion is more appropriate for Mid-Year and Budget discussions. Here is the summary provided at the meeting:

    The final General Fund salaries and benefits budgets of $35,611,692, include a negative $1,670,530 original salary savings and a positive $714,666 budget restoration for Departments that were fully staffed. In addition, the General Fund had $1,041, 299 salaries and benefits savings. While individual Departments had various savings, the Townwide salaries and benefits savings would translate to 5.6% if all positions are budgeted without vacancy savings factors. At this time, staff do not believe a change in assumption is necessary; however, staff remains open to continuing the conversation during the budget process.

3. On the 4th bulletin within the MD&A highlights - could we show the breakout of the transfers out of capital projects and general liability?

    Added. See page 18 of the ACFR. During FY 2023/24, the General Fund had an excess of revenues over expenditures of $4.0 million, excluding transfers. Transfers out exceeded transfers in by $3.2 million. The principal purpose of the Town's interfund transfers was contributions toward capital projects ($3.1 million) and general liability ($.43 million). The detail of the interfund transfers is illustrated in Note #5.

ATTACHMENT 2

4. On the second bulletin within in the MD&A highlights - it is noted that while the net positive of $5.9M in position the net difference from the prior year was $15.1 (61%). Given the size of the difference can we understand what was different from 22 to 23 - was this an anomaly?

    Added. See deletion per Commissioner's recommendation on page 18 of the ACFR. This is shown as the 2nd bullet under "Financial Highlights."

5. On page 75 of the packet, 4th paragraph in the discussion on sales tax revenue - notes the reduction in business-to-business activities, less sales tax activity and decrease to gas stations due to popularity of EV's. How do we know these causes for the difference - asking because I think this could be helpful information to know in the scorecard process. Also, given the evolution to EV's - have we thought about how we will replace traditional gas related revenues with EV driven revenue? These thoughts aren't really about changing the MD&A but broader questions.

    Not added. Great observations, but the discussion is more appropriate when performance metrics are discussed.

6. On page 76 of the packet, bottom of the page - $1.5 variance in salary and benefits - see my first note but another reason I was asking the overall staffing/salary/benefits question. We had several factors influencing one of our largest expense categories - labor negotiation, staffing/vacancy and benefits. Might be helpful to provide a chart of this category? I'm also really trying to understand the validity of our underlying assumptions.

    Not added. Please see response to Question 2.

7. Pages 81-83 Changes in Budgets (org and updated), Budgets (org and updated) vs Actuals. Not sure if we need two separate walk downs: The second set of charts showing all 3 histograms with a walk down of the differences including updated budget and actuals might suffice. I'm OK if others think this is helpful but offer it as a suggestion to tighten up the MD&A.

    Added. See streamlined presentation starting on page 31 et seq. of the ACFR. Staff removed and modified the graphics.

Town Manager Letter

8. While the $63m in unfunded pension liability increased from FY 2023 level of $59.9m, the major impact has been the Town's total pension expense has materially increased. In FY 2024 total pension expense was $11.2m which was a 91% or $5.3m increase from FY 2023 pension expense of $5.9m. This is the single largest cost increase the Town experienced in FY 2024.

Not added. See page 4 of the Management Letter which talks about variability. Here is the summary provided at the meeting.

Pension expense is a combination of net changes in net pension liability, deferred inflows and outflows of resources, and contributions in the current measurement period. Pension expense varies year to year based on actual market performance and actuarial assumptions. For example, FY 2022/23 was $5.9 million, FY 2021/22 was $3.4 million, and FY 2019/20 was $10.8 million.

9. There have been no ADP's made since $4.8m ADP in FY 2020 and $5.6m ADP in FY 2021.

   Confirmed. No further response is necessary.

10. FY2024's capital outlay of $12.4m was the largest single-year capital outlay in the past 10 years and represented a 39% increase over FY 2023. The next highest year was FY 2022 with $10.4m. For the 5-year period FY 20 – FY 24, the Town incurred a total capital outlay of $45.4m as compared to the prior 5-year period FY15 – FY19 of $31.6m. This represents a 44% increase.

    Noted. See additional information provided on page 34 in the Fixed Asset Presentation. The $7.1 million addition to construction in progress is comprised of $3.8 million for pathways projects, $1.2 million forstreets and curbs improvements, $0.9 million for land and building improvements, $0.6 million for bridges, $0.4 million for equipment, and $0.2 million for retaining walls, traffic signals, parking lots, and park improvements.

Independent Auditor's Report

11. Confirm the auditor has "audited the accompanying financial statements" and is expressing an opinion on "the financial statements" as opposed to the trial balance, which is an underlying record.

    Confirmed by auditor.

12. Confirm the auditor prepared the financial statements applying appropriate risk mitigation and the Town management accepts responsibility for the preparation and fair presentation of the financial statements.

    Confirmed by auditor.

Management's Discussion and Analysis

Financial Highlights

13. Separate the discussion of the FY 2024 increase in net position of $5.9m from the discussion of the change in the change in net position from the prior year. The $5.9m increase in net position for FY 2024 was because total revenues exceeded total expenses. The fact that the FY 2024 $5.9m increase was less than the prior year's increase of $15.1m is due to total expenses in FY 2024 increased $9.3m from FY 2023 level of $49.3m while total revenues remained relatively flat. As written, the discussion is confusing.

    Added. Please see the response to Question 4.

14. Staff should consider adding a full-throated disclosure of the $7.2m in ARPA/SLRF grant money the Town has received. The ARPA funds need to be fully committed to contracts and projects by December 2024 and fully expended by December 2026. Last year the Town reported separately an ARPA fund which had a balance of $3.6m which was transferred out. A discussion of how the full $7.2m was spent is an important disclosure. No one understands this.

    Added. Please see page 35 of the ACFR.

    General Fund Monies Made Available because of the ARPA Grant

    The Town recognized the American Rescue Plan Act (ARPA) operating revenue over three fiscal years including FY 2020/21 ($200,911), FY 2021/22 ($3,413,961), and FY 2022/23 ($3,614,872) for allowable expenditures under the standard allowance provision of the ARPA federal rules. The funds were received in the ARPA special revenue fund and were transferred out to other funds and used for qualifying public safety expenditures under the provisions of the Act.

The Utilization of the ARPA grant, enabled the Town to support the following activities using unrestricted resources:

Unrestricted Funds Available	**$7,229,744**
Less Council Approved Uses	
Parklets (Downtown Economic Recovery Efforts)	$ 930,000
Rent Waivers	746,463
CUP/ADA Fee Waivers	54,346
Destination Marketing	55,000
K-Rails (Downtown Economic Recovery Efforts)	88,654
Promenades	188,667
Direct Grants	110,000
Enhanced Senior Services	500,000
Capital Improvement Program Support Transfers	2,900,000
One-Time Community Grant (Council Action 2-21-2023)	150,000
One-Time to LGS REC 55+ Program (Council Action 2-21-2023)	225,000
One-Time to KCAT Producers (Council Action 2-21-2023)	100,000
One-Time Unhoused Residents Efforts (Council Action 2-21-2023)	25,000
One-Time Rent Forgiveness LGS REC (Council Action 3-21-2023)	200,000
One-Time Rent Forgiveness NUMU (Council Action 3-21-2023)	21,000
One-Time Unhoused Residents Efforts (Council Action 4-4-2023)	25,000
One-Time - Additional Chambers of Commerce (Council Action 5-2-2023)	33,000
One-time - Adult Recreation Center Interim Community Center (Council Action 8-15-2023 & FY 2024/25 Proposed Budget)	877,614
Total	**$7,229,744**

Net Position Discussion

15. Please explain “unavailable revenue classification (to revenue) of $2.3m. What is this?

    Not added. Please see response provided at the meeting. Under modified accrual bases of accounting, receivables that are not received within 60 days of year-end have to be reclassified as a liability. The unavailable revenue classification is the liability reclassification back to revenue under the accrual bases of accounting for the government wide financial statements.

ATTACHMENT 2

Governmental Activities

16. Why not restate FY 2023 to reflect the reclassification of garbage franchise fees so FY 2024 and FY 2023 are presented on a comparable basis? As presented it is confusing for the reader. At least disclose the amount of the reclassification.

    Added. See footnote on pages 23 and 29.

    "(1) Starting with the March 2024 services, Garbage Franchise Fees are categorized as encroachment fees under Charges for Services. The total amount classified in Charges for Services in FY 2023/24 was $765,900."

17. Provide more transparency regarding the $1.7m increase in capital grant activity. What were the specific grants that drove this increase?

    Added. See page 25 of the ACFR where discussion "Governmental Activities Revenue Discussion" exists.

    "$1.7 million net increase in capital grant activity including grants received toward the Los Gatos Creek Trail to Highway 9 Trailhead Connector project."

18. What is Town Management trying to accomplish by establishing an assigned "market fluctuation reserve"? I realize this is in the Fund Reserve Policy, but does this really accomplish anything? Should it be classified as nonspendable?

    Not added. Staff cursorily reviewed the item and will continue to research the classification. For the FY 2023/24 ACFR, the market fluctuation reserve is kept as assigned consistent with the resolution approved by the Council before June 30, 2024.

19. Governmental total expenses increased $9.3m. $7.7m of the increase is discussed. What is the cost force that contributed the additional $1.6m? Are these increases "one-time" or recurring?

    Added. See page 27 of the ACFR where discussion "Financial Analysis of the Town's Funds" exists. The other $1.6 million increase is attributable to multiple ongoing cost increases such as retiree medical expenses, utilities, landscape maintenance, safety supplies and equipment, and one-time costs in temporary employee services, labor relations services, consultant services, one-time grants, and building maintenance repairs.

ATTACHMENT 2

Governmental Funds Discussion

20. Disclose the cost force that caused the general operating increase of $1.5m. Why did this occur?

    Added. See page 30. The other $1.5 million increase is attributable to multiple ongoing cost increases such as retiree medical expenses, utilities, landscape maintenance, safety supplies and equipment, and one-time costs in temporary employee services, labor relations services, consultant services, one-time grants, and building maintenance repairs.

21. Discuss the capital outlay increase of $3.4m. What was this for?

    Added. Discussed in the Capital Asset section of the ACFR. See the response to Question 26.

22. Explain the $4.6m increase in General Fund expenditures from FY 23 level of $44.9m to FY 24 level of $49.5m. Why did this occur?

    Not added. Paragraphs 4, 5, and 6 on page 31 already describe the Governmental Funds General Fund portion. See detailed description.

23. Clarify the $2.6m from other financing sources for the Appropriated Reserves Fund was transfers in from the General Fund.

    Clarified. Refer to Note 5. Total transfer in including the 50% of Measure G proceeds is $3.1 million, the total transfer out is $0.5 million.

General Fund Budgetary Highlights

24. Consider adding a discussion of the operating surplus (e.g., excess of revenues over expenditure). It is not disclosed that the General Fund surplus for FY 2024 was $4.0m. Discuss if this was the result of onetime events or if the surplus reflected a structure where recurring revenues exceeded recurring expenditures.

    Added. See page 33.

    "The General Fund Statement of Revenues, Expenditures, and Changes in Fund Balance-Budget and Actual (GAAP) for Fiscal Year Ended June 30, 2024, reports an approximate favorable variance overall with the final budget of approximately $3.6 million. During FY 2023/24, the General Fund had an excess of revenues over expenditures of $4.0 million, excluding transfers. This favorable variance was created largely by the net effect of the following factors."

Variance with the Final General Fund Budget

25. Provide more detail regarding the $0.8m in operational “savings” Town-wide. What exactly is an “operational savings”?

    Added. See page 34.

    “Actual expenditures ended the fiscal year at $1.8 million below final budgeted expenditures. Significant factors affecting actual expenditures include: $1.0 million savings in salaries and benefits in limited term vacancies throughout the organization combined with $0.8 million less actual expenditures than budgeted in multiple categories Town-wide. The chart below illustrates the original expenditure budget, final expenditure budget and actual expenditures.”

Capital Assets

26. As a general comment this section needs additional work given the magnitude of the capital expenditures made in FY 24. Total capital expenditures were $12.0m with $7.1m in CIP and $3.9m for Infrastructure (streets and other). This is a material change from the prior year profile where total capital expenditures were $8.6m with $0 for CIP and $8.0m for infrastructure (streets and other). Why the $4.1m decrease in street investment year over year? There needs to be more discussion as to what specific projects are included in CIP and the year-over-year change in total capital expenditures.

    Added. Please see page 35 of the ACFR and Note 6.

    “The $7.1 million addition to construction in progress is comprised of $3.8 million for pathways projects, $1.2 million for streets and curbs improvements, $0.9 million for land and building improvements, $0.6 million for bridges, $0.4 million for equipment, and $0.2 million for retaining walls, traffic signals, parking lots, and park improvements.”

Capital Assets
Town of Los Gatos
For the Year Ended June 30, 2024

	Capital Assets	Accumulated Depreciation	Capital Assets, Net
Infrastructure - Streets	$ 86,301,911	$ (40,509,975)	$ 45,791,936
Infrastructure -Other	28,491,627	(10,552,383)	17,939,244
Subscription Right of Use Assets	1,622,573.00	(422,512.00)	1,200,061
Buildings	42,862,716	(11,995,280)	30,867,436
Land	26,064,735	-	26,064,735
Equipment	12,893,445	(10,870,937)	2,022,508
Construction in Progress	15,491,043	-	15,491,043
	$ 213,728,050	$ (74,351,087)	$ 139,376,963

"During the year, the Town transferred $2,907,014 from construction in progress (CIP) to buildings and improvements and $141,324 to infrastructure streets for capital projects that were completed and placed in service. The transfers out were offset by $3,894,579 of transfers in. The Town transferred $3,891,824 from infrastructure - streets back into CIP since these assets were not available for service. The net transfers out of infrastructure - streets of $3,750,500 include the $3,891,824 transfer out to CIP net of the $141,324 transfer in from CIP as reported in the above schedule. There was also a reclassification of equipment back into CIP of $2,751. Total transfers into buildings and improvements included a land reclassification of $1,368 for a total transfer in of $2,908,377. The assets reclassified to CIP had not been depreciated."

27. The schedule of "notable additions" should be gross additions and exclude current year depreciation. As shown, the schedule understates the magnitude of gross additions made.

    Added. Discussed in the Capital Asset section of the ACFR. See the response to Question 26.

28. Consider reporting depreciation and amortization expense separately. For FY 24 total depreciation expense was $5.0m and amortization expense was $220k.

    Not added. Not required by the Government Accounting Standards Board, and the amortization expense is not material to the total amount of the expense.

Economic Factors, Next Year's Budget, and Rates

29. In my opinion there is a major disconnect between the actual results for FY 24 and the FY 25 budget. This section references the "Five Year Forecast" which the FC reviewed and provided extensive comments. There is no information provided regarding the Five-Year forecast, so the reader does not have the ability to judge the merit of the comment "endeavored to maintain essential public services while controlling operational costs." The fact is the FY 24 GF results reported a surplus of $4.0m. Even if we adjust for the Mark to Market adjustment of $1.7m and exclude the "unplanned" capital outlay of $700k, there was an adjusted surplus of $3.0m. Unfortunately, for many years the GF budget has not been an effective fiscal management tool because there has been a negative bias in forecasting revenues and expenditures. This can easily be seen by comparing the GF original FY 24 budget, the GF final FY 24 budget and the actual results for "excess of revenues over expenditures". Historically revenues exceed the budget, and expenditures are favorable to the budget. When viewed in this historical context, I am unclear as to the purpose of this section.

    Added. Please see the additional discussion starting on page 37. This entire section is revised to present the economic outlook in a more understandable fashion.

Note 1

30. Reclassification – why not disclose the reclassification of the garbage fee? Are there any other reclassifications?

    Not added. See additional footnotes on pages 23 and 29. The revisions do not include a reclassification of the garage fee as this is not the result of an error. We added the below footnote to provide clarity for the user for the financial statements.

    "(1) Starting with the March 2024 services, Garbage Franchise Fees are categorized as encroachment fees under Charges for Services. The total amount classified in Charges for Services in FY 2023/24 was $765,900."

31. Why not adopt GASB 103 early?

    Not adopted. GASB 103, Financial Reporting Model Improvements will be effective for fiscal years ending June 30, 2026. Staff will consider an early adoption for the next fiscal year ACFR. One of the major changes will be that the analysis of budgetary variations will be included in Required Supplementary Information not in the MD&A.

Note 5

32. Is there a better description than “non-departmental”? It is difficult to understand what the source of transfers from the General Fund is and how this is linked to the Fund Balance.

    Not added. Appropriated funds are provided in the Non-Departmental Program to account for a variety of Town Services and activities not specifically attributable to individual Departments. Most of the transfers are expended in the Non-Departmental Program. We considered but did not identify a better term to provide clarity.

Note 6

33. Please explain the “transfers” column. What caused a $3.8m transfer from Infrastructure – Streets and a $2.9m transfer in of buildings and improvements? Does this suggest an internal control issue?

    Added. See Note 6 (a more detailed description provided below).

    “During the year, the Town transferred $2,907,014 from construction in progress (CIP) to buildings and improvements and $141,324 to infrastructure streets for capital projects that were completed and placed in service. The transfers out were offset by $3,894,579 of transfers in. The Town transferred $3,891,824 from infrastructure - streets back into CIP since these assets were not available for service. The net transfers out of infrastructure - streets of $3,750,500 include the $3,891,824 transfer out to CIP net of the $141,324 transfer in from CIP as reported in the above schedule. There was also a reclassification of equipment back into CIP of $2,751. Total transfers into buildings and improvements included a land reclassification of $1,368 for a total transfer in of $2,908,377. The assets reclassified to CIP had not been depreciated.”

34. Why not show separate depreciation and amortization by government activities?

    Not added. Not required by the Government Accounting Standards Board, and the amortization expense is not material to the total amount of the expense.

Note 10

35. Please explain the “deletions” for ERAF Risk and Economic Recovery. What is the counter entry?

    Added. Please see page Note 10. ERAF Risk should only show addition. Staff redlined the correction.

36. The FY 25 CIP budget shows for the GFAR an "assigned" beginning fund balance of $1.2m for ARPA. Why wouldn't this be included in the Governmental Fund schedule?

    Not added. CIP Budget will be updated with the correct terminology.

37. What is the reasoning for an ERAF assigned fund balance? If there is concern that this is true liability, why wouldn't we establish contingent liability on the General Fund Balance sheet?

    Not added. A future obligation is not a current liability, it can be assigned fund balance. The assigned fund balance was established by resolution.

38. What is the reasoning for not having an unassigned fund balance which could absorb unplanned revenue shortfalls or unplanned expenditures? Historically the Capital/Special Projects reserve has been tapped to fund this, which does not comply with the intent of the assigned reserve.

    Not added. An unassigned fund balance would be welcomed; however, a broader discussion of fund balances and the Town's approach to reserving resources should occur prior to changes. The Finance Commission will review the General Fund Reserve Policy at its December meeting.