

From: [Phil Koen](#)
To: [Gitta Ungvari](#); [Wendy Wood](#)
Cc: [Laurel Prevetti](#)
Subject: Comments for the FC Meeting - Agenda Item #1
Date: Monday, December 4, 2023 9:07:10 AM
Attachments: [Preliminary Comment on the FY 2023 ACFR - revised.docx](#)

[EXTERNAL SENDER]

Gitta,

Attached are my comments after reviewing the Transmittal Letter and the MD&A section of the ACFR. I'm prepared to discuss them tonight.

I will submit more comments on the financial statements and footnotes later this week.

I realize there are numerous comments/suggestions here – let's work through them. My goal is to increase disclosure and provide an easily readable analysis.

Thanks,

Phil

Preliminary Comments on the FY 2023 ACFR

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.

Here are my initial thoughts and questions on the transmittal letter and MD&A. I will provide additional comments on the basic financial statements and footnotes early next week.

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.

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

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?

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

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?

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

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

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"?

Page 4 – There is a statement "despite revenue constraints" – please explain constraints exist.

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?

MD&A

Most comments are focused on more disclosure and more analysis, to help the reader understand the financial statements.

Financial Highlights

- Can you provide more information on the \$1.6m litigation settlement. Perhaps this should also be addressed in a footnote 14 – litigation.
- Please explain how net expenses over revenues impacted the \$15.1m increase in total net position. Wouldn't this decrease the total net position?
- 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?
- 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?
- 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.
- 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.
- 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.
- 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?
- 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?

Overview of the Financial Statements

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.

Analysis of Government-Wide Financial Activities

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.
- 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.
- 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.
- 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.
- 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.”
- 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%.
 - 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?
 - 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.

- Add the discussion of the litigation settlement of \$1,565,000.

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.

Financial Analysis of the Town's Funds

Assigned Fund Balance

- 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.

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.
- 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.
- 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.
- 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?

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.

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?

I will have additional comments on the Basic Financial Statements and footnotes but will submit them early next week.

Thank you,

Phil Koen

From: Linda Reiners
Sent: Monday, December 4, 2023 9:50 AM
To: Gitta Ungvari <GUngvari@losgatosca.gov>; Laurel Prevetti <LPrevetti@losgatosca.gov>
Subject: Comments

[EXTERNAL SENDER]

Hi,

I've reviewed the documents and have some minor questions/comments.

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.

Along those lines - I had 3 big take aways.

- 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?

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

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.

Thanks for the consideration - look forward to tonight's discussions.

Linda

Sent from my iPad