Town Manager Responses to Finance Commissioners' Comments and Questions

Introduction

The Town appreciates the thorough and thoughtful review by the Finance Commission as demonstrated in its submitted comments and questions. The Finance Commissioners' comments/questions and Town Manager (TM) responses are organized in the following categories:

- General comments;
- Suggestions for modifying the presentation and correcting typographical errors;
- Requests for additional information regarding Town Finances; and
- Additional detailed questions and comments.

Many of the comments pertained to the Letter of Transmittal and MD&A. Under GASB guidance, care should be taken to avoid duplication. Two principles may be helpful in this regard:

- Management should use the letter of transmittal to convey any relevant information that is judged too subjective to be included in MD&A (for example, the potential effect of known events) and
- Since authoritative standards limit the content of MD&A to certain specified items, management should use the letter of transmittal to convey other relevant information.

General comments:

Page 32,33: Actual expenditures ended the fiscal year at $5.3 million below final budgeted expenditures. It is worth noting that ~$3.4M of the $5.3M of favorable variance is due to vacancies. This chronic variance (due to budget padding) should be somewhat smaller in the 2023-2024 budget with the addition of a modest vacancy factor of 4.6% which corresponds to ~$1.7M (as described on page 36).

TM Response: *Staff agrees that FY 2023/24 will show decreased budget savings.*

One overall general comment is we had a good year - our overall net position improved, revenues are up and while we underrun expenses the major driver (staffing) provides opportunity to improve services to the town. Along those lines I would suggest the opening paragraph on page 2 of the Transmittal Letter under Economic Conditions and Outlook could be modified to focus on the more significant drivers - ie property tax and sales tax which make up appr 62% of our revenue are both up. A total increase of 8.5% is not insignificant. Leading that discussion with TOT, and stating property tax "remain steady" (vs 7.5% increase) doesn't really reflect the overall picture? I know we don't want to get too comfortable with the current trend and what may occur in the future but downplaying good news doesn't really help us.

TM Response: *The order the revenue presentation is updated in the Transmittal Letter.*

Along those lines - I had 3 big take always.

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1) Revenues were up 8.5% - and $5M more than our Org Budget. The update revenue projection was within .3M of our final actual which means we got a pretty good handle on the changes mid year.
2). We under ran expenses by over $5M (appr 10%) from our updated budget and $2.5M from the original budget. In private business this might be perceived as a good thing but for the Town it may represent lost opportunity. This may be a good area to focus on how we can estimate our expenses more accurately, particularly at the mid-year point.
3). While revenue is up, expenses down - our pension liability grew substantially and given the underlining driver of market performance should be expected to impact our current year. From a overall summary perspective would you agree?

TM Response: *The savings was primary due to vacancies Town-wide. Staff estimates budget savings at mid-year and year end; however, the budget is not adjusted for salary savings. The FY 2023/24 Adopted Operating Budget and Five-Year Forecast include a 4.6% salary savings factor.*

The goal of this section is to provide objective and easily readable analysis of the government's financial activities based on current known facts, decisions, or conditions. The section needs to be simplified and the explanations made more. The explanations are complex and too detail.

TM Response: *Noted.*

While the draft is a good start, there is work to be done in the MD&A section to fully comply with GASB 34. This statement requires the MD&A to provide an objective and easily readable analysis of the government's financial activities based on currently known facts, decisions, or conditions. GASB 34's objective is to enhance the understandability and usefulness of the external financial reports of the Town to its citizens, Town Council, investors, and creditors. Additionally, accountability is the paramount objective of governmental financial reporting. Additionally, I have concerns with the Town Manager's Transmittal letter as noted below.

TM Response: *Noted.*

Management Discussion and Analysis - The goal of this section is to provide objective and easily readable analysis of the government's financial activities based on current known facts, decisions, or conditions. The section needs to be simplified and the explanations made more. The explanations are complex and too detail.

TM Response: *Noted.*

<u>Suggestions for modifying the presentation and correcting typographical errors:</u>

Commissioners provided corrections of typos and grammatical errors.

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Transmittal Letter - Page 2 – there is a typo regarding percentage of general fund revenues – 4.9%

TM Response: *All suggested edits and corrections of typos were incorporated. The percentage should read 44.9% and was corrected prior to the Commission's December 4th meeting.*

Footnote 11 – is the notation "for the year ended June 20, 2023, **pension expense** for each plan …" correct? Should this say **pension contribution**?

TM Response: *Corrected.*

MD&A - TOT revenues are not shown separately on Statement of Activities so the reader is unable to determine the amount. Breakout TOT as a separate line item since it is the majority of "Other taxes" to assist the reader.

TM Response: *Transient Occupancy Tax is listed separately in the General Fund Schedule.*

Add descriptions for Required Supplementary Information section and Supplementary Information section. These are also part of the Financial Statements which need to be explained.

TM Response: *Description added.*

MD&A - Total General Revenues of $39.4m as shown on the Statement of Activities increased 10.3% or $3.7m from FY 22, excluding the $1.5m settlement for litigation. Total General Revenues including special items for FY 23 was $40.9m which was 15% increase over prior year. This should be a highlight.

For the General Fund, excess revenues over expenditures resulted in a $5,718,884 surplus vs prior year $3,290,895 surplus, which represents a $2,427,898 or 74% increase over prior year. This should be highlighted along with a brief explanation for this increase. What contributed to this?

TM Response: *FY 2022/23 results have been added to highlights. The primary factors are summarized in the MD&A.*

Fund Financial Statements - Add descriptions for Required Supplementary Information section and Supplementary Information section. These are also part of the Financial Statements which need to be explained.

TM Response: *Description added.*

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Governmental Activities Revenue Discussion **-** Provide a subtotal for total Program revenues and total General Revenues on the Statement of Activities Schedule (page 24) for ease of understanding of the amount of revenue for each year shown.

Staff Response: *Implemented.*

Staff should consider including more graphs as a basis for explanation (less text) such as the ones provided by the Auditor.

TM Response: *Graphs added.*

Staff should consider showing only two years comparison (FY 23 and FY 22) since FY 21 is not presented in the financial statements.

TM Response: *Graphs added.*

Staff should highlight the good news story that revenues exceeded operating expenditures and there was an operating surplus for both FY 23 and FY 22.

TM Response: *Highlights added to FY 2022/23.*

Transmittal Letter - Page 2 – states the Town's economically sensitive TOT revenues remain near historic lows (?) and sales tax receipts are flattening. Please check this for accuracy.
MD&A - FY 23 TOT increased 100% over the low point of $1.1m in FY 21 and 12% over FY 22. Discuss the recovery in both % and $ from the low point in FY 21 (pandemic) so the reader has a better understanding of the trend in TOT. The trend is inconsistent with the statement regarding TOT in the transmittal letter. Reference to FY 19 should be dropped since FY 19 results are not presented in any schedules.
Confirm the trend in economically sensitive revenue items including Sales Tax, TOT tax and Property Taxes is accurate. FY 23 results are showing strong recovery and in total exceed FY 21 levels (low point) and FY 19 levels (pre-pandemic).

TM Response: *FY 2022/23 Transient Occupancy Tax (TOT) revenue collection increased by $0.3 million compared to the level collected in FY 2021/22; however, FY 2022/23 inflows of $2.2 million are still $0.5 million lower than the FY 2018/19 level of TOT collection (pre-pandemic level). Actual TOT collection was $120,357 below budget in FY 2022/23.*

While sales tax increased from the prior year, the actual sales tax collection was $152,657 below the budgeted amount, and therefore it is considered flat.

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Requests for additional information regarding Town Finances:

Transmittal Letter - Page 3 – The financial statements show the $3.6m ARPA funds were transferred to the General Fund. What qualifying expenditures under the Act were reimbursed and for how much? How much remains of the $7.2m ARPA grant?

MD&A - ARPA – technical question – what is the revenue recognition policy on ARPA Grant? Should revenue be recognized when a qualified expenditure has been made or when cash received? Also, how much of $7.2m is still available?

Footnote 16 – Covid – please disclose in detail which funds the FY 23 ARPA revenue of $3.6m was transferred to. Please also disclose for FY 22 ARPA revenue of $3.4m which funds the money was transferred to.

TM Response: *The Town received $7,229,744 from the American Rescue Plan Act (ARPA) grant. For FY 2020/21, $200K of ARPA proceeds were recognized as revenue to reimburse the Town for qualifying expenditures under the provisions of the Act, including boosting economic recovery, providing rent forgiveness, and directing grants to non-profit and social welfare organizations. For FY 2021/22 and FY 2022/23, the Town recognized $3.4 million and $3.6 million respectively in ARPA revenues for qualifying public safety expenditures. The ARPA fund was fully expended and the remaining balance is $0.00 as of June 30, 2023. See Note 19.*

Transmittal Letter - Page 3 – Regarding labor negotiations, please disclose the total increases approved as a %.

TM Response: *The three labor agreements called for one-time non-pensionable bonuses and a combined market adjustment and cost of living adjustment for the Police Officers Association (7.25%), Town Employees Association (8%), and Association of Federal, State, County, and Municipal Employees (7.5%) for FY 2022/23.*

For this same year, the unrepresented Confidential employees received a one-time non-pensionable bonus and a combined market and cost of living adjustment (COLA) of 8%. Temporary classifications received a market adjustment and COLA totaling 8%. The unrepresented Management employees received a 3% COLA and one-time non-pensionable bonus. Effective July 1 2023, Management employees (except for the Council appointed Town Manager and Town Attorney) received an additional 3% market rate adjustment effective April 2, 2023. This information is available to the Finance Commission and the public in the Adopted Operating Budget: https://www.losgatosca.gov/DocumentCenter/View/36220/FY-2023-24-Operating-Budget?bidId=

Footnote 1 – Basis of Accounting – consider adding a paragraph which discusses claims and judgments. Disclose how the Town accounts for material claims and judgments and associated legal and administrative costs when it is probable that the liability claim has been incurred and the amount of the loss can be reasonably estimated. Disclose where (which fund) the Town records estimated loss liabilities, including a) known loss events expected to be presented as claims later, b) unknown loss events that are expected to be claims and c) expected future development on claims are ready reported.

TM Response: *See Note 13- Risk Management.*

Disclose how the assigned balances are assigned. Is this done by the Town Manager or by the Town Council. What is the basis for assigning ERAF Risk of $689,608 in fund balance. Was all ERAF revenue recognized in FY 23, FY 22 and FY 21? Should it have been? If litigation is probable, then please discuss in the footnotes - litigation.
Footnote 10 – Please explain the addition and deletion accounting for ERAF Risk. Why is $2,298,692 shown as an addition to fund balance? Was $2,298,692 recorded as General Fund Revenue – Property Tax? (Please see ERAF Risk comment above). Discuss why the Town does not have an unassigned fund balance to fund unplanned expenditures. Historically the Town has used the Capital/Special Projects assigned fund balance to cover unplanned expenditures.

Discuss the ERAF set aside for potential settlement of lawsuit between the State and the School districts.

ERAF Risk – what is the basis of accounting for creating an assigned fund reserve in the General Fund for ERAF risk as opposed to a liability for claim or judgment? Does the risk not rise to the level of being probable or reasonably estimated?

TM Response: *The disclosure of the fund balance assignment is described in Note 1. The ERAF Risk Reserve was assigned by Town Council Resolution. Additional detail was provided to the Finance Commission at its October 9, 2023 regular meeting regarding the actual ERAF collection and the reserve (Items 7 and 8).*

Discuss why the Town does not have an unassigned fund balance to fund unplanned expenditures. Historically the Town has used the Capital/Special Projects assigned fund balance to cover unplanned expenditures.

TM Response: *Per the Town Council General Fund Reserve Policy, upon closing the Fiscal Year the entire unassigned balance will be placed in the Capital Projects/Special Project Reserve.*

Transmittal Letter - Page 3 – Please explain how a "successful" completion" of the labor negotiations "exacerbate" an "already existing imbalance between revenues and expenditures"? Does Staff believe there was an imbalance in FY 23 between revenues and expenditures? Is this a forward-looking or backward-looking statement?

TM Response: *This statement acknowledges the trends in the Five-Year Forecast contained in the Adopted Operating Budget.*

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Transmittal Letter - Page 3 – How did the Town adjust and prepare for rising pension costs in FY 23? Please explain.

TM Response: *To address the escalation in pension costs, previous Councils have allocated additional discretionary pension payments totaling $10.4 million. These additional discretionary payments will ultimately yield an approximate $12.7 million in contribution savings. In addition to the management of the Town's pension obligations, prior Councils have worked to curb cost escalations in Other Post-Employment Benefits (OPEB). In 2009, the Town initiated prefunding of the retiree healthcare benefit and has since established approximately $22.6 million in OPEB assets from zero in 2009. In addition, the Town plans an additional $690,000 annually toward mitigating pension costs.*

Transmittal Letter - Page 3 – Please clarify when the $10.4m in discretionary pension funding occurred. This was not in FY 23.

TM Response: *Clarifying language was added. The Town has contributed $4.7 million in additional discretionary payments in FY 2019/20 and $5.6 million in FY 2020/21. This level of detail is not appropriate for the Transmittal Letter and the referenced prior actions mitigate the increasing costs related to unfunded pension liabilities.*

Transmittal Letter - Page 4 – There is a "caution" provided to readers that the actuary reports provided by CALPERS are "forward looking" information. What is the purpose of this "caution"?

TM Response: *The caution is warranted since there is uncertainty in the forward-looking information.*

Transmittal Letter - Page 4 – There is a statement "despite revenue constraints" – please explain constrains exist.

The mention of "revenue constraints" is confusing in that FY 23 General Fund revenues exceeded General Fund Expenditures and resulted in a $5.7m surplus.

TM Response: *The Town's expenses are growing faster than its revenues.*

Transmittal Letter - Page 4 – increasing costs associated with unfunded federal and state mandates is cited as an issue. Can you give an example of unfunded federal and state mandates that increased costs?
For sake of clarity, provide an example of an unfunded federal or state mandate that is driving cost increases.

TM Response:

- *There are several bills that have added costs to capital projects, operations, maintenance, and fleet, including but not limited to:*

- *Americans with Disabilities Act – This federal mandate requires the Town to improve Town-owned buildings, parks, sidewalks, and streets in conjunction with every capital project. In developing the Town's ADA Transition Plan, all Town-owned assets were evaluated for compliance. A recent example is a project to improve restrooms and the human resources offices at the Civic Center. This project necessitated replacement of the access ramp to the lower level of the building. The cost of the design and construction of the ramp added an estimated $370,000 to the project.*

- *Municipal Regional Stormwater National Pollutant Discharge Elimination System (NPDES) Permit – This Permit addresses stormwater discharged to rivers and streams. The requirements are extensive and include water quality target goals, management of certain contaminants (such as Mercury and PCBs), reduction of trash in waterways, management of construction sites to prevent erosion, detection and elimination of illicit discharge, public information, outreach, and monitoring to document the reductions. The following are examples of the financial impacts: (1) in 2023, the Town funded and installed 17 trash capture devices in the storm drainage system and these must now be maintained by staff; (2) the Town is required to map the storm drainage system which is expected to cost almost $300,000; and (3) the Town is required to identify and fund new stormwater treatment(s) systems for 1.8 acres of existing impervious areas by 2025 with construction to follow.*

- *Waste management – Senate Bill (SB) 1383 was signed by Governor Brown on September 19, 2016 to reduce organic waste disposed in landfills by 50% by 2020 and 75% by 2025 (2014 baseline), and to reach recovery of 20% edible food that would otherwise be disposed in landfills by 2025. To achieve these goals, SB 1383 requires action in the following areas: organics collection, ordinance development, education and outreach, contamination monitoring, procurement of organic materials, edible food recovery, and compliance reporting. While certain elements of the implementation are completed through the waste collection and hauling Joint Powers Authority, Town staff time is required to achieve compliance. Enforcement and penalties for non-compliance began on January 1, 2022 for jurisdictions.*

- *Fleet Electrification – California has passed Advanced Clean Fleet requirements that, starting January 1, 2024, require the Town to transition its 80+ vehicle fleet to electric vehicles. New vehicles purchased after this date must be electric. At current market conditions, the EVs will require a larger capital expense than gas powered or hybrid vehicles. In addition, the conversion is going to require the installation of extensive charging infrastructure at Civic Center, PPW Yard, and the Police Operations Building. It is estimated by Silicon Valley Clean Energy that the total cost of fleet ownership will increase 56% as a result of the change to electric. The Town currently has 1.5 FTE Mechanics, both of whom will need to re-trained to work on EVs.*

- *Several bills and court decisions created unfunded mandates for the Police Department:*
  - *2015- Assembly Bill (AB) 953 - Racial Identity and Profiling Act*
  - *SB 1421 (2018) - Right to Know Act pertaining to records related to police misconduct and serious uses of force*
  - *AB 748 (2018) - Disclosure of written, video/body worn camera materials for law enforcement*
  - *SB 2 (2022) - Assessment process and decertification of law enforcement for Officer misconduct*
  - *SB 16 (2022) - Retention of internal affairs records requirements*
  - *New York v Bruins/SB 2 (2023) - Updated laws related to issuance of concealed weapons permits*

In schedule 14 are the staff numbers for 22/23 budget or actual? I assume the prior years are actual?

TM Response: *The Schedules show the budgeted number. Staff reports on actual vacancies to the Finance Commission quarterly with the Key Performance Indicators.*

Footnote 1 – Basis of Accounting – consider adding a paragraph which discusses claims and judgments. Disclose how the Town accounts for material claims and judgments and associated legal and administrative costs when it is probable that the liability claim has been incurred and the amount of the loss can be reasonably estimated. Disclose where (which fund) the Town records estimated loss liabilities, including a) known loss events expected to be presented as claims later, b) unknown loss events that are expected to be claims and c) expected future development on claims are ready reported.

TM Response: *See Note 13- Risk Management.*

MD&A - Can you provide more information on the $1.6m litigation settlement. Perhaps this should also be addressed in a footnote 14 – litigation.
Staff should provide more information regarding the legal settlement of $1,565,000. This could be done in the litigation footnote.

Footnote 14 – Litigation – discuss the litigation settlement of $1,565,000 and that it was recorded in the Appropriated Reserve Fund.

TM Response: *Note 14 includes all outstanding liabilities as of June 30, 2023. The settlement was collected during FY 2022/23 and is not an outstanding liability.*

On January 16, 2018, the Town annexed a portion of Shannon Road from the County of Santa Clara. After annexation, the Town noticed that necessary repairs to the road had not been made. On March 3, 2022, the Town sued the County of Santa Clara to seek repairs or funding for road repairs. The Town also sued two County contractors, Graniterock Construction and Uretek. All parties settled. The County paid the Town $1.5M, Graniterock Construction paid

$50,000, and Uretek paid $15,000. These funds are being used to make repairs to Shannon Road. This information was discussed at the March 7, 2023 Council meeting.

Appropriated Reserves Fund should disclose the amount of ARPA funds included in the $7.3m net transfer and why the $1.6m legal settlement was recorded into the Appropriated Reserves Fund and not the General Fund. Which fund paid the legal expenses?

TM Response: *There was no ARPA fund transfer to the Appropriated Reserve. The legal settlement is providing funding to the Shannon Road repair. Legal expenses were paid by the Town Attorney Department.*

Restricted cash - Should the cash received from the BMP Housing Program of $3.7m be reported as restricted cash in the General Fund since it is restricted for BMP Housing program activities? Even better, why not have this reported in a separate fund like Traffic Impact Mitigation fees to increase transparency?
Footnote 2 – should the BMP funds be included in Restricted Cash and Investments?

A special revenue fund for BMP Housing Program In-Lieu fee should be established given the current balance ($3.7m) and the fact that the funds are restricted for BMP Housing Program activities. Additionally, there are numerous Housing Element programs that are planned to be funded from the BMP fees as outlined in the adopted Housing Element.

TM Response: *Staff will research establishing ordinances and evaluate if a special revenue fund is warranted.*

<u>Additional detailed questions and comments:</u>

TM Response: *The redlined ACFR includes additional graphs, the removal of FY 2020/21 data, and summary presentations to address some of the Commissioners' comments. Many of the following questions require detailed year over year, normalized, and/or other analyses that are beyond the scope of the MD&A. The Town's Adopted Operating Budget contains information that is requested in some of these comments.*

Question: on page 26 last paragraph - the discussion on prior year one-time-pass through for fire safety doesn't specifically say how much it was (or I missed it). Would like to understand the $5.2m difference between 22 to 23 in General Gov't expenses better.

MD&A - Please explain how net expenses over revenues impacted the $15.1m increase in total net position. Wouldn't this decrease the total net position?
MD&A - FY 23 Pension expense of $5,870,044 – please add FY22 pension expense of $3,389,540 and FY 21 Pension expense of $9,806,974 and explain the year over year changes for all 3 years which are material. Why the change?
MD&A - When comparing year over year Total Expenses of $49,317,203 in FY 23 to $52,719,798 in FY 22, one-time activities such as the fire safety grant ($6.9m) in FY 22, the impact of pension

expense credit and OPEB credits ($4.4m) in FY 22 and $(2m) in FY 23 are materially impacting the analysis of the change. The total impact of known one-time activities should be disclosed and a "proforma" normalized Total Expense reported for each year to aid the reader in understanding the "normalized" year over year changes from FY 21, FY22 and FY23.
Confirm the trend in economically sensitive revenue items including Sales Tax, TOT tax and Property Taxes is accurate. FY 23 results are showing strong recovery and in total exceed FY 21 levels (low point) and FY 19 levels (pre-pandemic).
Question: on page 26 last paragraph - the discussion on prior year one-time-pass through for fire safety doesn't specifically say how much it was (or I missed it). Would like to understand the $5.2m difference between 22 to 23 in General Gov't expenses better.

Overview of the Financial Statements - The first paragraph is confusing and needs to be simplified to discuss the mix of revenue by source – Program Revenues vs Total General Revenues and what revenues are included in program and general revenues. Total general revenues and special items and Program revenues are reported separately and should be discussed separately in their own section. Program Revenues are applied against Total Expenses to show the net expense for all governmental activities. Comparing the net expense allows the reader to understand whether general tax revenues are sufficient to cover the net expense for all governmental activities.

Overview of the Financial Statements - Program Revenues - Discuss material change in Capital Grants and Contributions from FY 21, to FY 22 and to FY 23, including the impact of ARPA Grants. The change from FY 22 to FY 23 was $18,311,031 decrease and the change from FY 21 to FY 22 was $21,379,861. Why did charges for services decrease from FY 22 but are up $1m from FY 21.

Overview of the Financial Statements - General Revenues – Investment Earnings - Disclose the two components of investment earnings – interest income and the mark-to-market adjustment so the reader understands the year over year fluctuations.

Overview of the Financial Statements - General Revenues - Developer Fees - Provide an explanation for the change in developer fees for FY 21, FY 22, and FY 23. Please explain the revenue recognition policy since, I believe, it is tied to qualified expenditures and not to when cash is received. Explain the term "pass through developer contributions."

Overview of the Financial Statements - General Revenues – Property Tax - Disclose the dollar and percentage change for the components of property tax revenues. I believe total secured tax increased 9.2% from prior year, VLF increased 7.7% and ERAF decreased 3%.

Overview of the Financial Statements - I am unclear as to the $.4m decrease in property transfer tax – what does this exactly mean? In FY 23 there was a positive impact on general property tax over the statutory 2% increase resulting from home sales. Is the comment that in FY 23 this was not as great as the prior year? Isn't it a component of general property tax collection?

Overview of the Financial Statements - Disclose how much assessed valuations for the Town increased FY 23, FY 22, and FY 21. You can reference the SCC Assessor's Annual Report. I believe for Los Gatos the net assessment roll for FY 23 increased 7.77%, FY 22 increased 4.33% and increased 7.7% for FY 21. The increase in assessed valuations has been a major driver of increasing property tax revenues.

Governmental Activities Expenses Discussion - In comparing the change in total expenses across FY 21, FY 22, and FY 23 there are several one-time charges (fire safety pass through grant $6.9m, pensions expense and OPEB credit $4.4m, etc.) that make this comparison extremely difficult. To provide a better user experience and more fair comparison, one-time credits and one-time pass-through grants need to be adjusted out, so the reader has a better understanding of how total expenses on a normalized basis have changed over time for all operating departments. The current format fails to provide that level of clarity. This section needs a different approach to explain the underlying trends in total expenses.

Major Governmental Fund Results - Add discussion of the excess of Revenues over expenditures and discuss year over year change from FY 21, FY 22, and FY 23. The reader needs to understand that for FY 22 and FY 23 there were surpluses.

Major Governmental Fund Results - The revenue and expense discussion should disclose all one-time major events (fire safety pass through grant ($6.9m), pension and OPED credits ($4.4m), mark to market adjustments ($1.6m), pass through developer contributions ($1.1m), expensing the affordable housing loan ($1.2m), etc.) which impact the underlying trends and year over year comparisons for revenues and expenditures. The analysis should include both a discussion of actual results as well as results on a normalized "pro-forma" basis by removing known one-time events. Without this, the reader will not gain a sufficient understanding of the Town's underlying operating performance in FY 23, FY 22 and FY 21 let alone be able to judge whether the normalized revenues were sufficient to pay for normalized services for each year shown.

Major Governmental Fund Results - To provide more insight on expenditures for each category (public safety, general government, parks and public works, community development, library services) the analysis should clearly identify the increase in total expenditures from salary increases vs increases in benefit contributions. Both are important cost forces that need to be explained.

General Fund Budgetary Highlights - The analysis of budget to actual is entirely focused on comparing final budget to actual results. What is not discussed is the variance between original budget to actual results. An analysis which provides useful insights into the variance between original adopted budget and actuals as well as the final budget vs actuals will allow readers to assess the Town's ability to estimate and manage general resources throughout the year. For example, the original adopted budget expenditures totaled $47,354,218. The analysis provides a list of most of the changes approved which resulted in a final budget $50,204,894, a 6.1%

increase. Presumably, all of these were necessary to provide new services or maintain existing services. However, actual expenditures were $44,890,847 – reflecting a "savings" of $5,314,047 (10%) from the final budget and a "savings" from the adopted budget of $2,463,381 (5%). If the Town needed to spend $50,204,894 to deliver all services, why did the Town spend $44,890,847? Are these true "savings" in the sense the Town has become more efficient and does not need to spend that amount of money to deliver the planned level of service levels OR was this a cut in service levels in that the Town did not deliver the planned level of services that had been approved? This is a very important question to be discussed since the change from the adopted budget is material and in several places in the ACFR there is the mention of an imbalance between revenues and expenditures which does not appear to square with the budgetary outcomes. This only confuses the reader. Additionally, the adopted budget called for a deficit of revenues over expenditures of $1,816,881. During the year, the TC adopted revenue budget adjustments totaling $4,734,887 and increased expenditures of $2,850,676 which moved the deficit to a slight surplus. Was this the result of added information received, or the result of becoming less conservative in budgeting as the year progressed? I believe a re-write of this section is required so the reader can gain a better understanding of the budgetary process and is able to make a judgment on the Town's ability to estimate and manage its general resources throughout the year. It is hard to understand how the Town can increase the total expenditure budget to $50.2m during the year and then only incur $44.9m when the majority of expenses are salary and benefits.

The discussion of general fund budgetary highlights needs to be rewritten to make it more easily understood and to discuss variances from the original adopted budget and the final budget. This section is critical in that it provides the reader the necessary information to assess the Town's ability to estimate and manage general fund resources throughout the year. The magnitude of change from the adopted budget to actuals is material. For example, the original adopted budget planned for an ending GF Balance of $19,493,386. The actual ending balance was $29,528,304 or 52% greater. Why did this occur ? A partial explanation is during the year the Town Council approved additional expenditures of $2,850,676 increasing the budget to $50,204,894 presumably for additionally needed services. However, actual expenditures were $44,890,847 or a total of $5,314,047 (11%) less. This reduction in planned expenditures was a major component in increasing the general fund balance. But was this reduction a "savings" in the sense the Town was more productive or was it a "reduction in service levels" in that planned services were not delivered? This is not explained. A thoughtful analysis of budget vs actuals will address a subtle "theme" that seemingly weaves through the ACFR that there is some type of "imbalance between revenues and expenditures". This is stated a few times in the ACFR in different areas. And yet the actual results do not support this conclusion.

Economic Factors and Next Year's Budgets and Rates - There is a mention of a Five-Year Financial Forecast predicting operating shortfalls. There is no context about this forecast. I am not aware of any five-year forecast which reflects the actuals for FY 23 as its stepping off point. Additionally, it is stated a "strong return to pre-pandemic performance of the Town's economically sensitive revenues" is required to provide current service levels. Is this accurate given the discussion above regarding expenditures and the fact that FY 23 property taxes, sales taxes, and TOT taxes exceeded FY 19 (pre-pandemic) by 20%. These statements need to be fact checked.

The assumption of 3.6% growth in property tax collections is not supported by the SCC Tax Assessor's Office Annual Report FY 2023-2024 which reports a 7.72% growth in net assessment roll growth for Los Gatos for FY 24 and the SCC Finance Agency which has published a revenue estimate in September 2023 for FY 24 total property tax revenues increasing 6.7% over FY 23, which includes the impact of ERAF and VLF tax receipts. What is the basis for this 3.6% growth?

The Towns should disclose the projected increase in pension contributions over the next five years so the reader can understand the magnitude of these payments for both the miscellaneous and safety plans. Based on the latest analysis from Foster and Foster the combined annual contribution are projected to increase from $7.6m in FY 23 to $10m in FY 28 which is a 31.5% increase. Are any other discretionary payments planned given the increase in Total Governmental Fund Balances in FY 23 and FY 22?

The economic factors and next year's budget should be shortened and rewritten as well. Most importantly the section should provide up to date information regarding current facts as known. For example, SCC Assessor's Office has released the FY 2023 net assessment roll for Los Gatos which increased 7.72% from the prior year. In addition, the SCC Finance Agency has published revenue estimates for property taxes (including ERAF and VLF) which forecast a 6.7% growth over prior year. These would suggest that the Town's property taxes will be higher than the FY 24 budget which was built on a 3.6% growth. This is good news and should be disclosed.

Confirm the trend in economically sensitive revenue items including Sales Tax, TOT tax and Property Taxes is accurate. FY 23 results are showing strong recovery and in total exceed FY 21 levels (low point) and FY 19 levels (pre-pandemic).

Discuss more fully what actions were taken in FY 23 to address rising pension contributions (an element of pension expense) and increasing unfunded pension liabilities. Transmittal letter is confusing regarding actions taken in FY 23 vs prior periods.

There should also be a discussion of the future pension expense (or pension contributions) as a result of the increased unfunded pension liability. It is clear – pension contributions are materially increasing unless action is taken. With the GF balance ending over $10m greater than what was originally planned, perhaps the Town should consider making additional ADPs like those made in FY 20 and FY 21.

Staff should discuss in a revenue comment and a separate expenditure comment for both the government wide financial activities analysis and for the general fund analysis, all one-time revenue and expense items that are materially impacting year over year comparisons. The objective is to present on a "pro-forma" basis normalized total revenues and normalized total expenditures so the reader can easily understand underlying operating revenue and expenditure trends. The number of onetime events in just FY 22 is material. A partial list includes:

- Fire Safety pass through grant - $6.9mm
- ARPA revenues - $3.6m
- Pensions expense and OPEB credits - $4.4m
- Mark to market adjustments – ($1.6m)
- Expensing affordable housing loan - $1.2m
- Pass through developer contributions - $1.1m
- Total impact on all salary adjustments - ?