



## City Council Staff Report

**From: City Manager**

**Report Type: CONSENT CALENDAR**

**Lead Department: Administrative Services**

**Meeting Date: January 16, 2024**

Report #:2311-2230

### **TITLE**

Accept the City of Palo Alto's Audited Financial Statements as of June 30, 2023 and the Macias, Gini & O'Connell Management Letter; Approve the FY 2023 Annual Comprehensive Financial Report (ACFR) and Amendments to the FY 2023 Budget in Various Funds; and Adopt a Resolution to Extend and Amend the Development Services Reserve Fund Policy, as Recommended by the Finance Committee; CEQA Status – Not a Project

### **RECOMMENDATION**

Finance Committee and Staff recommend that the City Council:

1. Accept the City of Palo Alto's audited financial statements for the fiscal year ended June 30, 2023, and the accompanying reports prepared by Macias Gini & O'Connell LLP ("MGO")<sup>1</sup>.

Reports include:

- a. Report to the City Council (the "Management Letter"),
- b. Cable TV Franchise, Independent Auditor's Report and Statements of Franchise Revenues and Expenses for the years ended December 31, 2022, and 2021,
- c. Palo Alto Public Improvement Corporation (a component unit of the City of Palo Alto) Annual Financial Report for the year ended June 30, 2023,
- d. Regional Water Quality Control Plant, Independent Auditor's Report and Financial Statements for the year ended June 30, 2023, and
- e. Independent Accountant's Report on Applying Agreed-Upon Procedures related to the Article XIII-B Appropriations (GANN) Limit for the year ended June 30, 2023.

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<sup>1</sup> 11/28/2023 CMR# 2309-2041 Finance Committee Staff Report, *Discussion and Recommendation to the City Council to Accept the Macias Gini & O'Connell's Audit of the City of Palo Alto's Financial Statements as of June 30, 2023*

<https://portal.laserfiche.com/Portal/DocView.aspx?id=69139&repo=r-704298fc&searchid=098e186d-ecf7-43c8-af8d-c98790422d83>

2. Approve the Fiscal Year (FY) 2023 Annual Comprehensive Financial Report (ACFR) and reports collectively referred to as the Single Audit in CMR #2308-1857<sup>2</sup>. An electronic copy is available on the City's website<sup>3</sup>;
3. Amend the Fiscal Year 2023 Budget Appropriation Ordinance for various funds as identified *Recommended Amendments to the City Manager's FY 2023 Budget*; referenced as "Attachment B – Exhibit 1 and various capital projects as identified in Attachment B – Exhibit 2" (Attachment I) in CMR #2308-1857<sup>2</sup> PDF pp. 26-39 (Effective on first reading; five votes required);
4. Adopt a Resolution to Extend and Amend the Development Services Reserve Fund (DSRF) *Policy Resolution of the Council of the City Palo Alto to Extend and Amend the Development Services Reserve Fund Policy (Attachment II)*, previously adopted by Ordinance No. 5420 (Attachment III); and
5. Refer to staff review of the approval process for excess Budget Stabilization Reserve (BSR) allocations in both long-term retiree benefit funding policy and capital infrastructure reserve policy with the Finance Committee.

Hard copies of these reports were provided in 2023, though additional are available upon request.

## BACKGROUND

Every year, the fiscal year is closed out and the City Council publishes the City's financial report (Palo Alto Municipal Code 2.28.200). At the November 28, 2023 Finance Committee meeting, the Committee reviewed two staff reports: one transmitted by the City Auditor's Office and one by the City Manager's Office via the Administrative Services Department, and unanimously approved both reports for City Council consideration<sup>4</sup>:

- Office of the City Auditor: Discussion and Recommendation to the City Council to Accept the MGO Audit of the City of Palo Alto's Financial Statements as of June 30, 2023<sup>1</sup>.

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<sup>2</sup> 11/28/2023 CMR# 2308-1857 *Finance Committee Staff Report, Approval of the FY 2023 ACFR YE Budget Amendments, and Resolution to Extend and Amend the Development and Services Reserve Fund Policy*  
<https://portal.laserfiche.com/Portal/DocView.aspx?id=69140&repo=r-704298fc&searchid=222c8b61-ff08-4b38-ba4c-22c2a2d87b96>

<sup>3</sup> City of Palo Alto FY 2023 Annual Comprehensive Financial Report  
<https://www.cityofpaloalto.org/files/assets/public/v/1/administrative-services/city-budgets/fy-2023-city-budget/fy-2023-annual-comprehensive-financial-report.pdf>

<sup>4</sup> November 28, 2023, Finance Committee Action Minutes:  
<https://portal.laserfiche.com/Portal/DocView.aspx?id=68938&repo=r-704298fc>

- Administrative Services Department: Recommendation to Approve the Fiscal Year (FY) 2023 ACFR, Approve FY 2023 Budget Amendments in Various Funds and Amend the Development Services Reserve Fund Policy (DSRF) <sup>2</sup>.

In addition to these reports, the Finance Committee recommended that the Council refer to staff review of the approval process for the allocation of excess Budget Stabilization Reserve (BSR) balance, above the Council approved target range discussed in both the long-term retiree benefit funding policy and capital infrastructure reserve policy. The Committee discussed this in the context of potentially memorializing recent practice in these policies which includes Committee review.

MGO issued a clean opinion on each audit report. A finding was noted for the Appropriations Limit (or “Gann Limit”) Agreed-Upon Procedures Report where the incorrect adjustment factor was used in the calculation. Staff corrected the calculation and did not exceed the FY 2023 GANN Limit after the calculation was corrected.

The City also received the Certificate of Achievement for Excellence in Financial Reporting from the Government Finance Officers Association (GFOA) for its FY 2022 ACFR.

The Finance Committee discussed the status of the General Fund and the Budget Stabilization Reserve (BSR) balance. The General Fund Budget Stabilization Reserve (BSR) ended FY 2023 at \$61.5 million; after adjusting the BSR for FY 2024 uses approved by Council through November 2023, the net BSR balance is \$57.3million, \$3.4 million above Council’s 20% BSR target level for FY 2024. By policy, the City maintains a BSR balance of 15-20% of the annual operating expense, with a typical target level of 18.5%. In alignment with Council policy, the Committee and staff recommends that the excess is split between the Capital Fund Infrastructure Reserve (IR) and the Section 114 Pension Trust fund (\$1.7 million each); necessary budget actions to allocate the BSR funds in excess of the 20% target will be included in the FY 2024 Mid-Year Review (February 2024).

## **ANALYSIS**

### ***Government-wide***

As outlined in the staff report to the Finance Committee, at the close of FY 2023, the City’s total Net Position is \$1.354 billion, an increase of \$83.3 million or 6.6% over the prior fiscal year. The total increase of \$83.3 million consists of \$42.4 million from governmental activities and \$40.9 million from business-type activities. Approximately two-thirds of this increase are the City’s net investment in capital assets (land, buildings, infrastructure, vehicles, and intangible assets) and restricted funds. Approximately 90% of the City’s \$1.354 billion Net Position, approximately 90% is net investment in capital assets.

### ***General Fund***

The General Fund ended with a net Budget Stabilization Reserve (BSR) surplus of \$3.4 million, after adjusting for estimates used in the development of the FY 2024 Adopted Budget and Council approved uses of the BSR in FY 2024 through November 2023. Overall, at the end of the current fiscal year, the General Fund's fund balance was \$105.8 million, of which \$46.3 million is unassigned fund balance. The main difference between the BSR balance (\$57.2 million) and unassigned fund balance is the investment unrealized loss adjustment, as required by Governmental Accounting Standards Board (GASB) Statement No. 31. Discussion can be found in staff's November 28, 2023 report to the Finance Committee.

### ***Enterprise Funds***

As of June 30, 2023, the City's Enterprise Funds reported a total net position of \$827.7 million, an increase of \$36.6 million or 4.6% from the prior year. The increase is primarily from Electric and Gas Funds. Compared to FY 2022, the Change in Net Position for Enterprise funds increased \$49.2 million driven primarily by the Electric Fund, and Gas Funds, partially offset by the decrease in Airport Fund. Electric Fund received \$23.9 million related to the litigation of the Central Valley Project Improvement Act (CVPIA) operated by the U.S. Bureau of Reclamation. The payment comes after years of litigation by Northern California Power Agency (NCPA) members that the United States government overcharged power contractors in a manner contrary to the CVPIA legislation. The refund represents the City's share of the judgment issued by the US Court of Federal Claims.

### **FISCAL/RESOURCE IMPACT**

The actions recommended in CMR 2308-1857 pages 26-39<sup>2</sup> Attachment B, both Exhibits 1 and 2, recommend adjustments to the FY 2023 appropriated level of funds to align budgeted levels with year-end activities. Overall, these transactions ensure all funds remain in a positive financial picture.

### **STAKEHOLDER ENGAGEMENT**

This report has been prepared by the Administrative Service Department Accounting division and coordinated with the Office of the City Auditor and the Office of Management and Budget.

### **ENVIRONMENTAL REVIEW**

Council action on this item is not a project as defined by CEQA because the acceptance of the audited financial reports for the fiscal year ending June 30, 2023, approval of the ACFR for Fiscal Year 2023, the amendment to the Fiscal Year 2023 Budget Appropriation Ordinance, and extending a resolution of the DSRF Policy are fiscal activities which do not involve any commitment to any specific project which may result in a potentially significant physical impact on the environment. CEQA Guidelines section 15378(b)(4).

**ATTACHMENT**

Attachment A – FY 2023 Budget Amendments, Schedule B, Exhibit 1 and 2

Attachment B – Resolution to Extend and Amend the Development Services Reserve Fund (DSRF) Policy Previously Adopted by Ord 5420

Attachment C – Ordinance No. 5420

**APPROVED BY:**

Kiely Nose, Assistant City Manager

Lead Staff; Christine Paras, Assistant Director