TOWN OF LOS GATOS

COUNCIL FINANCE COMMITTEE REPORT

MEETING DATE: 12/7/2020

ITEM NO: 5

DATE: November 30, 2020

TO: Council Finance Committee

FROM: Laurel Prevetti, Town Manager

SUBJECT: Discuss and Provide Comments to the Town Council Regarding the Draft Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2020.

RECOMMENDATION:

Discuss and provide comments to the Town Council regarding the Draft Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2020.

BACKGROUND:

The Town contracts with an independent certified public accountant to examine the books, records, inventories, and reports of all officers and employees who receive, handle, or disburse public funds each fiscal year. The FY 2019/20 audit was performed by Badawi & Associates, an experienced firm specializing in audit services for California public agencies. The firm also prepared the Draft CAFR for the Town of Los Gatos (see Attachment 1).

The information contained in the CAFR provides detailed financial information which the Los Gatos community and others can use to better understand the fiscal standing of the Town. In addition, the financial information contained in the document is one element that the credit rating agencies review annually to affix a credit rating for the Town's outstanding debt obligations. In 2020, Moody's rating service affirmed the Town's general credit rating of Aaa, the highest rating possible.

DISCUSSION:

At the meeting, Town's Independent Auditor will present to the Town Council Finance Committee the draft audited Comprehensive Annual Financial Report (CAFR) dated June 30,

PREPARED BY: Stephen Conway
Finance Director

Reviewed by: Town Manager and Assistant Town Manager

DISCUSSION (continued):

2020. Staff and the Town's independent auditor will be available for the Committee's discussion.

Highlights of the draft audited financial results include:

Independent Auditor's Report (pages 13 through 15)
The auditor has given the Town's financial statements a "clean" audit opinion for the year ended June 30, 2020 (see the first paragraph on Page 14) giving reasonable assurance that the financial statements are "free of material misstatement."

Management's Discussion and Analysis (MD&A) (pages 18 through 36)
Page 18 of the CAFR begins the MD&A section of the report wherein summaries are presented for the Town on an entity-wide basis and fund type basis. Information is provided in this section with a year-to-year view, explaining how fund balances have changed between fiscal years ending June 30, 2019 and June 30, 2020. Information is also presented on the adopted General Fund budget to actuals and any significant budget adjustments made during FY 2019/20 (page 31 through 33).

Statement of Net Position (page 40)
The Statement of Net Position serves as a useful indicator of a government's financial position. The Town had net assets of $114.85 million at fiscal year end as compared to $114.82 million the prior year, an overall small increase of $30K over the prior fiscal year.

The largest portion of the net assets, $111.7 million, represents the Town's investment in its capital assets and infrastructure. Restricted assets of $7.1 million are resources that are subject to external restrictions on how they may be used. As of June 30, 2020, unrestricted net position reports a deficit of approximately $3.97 million. The unrestricted net position reported the prior year was a deficit of approximately $4.64 million. The deficit in unrestricted net position is primarily due to the Town's outstanding long term pension and Other Post Employment Benefit (OPEB) liabilities.

Basic Financial Statements (pages 39 through 96, including footnotes)
This section contains basic financial statements, including the "entity-wide" Statement of Net Position and Statement of Activities, financial statements for the fund types including Governmental Funds (such as the General Fund), Proprietary Funds, and the Private Purpose Trust Funds (Redevelopment Successor Agency).

The footnotes section provides details on significant items such as the Town's cash and investments (Note 2 beginning on page 69), its long term obligations (Certificates of

DISCUSSION (continued):

Participation) related to bonded debt (Note 6 page 74), the net pension liability for both the Town's miscellaneous and safety pension plans (Note 9 page 78), and a discussion of the Town's other post-employment benefit plan (Note 10 page 88).

Required Supplementary Information (pages 98 through 102)
The Schedules of Pension Plan Contributions are provided in this section.

Supplementary Information (pages 104 through 119)
This section provides budget to actual information for "non-major" funds which represent less than 10% of the Town's total assets/liabilities/revenues or expenditures.

Statistical Section (pages 123 through 153)
This section presents demographic statistics and ten-year historical financial data for the Town, including information on assessed valuations, fund balances, debt, property tax rates, personnel (full-time equivalent) history, principle employers, and other financial and demographic disclosures.

CONCLUSION:

Mr. Ahmed Badawi, C.P.A., managing partner of Badawi & Associates, will be participating in the Committee meeting. If you have questions prior to the meeting, please contact Director Conway and staff will share responses to the questions to the full Committee. Upon review and discussion of the draft CAFR by the Council Finance Committee, the final CAFR is scheduled for Town Council consideration on Tuesday, December 15, 2020. The Committee is welcome to provide comments to the Council.

FISCAL IMPACT:

There is no fiscal impact to provide recommendation to the Town Council for this report.

Attachment:
1. Draft Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2020.

TOWN OF LOS GATOS

COUNCIL FINANCE COMMITTEE REPORT

MEETING DATE: 12/7/2020

ITEM NO: 5

DESK ITEM

DATE: December7, 2020

TO: Council Finance Committee

FROM: Laurel Prevetti, Town Manager

SUBJECT: Discuss and Provide Comments to the Town Council Regarding the Draft Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2020.

REMARKS:

Staff received comments from Committee members and the public. Attachment 2 contains Committee Member's comments. Attachment 3 contains public comments received after publication of the Staff report and before 11:01 a.m. Monday December 7, 2020. In addition, one Committee member found typographical errors which will be corrected:

- Page 18, Management discussion bullet 7 should be the continuation of the sentence in bullet 6.
- Page 34, last line should be FY20/21 not FY19/20.

Staff and the Auditor will be available to respond questions during the meeting.

Staff responses to the Committee Members' questions are below.

Questions on the MD&A

Question: Page 19 talks about $2.2M in increases in intergovernmental grant revenues. What is the source of the grant the contributed to the increase and how are the funds used?
Answer: The majority of the approximate $2.0M increase in Intergovernmental revenues was attributed to the approximate $1.0M increase in revenues received from the VTA Measure B funding. There was an additional receipt of approximately $500K higher revenues received from MTC ($182K) and from the VTA/TFCA ($353K) capital grants. All of these monies were dedicated as funding sources for local street and road improvement projects.

PREPARED BY: Stephen Conway
Finance Director

Reviewed by: Town Manager and Assistant Town Manager

REMARKS (continued):

Question: Page 24 note 1 talks about a reclassification of 2019, although the reclassification doesn't appear to be made in the 2019 numbers. What is the dollar amount? And how and when was the misclassification identified? Also, since you disclose the need for the reclassification, do you want to change the 2019 numbers?
Answer: In staff's review of the changes in expenses by fiscal year and functional category in the prior year's Statement of Activities, it was discovered an error had been made in the reversal of the FY 2019 OPEB contributions which was allocated across all departments instead of being limited to the general government category. The credit should have only been charged to general governmental expenses in the prior year. This correction has no effect on net position but changes the expense totals by function. Total expenses did not change but the categories were affected on the Statement of Activities for the prior fiscal year ending June 30. 2019 as follows:

Question: Page 26 discussion of the Governmental Activities Expenses explains the increase in General Government expense is due to large swings in the amount allocated with the current year allocation adjustment increasing costs while the prior year allocation adjustment decreased costs. What is the reason for the large swing?
Answer: Please see the following table for details of error correction.

DETAILS OF FYE 2019 STATEMENT OF ACTIVITIES CORRECTION

Functions/Programs Expenses: Expenses: Expenses:	As Previously Reported 2019	Correct 2019 OPEB Contrib. Credit	Reverse Prior Year 2019 OPEB Contrib Credit	REVISED 2019 Expense
Police Department	$ 16,635,726		$ 1,089,749	$ 17,725,475
Parks and Public Works	$ 10,627,716		$ 482,861	$ 11,110,577
General Government	$ 8,163,991	$ (2,406,637)	$ 383,505	$ 6,140,859
Community Development	$ 5,064,637		$ 297,983	$ 5,362,620
Library Services	$ 3,059,294		$ 152,539	$ 3,211,833
Sanitation	$ 684,673			$ 684,673
	$ 44,236,037	$ (2,406,637)	$ 2,406,637	$ 44,236,037

Question: Page 26 discussion of Governmental Activities Expenses explains that Sworn employees received a 4% raise while all Non-sworn and management employees received 3%. What was the reason Sworn officers received a larger increase than the non-sworn employees? I'm particularly sensitive to this given the much larger per person pension costs for sworn officers.

REMARKS (continued):

Answer: In recognition for POA's willingness to contribute to the Town's unfunded pension liability, they received a slightly higher raise than non-sworn employees. Sworn employees also did not receive the 1.5% one-time bonus that the other bargaining units received in 2018.

Question: Page 27 indicates there is $700K in the Restricted Fund Balance that represents amounts placed in an IRS Section 115 trust. Restricted cash in the Government Fund on the Governmental Funds balance sheet reflects a similar amount. When do you expect to pay the funds to the Section 115 IRS Trust?
Answer: The funds have been placed in a CEPPT (IRS 115 qualified Trust). These funds are anticipated to be used in FY 20/21 to pay off a selected amortization base (CalPERS liability) as identified and recommended to the Town Council by staff after consultation with the Town's Finance Commission and the Town's actuary, Bartel and Associates.

Question: Page 28 indicates the Governmental Funds Balance Sheet has $4.5M identified in the Committed Fund Balance for additional discretionary payments toward pension and OPEB unfunded liabilities. How do you expect to use the $4.5M and when will the funds in the Committed Reserve be utilized/paid to CALPERs?
Answer: $3.6M of the General Fund Pension/OPEB reserve was used in July 2020 for additional discretionary payment made to CalPERS, the balance will be available to fund future ADP's to pay down the Town's unfunded pension liability.

Question: Page 29 has a table of Total Governmental Funds Revenues, Expenditures and Changes in Fund Balances year over year. How does the $4.8M in Intergovernmental Revenues tie to the aggregate of the $8,854K plus $850K for Grants and Contributions in the Town-wide Statement of Activities on page 41, and to the $2.2M increase over prior year receipts for "intergovernmental (grants) revenues" on page 19?
Answer: Intergovernmental revenues is just one subset of Grants and Contributions which included contributions from Non Gov sources. The total Operating Grants and Contributions ($3,854,188) and Capital Grants and Contributions ($850,111) reported on page 41 of the draft CAFR appear to add to $4,704,301. (Intergovernmental listed under program revenue include; public safety sales tax & supp law enforcement grant, PPW includes Measure B & gas tax.)

Question: Page 32 discusses General Fund Variances from budget for revenues and expenditures. It indicates that 5 revenue categories declined a total of $3.2M due to COVID over 4 months. If you annualize the 4 months to a year, it is $9.7M. Total revenue for the year from these 5 categories per the Statement on page 48 is $18,179K. This implies that for the 4 month period, revenues from these 5 categories declined 53%. Is this a realistic analysis, and if so, how much does the current 2020-2021 budget assume revenue from these categories decline over prior year non COVID impacted revenue?

REMARKS (continued):

Answer: The variance from budget is not equivalent to a revenue decline per se. Revenues could actually improve from the prior fiscal year but still have a negative variance from budget if the budget had forecasted larger growth than was met in the actuals collected. The variance from budget is for the entire fiscal year, though a major factor, not all of the variance from budget was due to COVID 19. Staff will be providing an update to major revenue trends in FY 20/21 on December 15, 2020.

Question: Page 34 under Economic Factor and Next Year's Budgets talks about the Town having identified contingencies should there be a revenue shortfall. Without going into specifics, what are the nature and type of actions the Town would consider?
Answer: Possible contingencies include the use of one-time revenues, operational savings initiatives, and the possible use of reserves upon recommendation by staff and Town Council approval.

Questions on the Basic Financial Statements
Statement of Position—Town-wide
Question: Why the $11.7M decrease to $22.3M in Nondepreciable assets year over year? Note 5 indicates there were $13.97M of Transfers and Retirements. Was this change primarily transfers of completed projects for street infrastructure that are now depreciable?
Answer: These changes in asset classification reflect amounts held in construction in progress (non-depreciable) that upon completion in FY 19/20 were reclassified and become "depreciable" assets once completed and placed into service.

Statement of Activities—Town-wide
Question: Compensated absences liability is growing. Can the Town do anything to manage it down, potentially to conserve cash, even if it's necessary to wait to address in the next labor negotiations?
Answer: Compensated absence accruals are the result of labor negotiations with all the Town bargaining units. There are leave balance caps on some of the leave types.

Governmental Funds Balance Sheet
Question: It looks like you broke Capital projects into 2 categories this year. The total of the 2 reserves increased $4.7M. What is the purpose of splitting the account into 2 categories? Also, from Note 8, it looks like the Capital Projects fund increased from $4.3M to $12.2M year over year? Why the large increase that was effectively a transfer from the Capital/Special Projects fund?

REMARKS (continued):

Answer: The use of the title was to keep it distinct from the General Fund's Capital and Special Projects Reserve for tracking purposes. If the same title was used for the GFAR fund balance it would be combined into a much larger amount than the amount that correlates specifically to the General Fund Reserve for Capital and Special Projects. All amounts in GFAR not restricted or assigned for parking or Comcast PEG are considered assigned for capital projects.

Question: What is the Market Fluctuations Reserve? How does it different from other reserves, if it is?
Answer: Market Fluctuations is an assigned reserve to identify fund balance for unrealized investment gains recorded as interest revenue for the year under GASB 31 that are not available as a cash asset unless sold. The Town typically holds all of its investments until maturity.

Question: Note 8: I would suggest that the purpose of the Capital Projects Reserve Fund and the Market Fluctuations Reserve Fund also be disclosed in Note 8.
Answer: Noted. We had no balance the prior year in Market Fluctuations, staff will add a short description to the CAFR footnote.

Reconciliation of Governmental Funds Balance Sheet to Government-Wide Net Position—Governmental Activities
Question: What is reason for 8.5% decrease in Allocation of Internal Service Funds Net Position to $7,731 amount from the prior year of $8,454?
Answer: The primary reason can be found on page 115 of the June 30, 2020 CAFR Combining Statement of Revenues and Changes in Net Position. The Town's Facilities Maintenance fund transferred out $788K to the Town's GFAR fund in FY 19/20 to fund five separate projects as planned in Town's FY 19/20 Capital Improvement plan including $183K of ADA Restrooms in the Adult Recreation Building, $300K for ADA restrooms and HR offices, $30K for Civic Center Plaza Railings, $75K for waterproofing, and $200K for fire suppression for the Town's IT Server Room. An additional 580K was also transferred out of the Equipment Replacement Fund to provide funding source for the Computer Aided Dispatch $525K and $55K to the Town's General Fund for Body Worn Cameras and Energy Weapons. These reductions in net position were offset by a $1.1M transfer from the Town's General Fund to the Town's Workers Compensation Internal Service fund to provide additional resources to address future claims. The effect of these transfers ($306K) and use of Equipment Replacement net position to purchase scheduled fleet and equipment replacements ($540K) were the primary drivers of the overall $723K reduction in net position between fiscal years.

REMARKS (continued):

Governmental Funds Statement of Revenues, Expenditures and Changes in Fund Balance—page 46

Question: Note 4 explains the nature of the Transfers in and out, but it doesn't give the dollar magnitude of any of the categories. For transfers that are reported as $1M or more in the footnote, what are the dollar amounts for capital projects & outlays, lease or debt payments, operating expense, and low and moderate-income housing projects in the General Fund, Appropriated Reserve Fund, and Internal Service Funds transfers?

Answer: The table in note 4 is a standard note presentation of fund transfers in and out between Town funds that is found in most governmental CAFRS. The most significant transfers were transfers out of the Town's General Fund $6,982,591 to the Town's GFAR fund to provide funding sources for the Town's capital improvement plan. The General Fund also transferred $1,061,256 to the Worker's Compensation Internal Service Fund as described in the answer regarding the change in total net position in the Internal Service funds. There were no transfers for lease or debt service payments or low and moderate income housing projects, this is legacy language that could be omitted in the final draft. The transfers out of Internal Service funds were also discussed previously in the discussion of the change in Internal Service Fund net position.

General Fund Statement of Revenues, Expenditures and Changes in Fund Balance—Budget to Actual

Question: When comparing Actual results to the Final Budget, the Town has a negative variance for every operating revenue account which is a swing from the prior year when the Town had a positive variance in all categories except 2 of the smaller accounts. The revenue variance in 2019 was a positive $2.4M and the variance in 2020 was a negative $1.6M, a swing of $4.0 million. The explanation on page 32 of the MD&A on the impact from COVID explains $3.2M of the swing. But even in the absence of COVID there is still a $600K decline in the favorable revenue variance. In addition, the favorable Expenditures variance declined significantly in 2020 from $7.3M to $3.7M year over year. The swing appears to be more than a statistical budgetary aberration. Was there a structural reason for the decline in favorable variances? I did not in the discussion on pages 32 and 33, there continued to be favorable expense variance incurred for unfilled staff positions.

Answer: The bulk of the variance from budget is attributed as you have mentioned to the economic impacts of the COVID -19 pandemic. There are other factors which may have played a role such as the cyclical nature of private development and its effects on building permit revenues and charges for services. Other revenues impacted were lower parking fines due to Council approved changes to downtown parking enforcement to aid the downtown's economic recovery and rent forgiveness for use of Town facilities. These actions, among other factors, could be considered additional collateral effects to revenues sustained as a result of the COVID-19 pandemic. (sale of land was not completed until FY 2021)

REMARKS (continued):

Proprietary Funds—Internal Service Funds Statement of Revenue, Expenses and Changes in Net Position—page 51
Question: Why did the Charges for services decrease for 13% year over year to $3,029K. Were services less or costs of services reduced?
Answer: IT Internal Service Fund charges were reduced because staff charges were moved to the General Fund and funded there with General Fund operating revenues. The reduction in staffing costs allowed the Charges for Services charged to Town departments for IT services to be lowered to recover non-personnel costs which are still paid out of the IT Internal Service Fund. (Two smaller internal service funds closed with activity now accounted for in the general Fund)

Question/Observation: It would be very useful for the Town Council to have a standalone paragraph on page 3 discussing the COVID impact on revenue in Q4. You discuss how much sales tax went down, but knowing the actual decline in Q4 revenue for all fees and taxes in Q4 would allow a better forecast of decreased revenue in 2021.
Answer: The CAFR document includes much discussion of COVID-19 anticipated impacts to the FY 20/21 budget in the MD&A's Economic Factors and Next Year's Budgets and Rates section beginning on page 34 through page 36 of the draft CAFR.

Question: On page 4, it would be very good to note as on page 24 a $4,000,000 decline in net position in 2020 compared to 2019.
Answer: There was actually a small increase to total net position of $32,000 between FY 2020 and 2019.

Question: On page 4 in the pension paragraph detailing amounts, add that the liabilities are based on a 7.15% investment return and a change of 1% would result in an increased liability of $X as shown on page 84 and also that the 2020 CalPERS return was 4.7%. Want to give more perspective that the liability is understated.
Answer: The measurement period for the net pension liability is actually presented in the June 30, 2020 CAFR is actually as of June 30, 2019. CalPERS reported a return on asset for the fiscal year ended June 30, 2019 of 6.7%. Net pension liability is presented fairly according to generally accepted accounting principles. The following paragraph on page 4 provides detailed cautionary language that the selection and potential changes in underlying pension assumptions could result in obligations being higher or lower and directs the reader to the discount rate sensitivity in Note 9.

Question: On page 4, in the third paragraph, delete "from zero in 2019." Duplicative.
Answer: Noted.

REMARKS (continued):

Question: On page 18 in the second bullet point paragraph, may want to add the page 29-line of 2020 excess revenues over expenditures of negative $4,350,379 compared to a positive $221,363 in 2019. Shows a $4 million decline year on year.
Answer: The increase in governmental expenditures is explained more thoroughly on page 30 of the MD&A. The increase largely resulted from the General Governmental expenditures recording a $4.8M expenditure related to the October 2019 additional discretionary payment made to CalPERS.

Question: On page 25, new operational and capital grants of $1.3 million were noted. Are these recurring or one-time?
Answer: The increase was largely attributable to increases receipt of VTA Measure B grant funding. Part of the VTA grants are formula based, the others are based on a competitive basis with other governments.

Question: On page 26, the paragraph on salary increases should note the effective date and the $ impact in 2020.
Answer: Noted.

Question: On page 35, in the pension paragraph add that the 2020 CalPERS return was 4.7%.
Answer: Noted. The pension discussion on page 35 reports the June 30, 2019 measurement date. CalPERS return for that fiscal year was 6.7%. To help illustrate the variability of future investment returns staff added the table on page 82 which reflects CalPERS short-term, long-term, and blended expected rate of return for the PERF fund.

Question: On page 48, why was interest under forecast by $1.6 million?
Answer: Page 48 reports a positive variance of $1.6M (interest revenues exceeding budget) mostly due to a dramatic decline of prevailing interest leading to an approximate $1.2M GASB 31 “mark to market” increase to interest earned at June 30, 2020. At time of the FY 19/20 budget preparation, interest rates were slowly stable, tending to slowly fall or remain flat, hence no expectation of large portfolio market gains based on prevailing rates. The Town holds its investments to maturity so it would not be wise to budget the speculative interest gain as an operational revenue as the Town would have to sell its positions in the bonds in order to actually receive this market value gain in cash.

Question: On page 48, what was the anticipated sale gain of $1.2 million that did not occur?
Answer: The anticipated sale was the Town’s Winchester lot (fire station parcel) sold to the County’s Central Fire District. Escrow on the sale was finalized and payment received in July 2020.

REMARKS (continued):

Question: On page 81, in the discount rate paragraph line 6 delete "adequate and the use of" and insert "used rather than the municipal bond rate" and delete "calculation is not necessary."
Answer: Noted however the language is the standard GASB 67 disclosure for this item. The result of the mandated cash flow calculation tests determines which discount rate to be utilized

Question: On page 95 under COVID, need to have more specific dollar estimates of declines in revenue in 2021, including actual declines in Q4 2020.
Answer: FY 2020/21 revenue estimates will be discussed at Town Council on December 15, 2020. Because of the nature of sales taxes collected in the Town, it is not possible to discern specific dollar amounts related exclusively to COVID-19 versus other factors.

Attachment (previously distributed):

1. Draft Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2020.

Attachment (distributed with this Desk Item):

2. Committee Member Comments
3. Public Comment Received after distributing the Staff Report and before11:01 a.m. Monday December 7, 2020.

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Comments from Terry Duryea, Finance Committee Member:

Hi Laurel, Arn and Steve
Hope each of you are weathering the unrelentless, but rainless, Covid storm as well as possible.

Here are my comments, which are mostly questions, on the draft CAFR. The questions are to help better understand the 2020 financial story and reasons for changes from 2019. I also have one key question on the impact of Covid on 2020/2021 based on the 4 month impact on 2020 that I'd like you to address. I've tried to include questions on the basic financial statements only if I couldn't find the answers in the MD&A.

Questions on the MD&A

- Page 19 talks about $2.2M in increases in intergovernmental grant revenues. What are the source of the grant the contributed to the increase and how are the funds used?
- Page 24 note 1 talks about a reclassification of 2019, although the reclassification doesn't appear to be made in the 2019 numbers. What is the dollar amount? And how and when was the misclassification identified? Also, since you disclose the need for the reclassification, do you want to change the 2019 numbers?
- Page 26 discussion of the Governmental Activities Expenses explains the increase in General Government expense is due to large swings in the amount allocated with the current year allocation adjustment increasing costs while the prior year allocation adjustment decreased costs. What is the reason for the large swing?
- Page 26 discussion of Governmental Activities Expenses explains that Sworn employees received a 4% raise while all Non-sworn and management employees received 3%. What was the reason Sworn officers received a larger increase than the non-sworn employees. I'm particularly sensitive to this given the much larger per person pension costs for sworn officers.
- Page 27 indicates there is $700K in the Restricted Fund Balance that represents amounts placed in an IRS Section 115 trust. Restricted cash in the Government Fund on the Governmental Funds balance sheet reflects a similar amount. When do you expect to pay the funds to the Section 115 IRS Trust?
- Page 28 indicates the Governmental Funds Balance Sheet has $4.5M identified in the Committed Fund Balance for additional discretionary payments toward pension and OPEB unfunded liabilities. How do you expect to use the $4.5M and when will the funds in the Committed Reserve be utilized/paid to CALPERs?
- Page 29 has a table of Total Governmental Funds Revenues, Expenditures and Changes in Fund Balances year over year. How does the $4.8M in Intergovernmental Revenues tie to the aggregate of the $8,854K plus $850K for Grants and Contributions in the Townwide Statement of Activities on page 41, and to the $2.2M increase over prior year receipts for "intergovernmental (grants) revenues" on page 19?
- Page 32 discusses General Fund Variances from budget for revenues and expenditures. It indicates that 5 revenue categories declined a total of $3.2M due to Covid over 4 months. If you annualize the 4 months to a year, it is $9.7M. Total revenue for the year from these 5 categories per the Statement on page 48 is $18,179K. This implies that for the 4 month period, revenues from these 5 categories declined 53%. Is this a realistic analysis, and if so, how much does the current 2020-2021 budget assume revenue from these categories decline over prior year non Covid impacted revenue?

ATTACHMENT 2

- Page 34 under Economic Factor and Next Year's Budgets talks about the Town having identified contingencies should there be a revenue shortfall. Without going into specifics, what are the nature and type of actions the Town would consider?

Questions on the Basic Financial Statements

Statement of Position—Town wide

- Why the $11.7M decrease to $22.3M in Nondepreciable assets year over year? Note 5 indicates there were $13.97M of Transfers and Retirements. Was this change primarily transfers of completed projects for street infrastructure that are now depreciable?

Statement of Activities—Town wide

- Compensated absences liability is growing. Can the Town do anything to manage it down, potentially to conserve cash, even if it's necessary to wait to address in the next labor negotiations?

Governmental Funds Balance Sheet

- It looks like you broke Capital projects into 2 categories this year. The total of the 2 reserves increased $4.7M. What is the purpose of splitting the account into 2 categories? Also, from Note 8, it looks like the Capital Projects fund increased from $4.3M to $12.2M year over year? Why the large increase that was effectively a transfer from the Capital/Special Projects fund?
- What is the Market Fluctuations Reserve? How does it different from other reserves, if it is?
- Note 8: I would suggest that the purpose of the Capital Projects Reserve Fund and the Market Fluctuations Reserve Fund also be disclosed in Note 8.

Reconciliation of Governmental Funds Balance Sheet to Government-Wide Net Position—Governmental Activities

- What is reason for 8.5% decrease in Allocation of Internal Service Funds Net Position to $7,731 amount from the prior year of $8,454?

Governmental Funds Statement of Revenues, Expenditures and Changes in Fund Balance—page 46

- Note 4 explains the nature of the Transfers in and out, but it doesn't give the dollar magnitude of any of the categories. For transfers that are reported as $1M or more in the footnote, what are the dollar amounts for capital projects & outlays, lease or debt payments, operating expense, and low and moderate-income housing projects in the General Fund, Appropriated Reserve Fund, and Internal Service Funds transfers?

General Fund Statement of Revenues, Expenditures and Changes in Fund Balance—Budget to Actual

- When comparing Actual results to the Final Budget, the Town has a negative variance for every operating revenue account which is a swing from the prior year when the Town had a positive variance in all categories except 2 of the smaller accounts. The revenue variance in 2019 was a positive $2.4M and the variance in 2020 was a negative $1.6M, a swing of $4.0 million. The explanation on page 32 of the MD&A on the impact from Covid explains $3.2M of the swing. But even in the absence of Covid there is still a $600K decline in the favorable revenue variance. In addition, the favorable Expenditures variance declined significantly in 2020 from $7.3M to $3.7M year over year. The swing appears to be more than a statistical budgetary aberration. Was there a structural reason for the decline in favorable variances? I did not in the discussion on pages 32 and 33, there continued to be favorable expense variance incurred for unfilled staff positions.

Proprietary Funds—Internal Service Funds Statement of Revenue, Expenses and Changes in Net Position—page 51

- Why did the Charges for services decrease for 13% year over year to $3,029K. Were services less or costs of services reduced?

From:	Ronald Dickel
To:	Stephen Conway; Gitta Ungvari
Cc:	Arn Andrews; Laurel Prevetti
Subject:	Finance Meeting Monday
Date:	Sunday, December 6, 2020 3:29:54 PM

Steve and Gitta

First, thanks Gitta for printing out the CAFR and agenda items. Much appreciated.

I look forward to the discussion Monday, but want to list out the following various comments and questions for discussion. I would appreciate this being distributed appropriately with the Brown Act to members of the finance committee.

Investment Report

Regarding the Investment Report, you have been extending the portfolio's maturities to a weighted average of 556 days, yielding a return of 1.86%. How do you view the risk of increasing maturities? If it was riskless, you would have always had increased maturities before presumably.

Also, assuming that the current treasury and other bonds yields hold steady, how much will the yield of 1.86% decline by the end of FY 2021?

Finally, $24,500,000 has been withdrawn YTD compared to $11,800,000 deposited. How does this compare to prior years and do you anticipate more net withdrawals for the year?

CAFR

It would be very useful for the Town Council to have a standalone paragraph on page 3 discussing the COVID impact on revenue in Q4. You discuss how much sales tax went down, but knowing the actual decline in Q4 revenue for all fees and taxes in Q4 would allow a better forecast of decreased revenue in 2021.

On page 4, it would be very good to note as on page 24 a $4,000,000 decline in net position in 2020 compared to 2019.

On page 4 in the pension paragraph detailing amounts, add that the liabilities are based on a 7.15% investment return and a change of 1% would result in an increased liability of $X as shown on page 84 and also that the 2020 Calpers return was 4.7%. Want to give more perspective that the liability is understated.

On page 4, in the third paragraph, delete "from zero in 2019." Duplicative.

On page 18 in the second bullet point paragraph, may want to add the page 29 line of 2020 excess revenues over expenditures of negative $4,350,379 compared to a positive $221,363 in 2019. Shows a $4 mln decline year on year.

On page 25, new operational and capital grants of $1.3 mln were noted. Are these recurring or one-time?

On page 26, the paragraph on salary increases should note the effective date and the $ impact in 2020.

On page 35, in the pension paragraph add that the 2020 Calpers return was 4.7%.

On page 48, why was interest under forecast by $1.6 mln?

On page 48, what was the anticipated sale gain of $1.2 mln that did not occur?

On page 81, in the discount rate paragraph line 6 delete "adequate and the use of" and insert "used rather than the municipal bond rate" and delete "calculation is not necessary."

On page 95 under Covid, need to have more specific dollar estimates of declines in revenue in 2021, including actual declines in Q4 2020.

Thanks for all the hard work on the CAFR in these trying covid times. See you tomorrow.

Ron

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Subject: Comments of CAFR

From: Phil Koen <pkoen@monteropartners.com>
Sent: Monday, December 7, 2020 10:22 AM
To: Laurel Prevetti <LPrevetti@losgatosca.gov>
Cc: Marico Sayoc <MSayoc@losgatosca.gov>; Rob Rennie <RRennie@losgatosca.gov>; Stephen Conway <sconway@losgatosca.gov>; Terry Duryea <[redacted]>; Ron Dickel <[redacted]>; Rick Tinsley [redacted] [redacted]>; [redacted]
Subject: Comments of CAFR

Hello Laurel,

Due to a conflict I will not attend the Finance Committee meeting tonight, so I am sending you my written comments in advance of the meeting for your review and consideration. I have also copied the Finance Committee members on this email.

Since perhaps not all members of the Committee are equally versed in the reporting requirements outline by GASB 34 for the MD&A section of the CAFR, I have attached a brief background piece that discusses those reporting requirements and the linkage to the transmittal letter. Hopefully, everyone will find this educational and helpful.

In an effort to be constructive I have taken the time to redraft the Financial Highlights section of the MD&A with the goal of providing a balanced discussion of both the positive and negative changes from prior year and to provide more disclosure regarding a) the negative unrestricted net position, b) the Town's net pension liability and the cost of the pension plans, and c) the trend in government-wide revenue and expenses. Please note that I have broken the Highlights into a section that discusses Government-Wide results vs. Fund Level results. The current draft does not make that distinction clear.

I am aware that members of the Finance Committee have already shared their comments with you, many of which I agree with. Not wanting to duplicate those comments, I will focus on my top four concerns.

Unrestricted Net Position
On page 18 of the CAFR an explanation of the $675k decrease in the negative unrestricted net position is provided. I do not agree with the explanation and would ask that the auditors to confirm the explanation. At a high level, the improvement was due to a slightly larger year over year increase in spendable assets and deferred outflows versus the increase in total liabilities and deferred inflows. I am not of the opinion that use of restricted cash to invest in infrastructure is the cause for the slight improvement in unrestricted net position. Additionally, I think it is important to fully disclose that a negative unrestricted net position indicates that the Town does not have sufficient assets to meet its long-term obligations such as the pension and OPEB plans as of the end of the fiscal year. As pointed out in the CAFR, this is not an uncommon occurrence when governments overly rely on a pay-as-you-go model vs funding the accrued liability. Having a negative unrestricted net position is not a positive financial metric and should not be minimized.

Total Net Pension and Deferred Outflows
In the transmittal letter the Town mentions that the net pension liability is $57.2 million and the OPEB net liability is $9.1 million. I would suggest that all comments regarding the pension and OPEB liabilities be moved from the transmittal letter to the Highlights section of the MD&A and further comments provided. For example, there is no discussion in the Highlights section that the ADP of $4.8 million discussed in the transmittal letter is included in the Deferred Outflows

ATTACHMENT 3

and accounts for the entire increase in Deferred Outflows from prior year. Additionally, there is no disclosure that total pension and OPEB expense in the government-wide expenses totaled $12.6m and increased 14.6% from prior year. The rate of increase in pension and OPEB expenses relative to the rate of increase in Government-wide total revenues (which grew only 1.1%) has a material impact on the Town's long-term financial health. There needs to be more discussion regarding the recent trends and expected future trends.

Economic Factors, trends affecting the forecasted fund balance and Footnotes 15 and 16
The CAFR discusses the impact of COVID 19 on the Town's financial position in footnote 15. Specifically, it discusses that sale tax and TOT receipts **decreased** in FY 20 from FY 19 **actual levels**. However, the CAFR is confusing in its discussion of the budget for FY 21 and potentially misleads the reader into thinking that the FY 21 budget is conservative in its revenue forecast. Specifically, on page 35 the CAFR discusses that both sales tax and TOT receipts were budgeted to reflect decreases from "**prior year's adopted**" budget, not prior year's actual results. While on the surface that sounds conservative, however, the FY 21 approved budget for both revenue streams represent an **INCREASE** from FY 20 actual levels. In the case of sales tax, the increase is approximately $400k, and for TOT receipts the increase is also approximately $400k. Given the prolonged impact of COVID 19 on the local economy, it is highly unlikely that these budgets are to be achieved and it is more likely than not there will be material shortfall from the adopted budget for both tax receipts.

Footnote 15 goes on to mention that the budget identified "contingences should revenues come in below projected amounts" and that the "Town is carefully monitoring actual revenues and expenditures". While that might indeed be the case, the footnote should disclose what those "contingences" are and should also provide the reader with some insight into the likelihood of such contingences being acted upon. I am not aware of any actual revenues or expenditures for Q1 FY 21 being published, so there is no context for the reader to judge the conditions that are expected to have a significant impact on the current year results from operations and financial position.

My concern is further heightened when footnote 16 is taken into consideration. Footnote 16 warns the reader that there could be an additional $1.2 million negative impact on the FY 21 operating results arising from the claw back of RDA distributions and ERAF distributions. When we combine this with the highly likely shortfall in sales and TOT receipts, the Town could be facing at least $2.0 million in known potential FY 21 revenue shortfalls. Please note that this does not include other COVID sensitive revenue streams such as permits and fees, and business licenses and it also assumes that sale tax and TOT receipts are equal to prior years. How the Town plans to address a potential material shortfall in revenue should be discussed in the CAFR.

General Fund Unassigned Fund Balance
Again, in FY 20, the Staff has classified the entire general fund balance of $29.3 million into restricted, committed and assigned fund balances, choosing not to keep any of the general fund balance as unassigned. I believe this misleads the reader into thinking that the assigned fund balances are truly assigned. History has shown that whenever a budget expenditure adjustment is proposed which needs resources to fund, the Staff has pulled such funding from the Capital/Special Projects assigned fund balance. The Capital/Special Projects fund balance has been used to fund everything from incremental headcount, on-going tree trimming services and engineering consultants in addition to funding the Capital Improvement Fund.

GASB 54 addresses the fund balance distinctions. When funds are "assigned", the government is setting these funds aside for the specific purpose identified. This indicates to the reader that the resources are at a minimum intended to be used for that purpose. In the case of the Capital/Special Projects footnote 8 in the CAFR states, "the Capital/Special Projects assigned fund balance will be used for the acquisition and construction of capital facilities as well as special projects or activities as directed by the Town Council."

Given the history of using this fund balance to routinely provide resources for budget expenditure adjustments, I recommend that some amount of the General Fund balance, perhaps $2 million, remain "unassigned". This will indicate to the reader that these funds are available to the Council to be used as directed and improves the integrity of the

Capital/Special Projects assigned balance. If you look at many cities in Santa Clara county, most have some amount of the General Fund balance as “unassigned”.

There is one other point that should be made while we are discussing fund balances. The resolution passed in June 2020 which approved the fund balance under GASB 54 specifically established a Surplus Property Revenue General Fund Reserve to receive the monies from the sale of surplus property and assigned approximately $1.2 million to the Surplus Property Reserve as of the closing of FY 20. That reserve does not appear in the General Fund balance sheet presented in the CAFR. Instead there is a new assigned fund balance called “Market fluctuations”. There is no explanation in the CAFR about this change nor the intent of the “market fluctuations” assigned fund balance. Furthermore since the Surplus Property Revenue General Fund Reserve was established by a Council Resolution which would indicate that the reserve is a “committed reserve” like the budget stabilization and catastrophic reserves, I am not sure that the Staff has the power to change this fund designation to a “assigned” fund balance. I am under the impression that only a Council resolution can reassign monies from a committed to an assigned fund balance. This point needs to be closely examined.

Thank you for considering the above. I apologize for the length of this email, but getting the CAFR correct is very important.

Phil Koen

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