



CITY OF CUPERTINO

AGENDA

AUDIT COMMITTEE

This will be a teleconference meeting without a physical location.

Monday, November 15, 2021

4:00 PM

Special Meeting

TELECONFERENCE / PUBLIC PARTICIPATION INFORMATION TO HELP STOP THE SPREAD OF COVID-19

In accordance with Government Code 54953(e), this will be a teleconference meeting without a physical location to help stop the spread of COVID-19.

Members of the public wishing comment on an item on the agenda may do so in the following ways:

- 1) E-mail comments by 2:00 p.m. on Monday, November 15 to the Audit Committee at AuditCommittee@cupertino.org. These e-mail comments will be received by the Audit Committee members before the meeting and posted to the City's website after the meeting.**
- 2) E-mail comments during the times for public comment during the meeting to the Audit Committee at AuditCommittee@cupertino.org. The staff liaison will read the emails into the record, and display any attachments on the screen, for up to 3 minutes (subject to the Chair's discretion to shorten time for public comments). Members of the public that wish to share a document must email AuditCommittee@cupertino.org prior to speaking.**

3) Teleconferencing Instructions

Members of the public may observe the teleconference meeting or provide oral public comments as follows:

Oral public comments will be accepted during the teleconference meeting. Comments may be made during "oral communications" for matters not on the agenda, and during the public comment period for each agenda item.

To address the Audit Committee, click on the link below to register in advance and access the meeting:

Online

Register in advance for this webinar:

https://cityofcupertino.zoom.us/webinar/register/WN_Jba30XvGQhm2uG8SpT4cAA

Phone

Dial: 669-900-6833 and enter Webinar ID: 941 6458 9868 (Type *9 to raise hand to speak, *6 to unmute yourself). Unregistered participants will be called on by the last four digits of their phone number.

Or an H.323/SIP room system:

H.323:

162.255.37.11 (US West)

Meeting ID: 941 6458 9868

SIP: 94164589868@zoomcrc.com

After registering, you will receive a confirmation email containing information about joining the webinar.

Please read the following instructions carefully:

- 1. You can directly download the teleconference software or connect to the meeting in your internet browser. If you are using your browser, make sure you are using a current and up-to-date browser: Chrome 30+, Firefox 27+, Microsoft Edge 12+, Safari 7+. Certain functionality may be disabled in older browsers, including Internet Explorer.**
- 2. You will be asked to enter an email address and a name, followed by an email with instructions on how to connect to the meeting. Your email address will not be disclosed to the public. If you wish to make an oral public comment but do not wish to provide your name, you may enter "Cupertino Resident" or similar designation.**
- 3. When the Chair calls for the item on which you wish to speak, click on "raise hand." Speakers will be notified shortly before they are called to speak.**
- 4. When called, please limit your remarks to the time allotted and the specific agenda topic. In compliance with the Americans with Disabilities Act (ADA), anyone who is planning to attend this teleconference meeting who is visually or hearing impaired or has any disability that needs special assistance should call the City Clerk's Office at 408-777-3223, at least 6 hours in advance of the meeting to arrange for assistance. In addition, upon request, in advance, by a person with a disability, meeting agendas and writings distributed for the meeting that are public records will be made available in the appropriate alternative format.**

NOTICE AND CALL FOR A SPECIAL MEETING OF THE AUDIT COMMITTEE

NOTICE IS HEREBY GIVEN that a special meeting of the Audit Committee is hereby called for Monday, November 15, 2021, commencing at 4:00 p.m. In accordance with Government Code 54953(e), this will be a teleconference meeting without a physical location to help stop the spread of COVID-19. Said special meeting shall be for the purpose of conducting business on the subject matters listed below under the heading, "Special Meeting."

SPECIAL MEETING

ROLL CALL

ORDERS OF THE DAY

APPROVAL OF MINUTES

1. Subject: Approve minutes from Regular Meeting on October 25, 2021
Recommended Action: Approve minutes from Regular Meeting on October 25, 2021
[A - Draft Minutes](#)

ORAL COMMUNICATIONS

This portion of the meeting is reserved for persons wishing to address the Committee on any matter within the jurisdiction of the Committee and not on the agenda. Speakers are limited to three (3) minutes. In most cases, State law will prohibit the Commission from making any decisions with respect to a matter not on the agenda.

NEW BUSINESS

2. Subject: OPEB & Pension Trust Investment Policy Review
Recommended Action: Consider Accepting OPEB & Pension Trust Investment Policies
[Staff Report](#)
[A - OPEB Trust Investment Policy](#)
[B - Pension Trust Investment Policy](#)
[C - U.S. Bank Research and Due Diligence Process](#)
3. Subject: HdL Contract and Refund Error Report
Recommended Action: Accept HdL Contract and Refund Error Report
[Staff Report](#)
4. Subject: Embezzlement Update
Recommended Action: Receive Embezzlement Update
5. Subject: Proposed Audit Committee 2022 Schedule and Work Plan

Recommended Action: Receive Proposed Audit Committee 2022 Schedule and Work Plan and Provide Input

[A - Proposed Audit Committee 2022 Schedule and Work Plan](#)

6. Subject: Budget Form Review and OpenGov Study Session

Recommended Action: Discuss Budget Form Review and Receive OpenGov Study Session

[A - Budget Format Review Update](#)

[B - Sub-Committee Initial Comments on Budget Format Review](#)

[C - Sub-Committee Formal Memorandum on Budget Format Review](#)

[D - Budget Format Review Update PPT](#)

[E - Questions Regarding the Current Budget Report](#)

[F - OpenGov Training](#)

OLD BUSINESS

STAFF AND COMMITTEE REPORTS

FUTURE AGENDA SETTING

ADJOURNMENT

In compliance with the Americans with Disabilities Act (ADA), anyone who is planning to attend this teleconference meeting who is visually or hearing impaired or has any disability that needs special assistance should call the City Clerk's Office at 408-777-3223, at least 6 hours in advance of the meeting to arrange for assistance. In addition, upon request, in advance, by a person with a disability, meeting agendas and writings distributed for the meeting that are public records will be made available in the appropriate alternative format.

Any writings or documents provided to a majority of the members after publication of the agenda will be made available for public inspection. Please contact the City Clerk's Office in City Hall located at 10300 Torre Avenue, Cupertino, California 95014, during normal business hours.

IMPORTANT NOTICE: Please be advised that pursuant to Cupertino Municipal Code section 2.08.100 written communications sent to the Cupertino City Council, Commissioners or City staff concerning a matter on the agenda are included as supplemental material to the agenda item. These written communications are accessible to the public through the City's website and kept in packet archives. Do not include any personal or private information in written communications to the City that you do not wish to make public, as written communications are considered public records and will be made publicly available on the City website.

Members of the public are entitled to address the members concerning any item that is described in the notice or agenda for this meeting, before or during consideration of that item. If you wish to address the

members on any other item not on the agenda, you may do so during the public comment.



CITY OF CUPERTINO

Agenda Item

21-10094

Agenda Date:
11/15/2021 Agenda #: 1.

Subject: Approve minutes from Regular Meeting on October 25, 2021

Approve minutes from Regular Meeting on October 25, 2021

City of Cupertino
Audit Committee Regular Meeting
Minutes
October 25, 2021

CALL TO ORDER

At 4:00 p.m., Chair Liang called the special meeting to order. This was a teleconference meeting with no physical location.

ROLL CALL

Committee Members Present: Chair Daisy Liang, Committee Member Song (arrived late), Vice Mayor Chao, Councilmember Moore

City Staff Present: Greg Larson, Kristina Alfaro, Zach Korach, Thomas Leung

Absent: Vice Chair Chen

Guests: Carlos Oblites and Chris McCarry (Chandler), Rick Rosenthal and Ryan Maxey (US Bank), Mitch Barker and Jennifer Meza (PARS), Mark Steranka (Moss Adams)

1. APPROVAL OF MINUTES

Councilmember Moore moved to approve the regular meeting minutes of July 26, 2021 and special meeting minutes of September 27, 2021. Vice Mayor Chao seconded and the motion carried unanimously by all members present.

ORAL COMMUNICATIONS

Ms. Peggy Griffin expressed concern over City credit cards and the volume and dollar amount of transactions. Ms. Griffin noted there should be a policy, training, and audit of credit card transactions. Korach referenced the internal auditor's procurement operational review and the timing and scope.

NEW BUSINESS

2. Mandatory KnowB4 Training from Infrastructure Division – 10 minutes

Iqraam Nabi from the City's Innovation & Technology Department provided the security training.

3. Treasurer's Investment Report for Quarter Ending September 30, 2021 – 35 minutes

Chris McCarry provided an overview of the economy and market impacts. Carlos Oblites provided an overview on the portfolio over the last quarter. Chair Liang asked about the credit quality of the portfolio and if the City was taking on too much risk. Oblites explained the rating criteria used by S&P and Moody's and that all of the City's investments have very strong ratings. He provided additional information on the acquisitions and dispositions over the previous quarter. Chair Liang asked about the return in Q2 and Q3. Oblites spoke to the fluctuation in value as a result of increasing interest rates; however, the yield or interest income was still strong. Councilmember Moore inquired about the LAIF statement and why the

balances did not change over the previous month. Oblites explained that the interest apportionments are not paid out until subsequent to quarter end. Chair Liang requested that the bank reconciliation be provided with the operating statements. Korach explained bank reconciliations are not ready for Audit Committee meetings due their preparation requiring 30-45 days following the period end.

4. OPEB and Pension Investment Trust Performance Report as of September 30, 2021 – 20 minutes

Mitch Barker provided a brief overview of the 115 Trust Program. Rick Rosenthal provided an overview on the investment portfolios over the quarter. Chair Liang asked how the performance will look in the fourth quarter of 2021. Rosenthal noted that the month of October has shown strong performance and rebounded from the difficult September. Chair Liang inquired about the contributions made and the timing as well as the fee structure. A brief discussion regarding fees will be included in the next report.

5. Review and Consider Accepting OPEB and Pension Investment Trust Policies – 25 minutes

Korach provided background on previous meetings' discussions, specifically toward prohibited investment classes and socially responsible investing. Rosenthal confirmed and reiterated much of the overview. Councilmember Moore asked about the policies needing to be updated to include the most recent portfolio balances. Korach confirmed that those updates would be made prior to submission to City Council. Councilmember Moore asked where in the policy the City would be prohibited from investing in Bitcoin (BTC). Rosenthal submitted that BTC is not an equity and would never come into the portfolio; however, recommended that a prohibition be made in the policy if the Committee so chooses. Councilmember Moore expressed interest in prohibiting cryptocurrencies. She also inquired what controls are in place to screen ETF investments. Rosenthal discussed his firm's research and due diligence process and advised that as new investment types are developed, the policy be reviewed and amended as necessary and applicable. Ms. Griffin (member of the public) encouraged the policy prohibit cryptocurrency, leveraged assets, and assets with high beta. Councilmember Moore inquired about the volatility of the portfolio and requested staff to bring back information on US Bank's approved investment list and volatility mitigation measures that are in place. Vice Mayor Chao wondered what other agencies policies are like. Vice Mayor Chao moved for staff to bring back recommendations on the volatility of investment including, but not limited to, cryptocurrency. Councilmember Moore seconded and the motion carried unanimously by all members present.

6. Internal Audit Update – 20 minutes

Mark Steranka provided an overview on the Policy Inventory project as well as the internal audit update for all scheduled projects. Councilmember Moore and Vice Mayor Chao inquired about the attachments and the organization/ordering of the information included. Vice Mayor Chao asked that all internal audit reports/documents be posted on the City's website. Korach said they would be posted going forward. Ms. Peggy Griffin thanked the internal auditors and requested that the deliverables be posted on the City's website. Councilmember Moore asked if Moss Adams will be looking at the municipal code regarding purchasing and the City's purchasing policy, what is City Manager authority, spot-checking will be completed,

purchasing threshold agency comparisons, parks and recreation contracts, and contract approval process. Steranka confirmed that policies, procedures, and thresholds will be looked at. Vice Mayor Chao requested links to be included in the status update reports and asked about credit card policies. Steranka confirmed it would be included in the policy inventory. Vice Mayor Chao inquired about contingency budgeting. Steranka noted that it would be included. Vice Mayor Chao asked about procedures versus policies and how they are identified. Steranka explained the process. Vice Mayor Chao asked about CIP budgeting and multiyear projects. Councilmember Moore hoped that Moss Adams will look at the financial policies in the budget and how contingencies are calculated.

Councilmember Moore moved to continue items 7, 8, and 9 to the special meeting on November 15, 2021. Vice Mayor Chao seconded and the motion carried unanimously by all members present.

OLD BUSINESS

None.

STAFF AND COMMITTEE REPORTS

None.

FUTURE AGENDA SETTING

None.

ADJOURNMENT

The meeting adjourned at 6:00 p.m.

Recording Secretary:

Zach Korach, Finance Manager



CITY OF CUPERTINO

Agenda Item

21-10080

Agenda Date:
11/15/2021 Agenda #: 2.

Subject: OPEB & Pension Trust Investment Policy Review

Consider Accepting OPEB & Pension Trust Investment Policies



ADMINISTRATIVE SERVICES DEPARTMENT

CITY HALL
10300 TORRE AVENUE • CUPERTINO, CA 95014-3255
TELEPHONE: (408) 777-3220 • FAX: (408) 777-3109
CUPERTINO.ORG

AUDIT COMMITTEE STAFF REPORT

Meeting: November 15, 2021

Subject

OPEB & Pension Trust Investment Policy Review

Recommended Action

Accept staff report and provide recommendations.

Discussion

Background

In FY 2009-10, the City established a Section 115 Trust to help fund its retiree health obligations, also known as other post-employment benefits (OPEB). In FY 2017-18, the City also established a Section 115 Trust to pre-fund its pension obligations and reduce the potential impact of pension cost volatility on the City's operating budget.

The Audit Committee is responsible for reviewing the investment policies for the Section 115 Trusts. On October 22, 2019, the Audit Committee reviewed the investment policies. It adopted an OPEB Trust Investment Policy with a target rate of return of 6.5% and a Pension Trust Investment Policy with a target rate of return of 6.25%. The Investment Manager, US Bank, manages security selection and asset allocation in accordance with the investment policy.

Section 115 Trust Overview

A Section 115 Trust is a tax-exempt investment tool that allows local governments to pre-fund pension and retiree health costs. The benefits of a Section 115 Trust include the following:

- Local control over assets: The City controls the contributions, withdrawals, investment strategy, and risk level of assets in the Trust.
- Potential for higher investment returns than General Fund: Investment requirements that apply to the City's General Fund assets under Government Code 53601 are not applicable to Trust assets.

- Pension rate stabilization: Assets can be transferred to CalPERS at the City's discretion to pay for Normal Cost or UAL contributions, and can be used to reduce or eliminate large fluctuations in the City's pension costs.
- Diversification: Trust assets will be diversified from CalPERS investments.

OPEB Trust Overview

In FY 2009-10, the City established a Section 115 Trust to help fund its retiree health obligations, also known as other post-employment benefits (OPEB). Compared to a pay-as-you-go plan, the OPEB Trust allows the City to:

- grow assets to pay future OPEB benefits;
- earn higher returns than the General Fund;
- reduce its total cost for providing post-employment benefits; and
- reduce its net OPEB liability.

As of June 30, 2021, the City's OPEB Trust has a market value of \$38.0 million and has earned an annualized investment return of 8.16% gross of fees since inception.

OPEB Trust Investment Objective

The OPEB Trust has a 'Balanced' investment objective with a target rate of return of 6.5%. The investment objective is designed to provide a moderate amount of current income with moderate growth of capital. This objective is recommended for investors with a long-term time horizon. The strategic asset allocation ranges and tactical targets for this objective are listed below:

Asset Class	Range	Target
Fixed Income	20-40%	29%
Equities	50-70%	63%
Real Estate	0-15%	5%
Commodities	0-10%	2%
Cash	0-10%	1%

CalPERS Overview

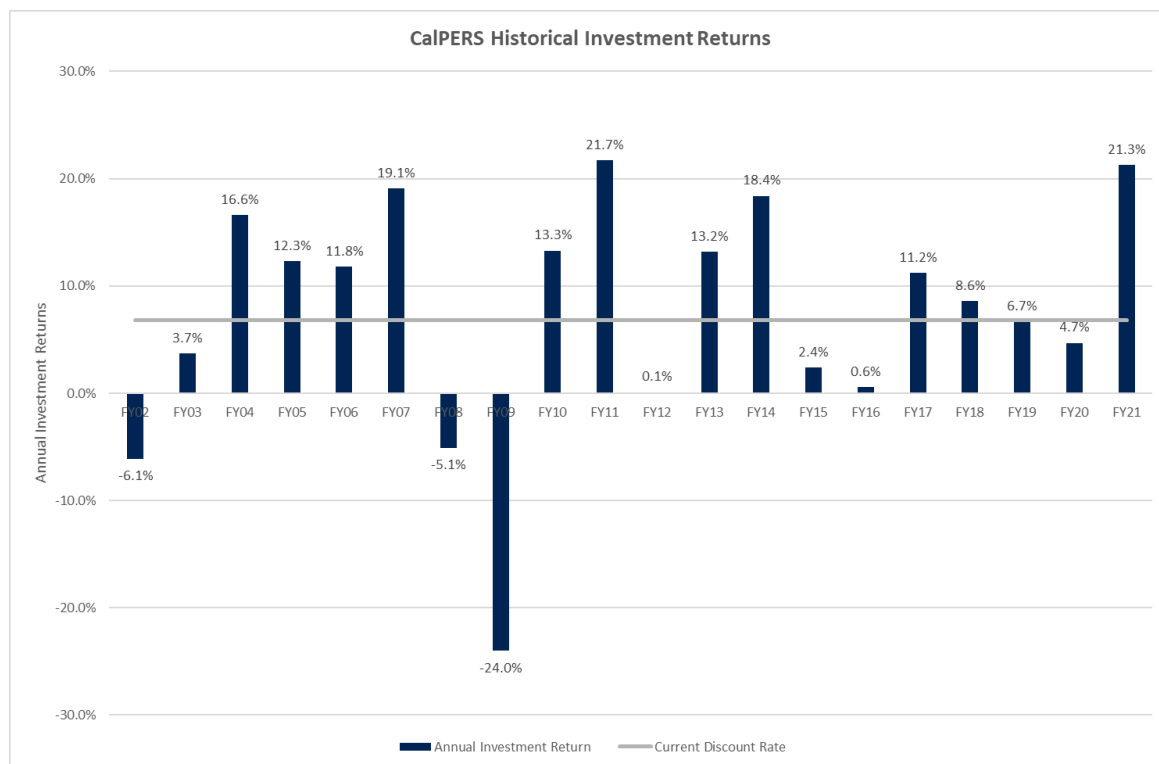
The City provides a defined benefit pension to its employees through the California Public Employees' Retirement System (CalPERS). Retiree pensions are calculated using a formula based on an employee's age, earnings, and years of service, and are funded by a combination of employer contributions, employee contributions, and investment earnings. Each year, CalPERS determines an employer's contributions based on actual investment returns and actuarial assumptions including:

- expected investment returns (discount rates),
- inflation rates,
- salaries,
- retirement ages, and
- life expectancies.

As of the June 30, 2019 actuarial valuation, the City's CalPERS plan has an actuarial liability of \$148.5 million, an unfunded liability of \$49.2 million, and a funded ratio of 66.9%. The unfunded liability is the difference between pension assets and liabilities while the funded ratio is the ratio of pension assets to liabilities.

A defined-benefit plan is considered adequately funded if its assets equal or exceed the value of its future liabilities. When the funded ratio is lower than 100%, the plan has insufficient assets to pay all future liabilities. Poor investment returns during the Great Recession significantly decreased the plan's assets. In addition, enhanced benefits and actuarial assumption changes due to increased life expectancies increased the plan's liabilities. These two factors significantly decreased the funded status of the system.

Over the past few years, CalPERS has taken steps to improve the long-term financial sustainability of the system. In December 2016, the CalPERS board voted to reduce the discount rate, also known as the assumed rate of return for investments, from 7.5% to 7.0% over three years from FY 2018-19 to FY 2020-21. In February 2018, the CalPERS board also voted to decrease the amortization period for new pension liabilities from 30 years to 20 years effective July 1, 2019. While these changes will provide long-term benefits to the pension plan, they will also increase the City's pension contributions.



For FY 2020-21, CalPERS reported a preliminary investment return of 21.3%, bringing the average investment return to 10.3% for a 5-year period, 8.5% for a 10-year period, 6.9% for

a 20-year period, and 8.4% for a 30-year period. Given that returns in a given year are volatile, it can be more instructive to look at returns over longer time horizons.

Time Period Total Investment Return	
1 Year	21.3%
5 Year	10.3%
10 Year	8.5%
20 Year	6.9%
30 Year	8.4%

Under the "Funding Risk Mitigation Policy," approved by the CalPERS Board of Administration in 2015, the double-digit return in FY 2020-21 will trigger a reduction in the discount rate used to calculate employer and Public Employees' Pension Reform Act (PEPRA) member contributions. The discount rate, or assumed rate of return, will drop to 6.8% from its current level of 7%. The impact of the Risk Mitigation Policy will affect contributions starting in FY 2023-24.

Currently, CalPERS is conducting its Asset Liability Management (ALM) process. The ALM process, which runs on a four-year cycle, reviews the current investment strategies and actuarial assumptions. The ALM process can result in changes to the asset allocation of the investment portfolio, new actuarial assumptions, and changes to the discount rate. As a result, the CalPERS Board of Administration may elect to lower the discount rate even further. The positive returns experienced in FY 2020-21 would mitigate a potential lowering of the discount rate.

Pension Trust Overview

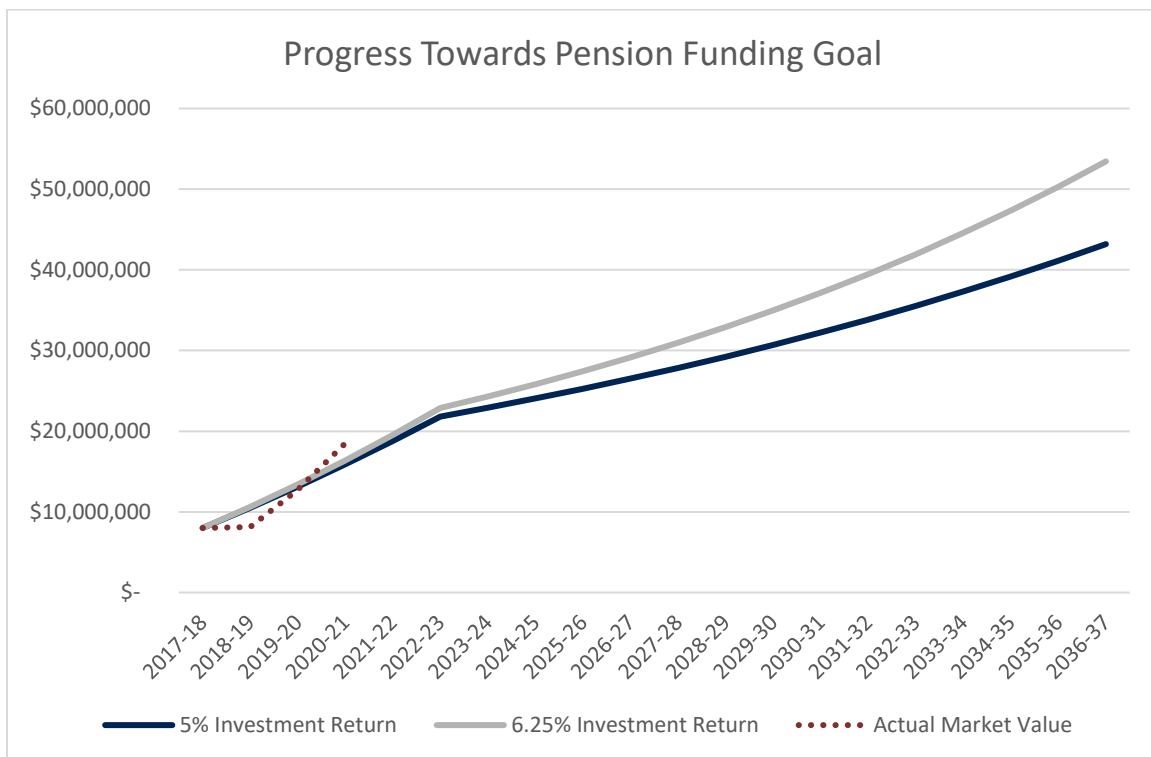
Given that pension obligations are one of the City's largest financial obligations, the City has taken proactive steps to reduce the impacts of pension cost volatility. In March 2018, the City provided options to Council on addressing rising pension costs. In April 2018, the City presented a long-term pension funding strategy to the Fiscal Strategic Plan Committee. In May 2018, the City implemented a Pension Rate Stabilization Program (PRSP), also known as a Section 115 Trust, to reduce pension rate volatility on the City's budget. The City contributed \$8.0 million in FY 2018-19 and \$4.0 million in FY 2019-20, bringing total contributions to \$12.0 million. The Pension Trust helps the City to:

- grow assets for future pension contributions;
- invest assets over appropriate time horizons;
- earn higher investment returns than the General Fund;
- reduce pension contribution volatility; and
- diversify funds from CalPERS investments.

As a fiscal sustainability measure, the City funds the Pension Trust using a more conservative discount rate of 6.25%. The City's pension funding goal is to accumulate sufficient funds in the Pension Trust to fund the difference between a 6.25% and a 7% discount rate and achieve a funded ratio of 80% over 20 years. The City's projections

indicated that the City would need to accumulate over \$42 million in the Pension Trust within 20 years to achieve its pension funding goal.

To achieve this goal, the funding strategy proposed \$8.0 million in initial funding, along with additional funding of \$10.0 million over the first five years. The following chart illustrates the City's progress towards its pension funding goal. The 5% investment return represents the lowest investment return that would allow the City to achieve its goal. A 6.25% investment return is the current target rate of return of the Pension Trust. The dotted line represents the actual market value of the City's Pension Trust. The Pension Trust was funded with an initial contribution of \$8.0 million and subsequent contributions of \$4.0 million in FY 2019-20 and \$2.0 million in FY 2020-21. As of June 30, 2021, the City's Pension Trust has a market value of \$18.5 million and has earned an annualized investment return of 15.44% gross of fees since inception. This chart illustrates that the City is on track towards its pension funding goal.



Note: The 5% Investment Return and 6.25% Investment Return projections are for illustrative purposes only. Actual returns will be different.

Given this strategy and the City's current progress, the City is in a strong position to withstand the effects of pension cost increases. By using a more conservative discount rate than CalPERS, the City can allocate more towards pension funding each year than required by CalPERS. If CalPERS investment returns fall short of assumptions, the City will be better prepared for future pension cost increases. If the discount rate is lowered below the recent triggered reduction to 6.8%, which is a distinct possibility, the City will be better prepared to absorb these costs.

Pension Trust Investment Objective

The Pension Trust has a 'Balanced' investment objective with a target rate of return of 6.25%. This investment objective is designed to provide a moderate amount of current income with moderate growth of capital. This objective is recommended for investors with a long-term time horizon. The strategic asset allocation ranges and tactical targets for this objective are listed below:

Asset Class	Range	Target
Fixed Income	20-40%	29%
Equities	50-70%	63%
Real Estate	0-15%	5%
Commodities	0-10%	2%
Cash	0-10%	1%

Discount Rate

Defined benefit plans are highly sensitive to the discount rate assumption. The discount rate is the expected rate of return of the plan's assets over the long term. The discount rate will depend on the plan's size, asset allocation, time horizon, and other considerations. The duration of the defined benefit obligation for a retiree health plan is often longer than that for a pension plan. As a result, the choice of discount rate for OPEB plans can be higher than for pension plans.

From the City's perspective, the discount rate is important as it is used to determine the City's annual contributions to the plan, the plan's unfunded liability, and the plan's funded status. In other words, the discount rate is used to determine whether a plan has enough assets to meet its future obligations. The discount rate must be realistic to allow the City to foresee funding issues that may impact future operating budgets and future generations of retirees and plan members. If the discount rate assumption is too high and investments earn less than expected, a funding shortfall may result, requiring the City or CalPERS members to make greater contributions than expected.

OPEB Discount Rate Analysis

The discount rate of the OPEB Trust is currently 6.5%. Under GASB 75, if an OPEB plan holds investments in a trust specifically to pay for future benefit payments and those assets are projected to be sufficient to make the projected benefit payments, the discount rate is based on the long-term expected rate of return for those investments.

The City's OPEB contributions are primarily driven by investment returns and changes in medical costs. A 1 percentage point decrease in the discount rate is expected to increase OPEB contributions by up to \$565,000 per year.

CalPERS Discount Rate Analysis

While CalPERS currently uses a discount rate of 7% and although the rate was recently triggered to be reduced to 6.8%, market experts project lower returns for the next several decades due to lower-than-historical interest rates and economic growth. The Pew Research Center forecasts a long-term investment return of 6.4% while J.P. Morgan, and Wilshire Associates forecast a long-term investment return of 6.5% for typical pension fund portfolios.

The discount rate has a significant effect on the City's CalPERS contributions. If the discount rate is less than the 6.8% assumption, the City's CalPERS contributions will increase. If CalPERS lowers the discount rate by 1 percentage point, the City's contributions will increase by up to \$2.4 million per year.

This analysis shows the potential contribution impacts if CalPERS were to lower the discount rate based on lower expected investment returns.

Recommendation

The City recommends maintaining the discount rates of 6.50% for the OPEB Trust and 6.25% for the Pension Trust. The discount rates are based on the long-term expected rate of return for assets in the trusts and the City's time horizon for the investments.

US Bank, the Investment Manager, and PARS, the Trust Administrator, have estimated a long-term expected return of 6.56% based on the current asset allocation (60%-80% equities).

The City recommends a higher discount rate for the OPEB Trust than the Pension Trust because OPEB investments are expected to have a longer time horizon. OPEB obligations are generally longer in duration and the City expects to withdraw Pension Trust funds earlier to fund CalPERS contributions. Given that changes to the CalPERS discount rate have larger effects on the City's operating budget and are farther out of the City's control, it is important that the City be able to use the Trust to pay CalPERS contributions as needed. A lower discount rate can reduce investment return volatility and reduce the probability of losses to assets, allowing the City to preserve its capital better.

The Audit Committee has reviewed these policies at the September 27, 2021 and October 25, 2021 Audit Committee meetings and most recently, provided the following input and requests:

- volatility study
- cryptocurrencies to be a prohibited asset class and transaction
- leveraged assets to be a prohibited asset class and transaction

The City's investment trusts follow a "balanced" investment objective which is designed to provide moderate current income with moderate growth of capital. Investors should

have sufficient tolerance for price and return volatility and substantial period declines in investment value. This objective is recommended for investors with the long-term time horizon. Because future economic and market conditions are unknown, volatility studies are difficult to generate while providing accurate and meaningful information from which decisions may be based. Please refer to attachment "C" for a detailing of U.S. Bank's Research and Due Diligence Process.

With strong reserves and a fully-funded OPEB plan, the City is able to maintain a long-term investment horizon which deploys the "balanced" investment objective. As stated, there may be periods of substantial decline in investment value and the portfolio should expect periodic volatility. However, over the long-term, a 6.56% return on investment is expected based on the current investment objective. More conservative investment objectives such as "moderate" and "moderate-conservative" would expect less volatility and decline in investment value; however, over the long-term, would also expect lower returns on investment. Many agencies anticipate needing to access the funds in their respective trusts sooner and elect to invest with more emphasis on preserving capital in the near-term.

In reviewing the city's investments reports, it's important for a governing body to maintain a wholistic approach as policy makers. Responding to performance or current market conditions and making regular changes to a policy or portfolio that has a long-term time horizon (20 years) may compromise the work that has been completed in past years and also hinder the portfolio's ability to respond to ever changing market conditions. Understanding the purpose and goals of the investment trusts is essential in analyzing investment performance and considering policy and/or portfolio changes.

Direct or indirect exposure to cryptocurrencies, despite its extreme unlikelihood of appearing in the portfolio, has been added as a prohibited asset class and transaction for both policies.

The Committee's request to include leveraged assets as a prohibited asset class and transaction was duly noted and staff worked with U.S. Bank on this request. Leverage is a tool to manage risk and return. The use of leverage allows an investor to meet their return target without decreasing the risk-reward ratio of their portfolio. That is, leverage leads to an increase in risk, but the increase in risk is actually lower compared to an attempt to meet the return target without the use of leverage.

Staff is recommending that unregistered Hedged Equity and Hedged Fixed Income positions be included as prohibited asset classes; however, it is also recommended to have registered Hedged Equity and Fixed Income positions remain as an allowable asset class. Additionally, staff recommends establishing bounds for use of leverage at no more than 10% of the total market value of the Portfolio at any given time.

Lastly, on page 4 of each policy, the term “physical” has been added when referring to prohibited commodities. This is for purposes of distinguishing between physical commodities, a prohibited asset class, and commodity mutual funds, an allowable asset class.

Sustainability Impact

There is no sustainability impact.

Fiscal Impact

There is no direct fiscal impact at this time. The discount rate assumptions will affect the City's contributions to the plan, the plan's assets, and the plan's liabilities.

Prepared by: Thomas Leung, Senior Management Analyst

Reviewed by: Zach Korach, Finance Manager


Approved for Submission by: Greg Larson, Interim City Manager

Attachments:

A – OPEB Trust Investment Policy

B – Pension Trust Investment Policy

C – U.S. Bank Research and Due Diligence Process

 <p style="text-align: center;">Other Post-Employment Benefits (OPEB) Investment Policy</p>	Citywide Policy Manual
	Attachments: N/A
Effective Date: December 7, 2021	Responsible Department: Administrative Services
Related Policies & Notes: City Investment Policy, Pension Investment Policy	

Overview

In response to the Government Accounting Standards Board (GASB) Statement No. 45, replaced by GASB Statement No. 74 and GASB Statement No. 75, new disclosure requirements for Other Post-employment Benefit (OPEB) Plans, the City of Cupertino has adopted a Section 115 Trust and Plan that seeks to satisfy these liabilities for certain eligible employees

Executive Summary

Account Name:	City of Cupertino OPEB Trust
Account Number:	6746035000
Investment Authority:	Full Investment Authority
Current Assets:	\$ 31.4 37.6 million (September 2020 2021)
Time Horizon:	Long-Term
Target Rate of Return:	6.5%
Communication Schedule:	Meetings will be conducted at least twice per year

U.S. Bank Portfolio Manager:	Rick Rosenthal richard.rosenthal@usbank.com 213-443-1848
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U.S. Bank Relationship Manager:	Carolyn Cox Ryan Maxey carolyn.cox@usbank.com ryan.maxey@usbank.com 415-677-3603 503-464-3789
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Investment Objective: ‘Balanced’

This investment objective is designed to provide a moderate amount of current income with moderate growth of capital. Investors should have sufficient tolerance for price and return volatility and substantial periodic declines in investment value. This objective is recommended for investors with a long-term time horizon.

The strategic asset allocation ranges and tactical targets for this objective are listed below:

Asset Class	Range	Benchmark Target
Fixed Income	20-40%	29%
Equities	50-70%	63%
Real Estate	0-15%	5%
Commodities	0-10%	2%
Cash	0-10%	1%

Investment Guidelines

Overview

This document defines the investment policy, guidelines and performance objectives applicable to the assets of The City of Cupertino’s OPEB Trust. The goal of this Policy is to create an investment framework within which the assets can be actively yet prudently managed.

The purpose of this document is threefold.

- First, it will set forth an investment structure for managing the Portfolio assets. This structure is expected to produce an appropriate level of overall diversification and total investment return over the investment time horizon.
- Second, it will serve as to encourage effective communications between the organization and parties involved with investment management decisions.
- Third, these guidelines will provide a framework to measure ongoing investment performance.

Within the constraints imposed by these policies, Investment Managers are expected to comply with all applicable fiduciary and due diligence requirements under the “prudent investor” rules, which state: “Investments shall be made with judgment and care, under circumstances then prevailing, which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived.” All applicable laws, rules and regulations from various local, state, federal and international political entities that may impact the Portfolio are to be adhered to.

Diversification

Your Portfolio Manager is responsible for maintaining the balance between the various asset classes based on the investment objective's strategic asset allocation. As a general policy, the Investment Manager will maintain reasonable diversification at all times by asset class, credit quality, issuer, sector, industry, and country.

The following parameters shall be adhered to in managing the portfolio:

Fixed Income Assets

- The fixed income investments are to maintain intermediate-term average weighted duration, between three-seven years.
- At the time of purchase, no single fixed income issuer shall exceed 2% of the total market value of the Portfolio, with the exception of U.S. Treasury or Agency obligations.
- The direct high-yield portion shall constitute no more than 10% of the total market value of the Portfolio.
- Hedged fixed income positions shall constitute no more than 10% of the total market value of the Portfolio

Equity & Growth Assets

- The domestic equity investments are expected to be diversified at all times by size, industry, sector, and style (Large Cap, Mid Cap, and Small Cap).
- At the time of purchase, no individual equity security shall exceed 2% of the total market value of the Portfolio.
- The international equity investments (including emerging markets) shall constitute no more than 20% of the total market value of the Portfolio
- The real estate investments shall be captured through the use of diversified mutual funds or ETFs investing in REITs; and shall constitute no more than 15% of the total market value of the Portfolio.
- The commodities investments shall be captured through the use of diversified mutual funds or ETFs; and shall constitute no more than 10% of the total market value of the Portfolio.
- Hedged equity positions shall constitute no more than 10% of the total market value of the Portfolio

Permitted Asset Classes and Security Types

Fixed Income & Cash Equivalent Investments:

- Domestic Certificates of Deposit (rated A-1/P-1 or better)
- Domestic Commercial Paper (rated A-1/P-1 or better)
- Floating Rate Notes
- Money Market Mutual Funds
- U.S. Treasury Bonds, Bills and Notes
- U.S. Agency (and Instrumentality) Discount Notes, Notes, and Bonds
- Treasury Inflation-Protected Securities (TIPS)

- Municipal Bonds and Notes
- Corporate Bonds
- Mortgage-Backed Bonds (MBS)
- Asset-Backed Bonds (ABS)
- High-Yield Bonds (rated B-/B3 or better)
- Dollar denominated Foreign Bonds and Notes
- Bond Mutual Funds

Equity Investments:

- Common & Preferred Stocks
- American Depository Receipts (ADRs)
- Domestic and International Equity Mutual Funds (Open and Closed)
- Emerging Market Equity Funds or Exchange Traded Funds (ETFs)

Alternative Investments:

- Commodities Mutual Funds or Exchange Traded Notes (ETNs)
- REIT Investment or Pooled Strategy or Fund of REITs
- Registered Hedge Funds or Hedge Fund of Funds

Prohibited Asset Classes and Transactions

The Investment Manager is prohibited from purchasing or holding any of the following types of investments:

- Partnerships unless investing in Master Limited Partnerships invested in a mutual fund and limited in scope and allocation of Portfolio based on asset class limitations of table above
- Letter stock and other unregistered securities; **physical** commodities or other commodity contracts; and short sales or margin transactions
- Investments in the equity securities of any company with a record of less than three years continuous operation, including the operation of any predecessor
- Investments for the purpose of exercising control of management
- **Direct or indirect exposure to cryptocurrencies**
- **Leveraged securities, other than registered Hedged Equity and Hedged Fixed Income positions**

Duties and Responsibilities

- 1) CITY OF CUPERTINO AUDIT COMMITTEE
 - a) Establish, approve, and maintain investment objectives, guidelines, and policies (including this Policy).
 - b) Appoint Investment Managers who can be reasonably expected to adhere to the investment guidelines and meet the investment objectives as established.
 - c) Monitor the investment performance of the Portfolio and compare actual investment performance relative to an appropriate benchmark index given the stated investment guidelines and objectives set forth in this Policy.

- d) Conduct a formal review of the Portfolio's asset allocation, investment structure and performance annually or more frequently as the need arises.
- e) Periodically review the Portfolio performance against objectives.

2) CITY OF CUPERTINO CITY COUNCIL

- a) Adopt the Policy by resolution of the City Council on an annual basis.

3) PORTFOLIO MANAGER

The Portfolio Manager will be responsible for carrying out the activities related to the Portfolio in accordance with the Policy including:

- a) Manage the day-to-day investment of Portfolio assets in accordance with the Policy guidelines and objectives included herein.
- b) Exercise full investment discretion and prudence in the selection and diversification of investments.
- c) Promptly bring to the attention of the City Treasurer or designee any investment that is subsequently downgraded and fails to meet the quality guidelines, along with a recommendation of retention or disposal.
- d) Provide on a quarterly basis the following investment reporting:
 - (i) Year-to-date rate of return
 - (ii) Annualized one, three, five, etc. rates of return
- e) Provide annually to the City's Audit Committee a commentary and analysis of investment performance to include an evaluation of the current and future investment environment and potential impact of the investment environment on achievement of investment objectives.

Investment Policy Statement Review


The City's Audit Committee will review and the Cupertino City Council will adopt this Investment Policy Statement at least annually to determine whether stated investment objectives are still relevant and the continued feasibility of achieving the same. It is not expected that the Policy will change frequently. In particular, short-term changes in the financial markets should not require adjustments to the Policy.

If at any time the Portfolio Manager finds the above guidelines too restrictive or possibly injurious to investment returns, they should communicate that information immediately to the City's Audit Committee.

City Manager's signature: _____

Date: _____

Revisions: 6.5.2018, 5.29.2019, 11.19.2019, 11.17.2020

 Pension Trust Investment Policy	Citywide Policy Manual
Effective Date: December 7, 2021	Attachments: N/A
Related Policies & Notes: N/A	Responsible Department: Administrative Services

Investment Policy Statement

Overview

The City has established a Section 115 Trust with PARS to assist in stabilizing the potential impact of pension cost volatility on the City's operating budget. The City intends to use the Section 115 Trust to pre-fund pension costs and proactively address the unfunded liability. The City's goal is to have sufficient assets in the trust to increase the funded status to over 80% within 20 years, as well as fund the difference between a 7.0% and 6.25% discount rate.

Executive Summary

Account Name: City of Cupertino Pension Trust
 Account Number: 6746050100
 Investment Authority: Full Investment Authority
 Current Assets: ~~\$13.6~~ 18.3 Million (September ~~2020~~ 2021)
 Time Horizon: Long-Term
 Target Rate of Return: 6.25%
 Communication Schedule: Meetings will be conducted at least twice per year

U.S. Bank Portfolio Manager: Rick Rosenthal
richard.rosenthal@usbank.com
 213-443-1848

U.S. Bank Relationship Manager: ~~Carolyn Cox~~ Ryan Maxey
carolyn.cox@usbank.com ryan.maxey@usbank.com
~~415-677-3603~~ 503-464-3789

Investment Objective: ‘Balanced’

This investment objective is designed to provide a moderate amount of current income with moderate growth of capital. Investors should have sufficient tolerance for price and return volatility and substantial periodic declines in investment value. This objective is recommended for investors with a long-term time horizon.

The strategic asset allocation ranges and tactical targets for this objective are listed below:

Asset Class	Range	Benchmark Target
Fixed Income	20-40%	29%
Equities	50-70%	63%
Real Estate	0-15%	5%
Commodities	0-10%	2%
Cash	0-10%	1%

Investment Guidelines

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If at any time the Portfolio Manager finds the above guidelines too restrictive or possibly injurious to investment returns, they should communicate that information immediately to the City's Audit Committee.

City Manager's signature: _____

Date: _____

Revisions: 6.5.2018, 11.19.2019, 11.17.2020

U.S. Bank Institutional Portfolio Management

U.S. Bank assumes fiduciary duty for the assets we manage. U.S. Bank, and the investment managers with whom we work, are bound to highly ethical fiduciary standards. Our philosophy includes our role as an unbiased, fiduciary investment advisor and custodian. Your portfolio will be managed within the framework of your investment policy statement and will reflect the research that U.S. Bank employs.

Investment Philosophy

At U.S. Bank, we believe our job is to help improve your odds of financial success. Our goal is to produce consistent, long-term investment results that meet or exceed our clients' expectations.

Our investment process centers on a highly collaborative approach:

- Asset allocation research, conducted by our Capital Markets Group
- Vehicle assessment and selection by our traditional and alternatives due diligence teams
- Institutional investment management, asset allocation and vehicle selection provided by the Institutional Investment Oversight Committee
- Portfolio construction implemented by your portfolio manager

Investment policy review and development

At the onset of an investment relationship, we have a dialogue with staff and other key stakeholders to gain a better understanding of your time horizon, return objectives, risk tolerance, income and liquidity needs, and any unique constraints or needs that you may have. We review your existing investment policy statement (IPS) to ensure that it properly reflects your objectives for risk and return and that it is based on realistic assumptions.

We will determine whether the document is comprehensive and flexible enough and if it contains internal inconsistencies. We will pay close attention to issues relating to asset allocation and investment style, as well as the benchmarks and standards set forth for evaluating performance. If needed, modifications to the IPS will be recommended. U.S. Bank believes that the IPS is a living document and should be reviewed and positively affirmed by key stakeholders at least annually.

Portfolio construction

Portfolio construction involves combining asset classes to populate investment portfolios. Our portfolio construction process involves reflecting on our economic outlook, assessing the strategic asset allocation output and engaging with our due diligence teams for their views on how to best represent asset classes we want to include, to ensure we capture our target risk premia.

Research and manager selection

U.S. Bank employs a manager platform that includes Separately Managed Accounts (SMAs), mutual funds and exchange traded funds (ETFs) from strategically selected outside managers, who are fully researched and vetted by a separate team of investment professionals. This robust selection process provides you with access to managers who specialize in specific asset classes and styles of investing, providing diversification to your portfolio. Our due diligence process ensures that we provide managers who consistently adhere to their stated investment guidelines and provide style-consistent performance.

We use a combination of proprietary and non-proprietary databases for our research. No managers are charged for inclusion. We subscribe to multiple databases (Morningstar, Factset, ETF.com and Bloomberg) to have robust coverage of funds, SMAs and ETFs. When we are interested in finding a new strategy, we have upwards of 30,000 products available. This approach allows us a truly scan-the-universe perspective from which we can apply qualitative and quantitative research to find strategies of interest.

We also emphasize intensive research practices to stay aware of crucial information and trends that may impact investment portfolios. Our investment practices are the result of an objective analysis of global markets and economies and available investment strategies. At U.S. Bank, you access relevant, objective, unbiased and market-responsive portfolio oversight which produces a strong investment solution.

Our Investment Strategy Committee meets weekly to discuss market and global policy events and to share key insights regarding the economy and capital markets (e.g., equities, fixed income, and real assets). Each group member presents their outlook on such things as:

- Domestic, developed foreign and emerging economies
- Inflation
- Domestic and global interest rates
- U.S. dollar relative to major currencies
- Federal Reserve and Central Bank target rates

Due diligence process

Our Due Diligence team utilizes a carefully developed, well-defined, and deliberate research process in selecting managers. Our initial four-step review is critical in helping to narrow down a broad range of potential options to a manageable number of quality choices that offer optimum potential for clients with various investment objectives. There are checkpoints in place through every step that solidify this investment process. Once managers are identified and selected for our platform, their ongoing performance and other management attributes are constantly monitored.

The due diligence professionals assess the track records of manager candidates, as well as other factors that require scrutiny:

Due diligence research factors	
Quantitative factors	
Performance history	— reviewing the manager's track record in terms of absolute returns, relative returns, risk-adjusted returns and alpha — performance volatility versus its benchmark.
Assets under management	— determining if the firm and the specific portfolio being considered has sufficient assets under management to properly diversify investment risk.
Strength of firm	— typically, managers must have at least a five-year track record to be considered.
Qualitative factors	
Purpose	— the manager's investment objective and how it is achieved. We prefer managers who own a limited number of positions within a portfolio and that manager turnover carefully in order to limit tax implications for non-qualified investments.
Philosophy	— how market prices, investor behavior, security valuation and other factors influence the manager's investment strategy. Taking the time to understand the thinking behind an investment approach is critical to determining how appropriate a manager is for our platform.
Process	— the degree of conviction the manager has around the investment approach being used today. The goal is to assure that a level of consistency can be expected. We also review the factors that might justify a decision by the manager to alter their process.
People	— assuring that those making day-to-day investment decisions have the experience necessary to execute and adhere to the process. Typically, we seek managers or management teams that have been in place for five years. They should be backed by a stable, experienced investment staff. Our internal team and third-party partners conduct candid and consistent interviews with each candidate firm to assure that objective standards are met. The goal is to identify managers that meet the defined investment directive and have convinced us that their capabilities match our investment standards.

Step 1: Define an investment directive

A critical starting point is to identify the specific investment directive that is to be fulfilled through the search process. Understanding the specific objectives and other parameters help lay the groundwork for a focused search process. Among the factors that help define additional steps of the due diligence process are:

- Investment objectives—capital appreciation, current income, etc.
- Asset class—mid-cap value, low-grade bonds, emerging market stocks, etc.
- Potential investment vehicles—mutual funds, separately managed accounts, exchange traded funds (ETFs), etc.
- Style characteristics desired in selected managers.
- Risk and return attributes that should be evident.
- Desired management approach related to factors such as how the investment is structured in comparison to its benchmark and the manager's security selection process.

Specifying this level of information related to the desired investment directives can significantly streamline the selection process and help match potential managers to the defined investment needs of our clients.

Step 2: Identify candidate firms to be studied

Using the specific direction identified in step one as a guideline, a rigorous search process begins. Potential candidates for consideration into our investment platform are identified using various industry databases as well as other industry sources and contacts that we have established over the years.

We can also compare broad information about the manager to our own selection criteria to help fine tune our screening process. In a typical search, 10 or more potential investment managers may be identified for more thorough examination in the next phase of the due diligence process.

Step 3: Assess quantitative and qualitative factors

The screening process continues by assessing the track records of manager candidates, as well as other factors that require more careful scrutiny by our due diligence professionals.

Quantitative Factors - a review of the record of the investment manager is often the first screen included in the process. This is particularly true when we study investment categories that have a large number of managers to choose from. The factors reviewed include:

- Performance history: Reviewing the manager's track record in terms of absolute returns, relative returns, risk-adjusted returns and alpha—performance volatility versus its benchmark.
- Assets under management: Determining if the firm and the specific portfolio being considered has sufficient assets under management to properly diversify investment risk.
- Strength of firm: Typically, managers must have at least a five-year track record to be considered, although some exceptions are made.

Qualitative Factors - effective due diligence process goes well beyond the numbers to look at other characteristics that meet our established criteria and match the specific investment directives identified in Step 1. Among the key aspects we consider are:

- Purpose: The manager's investment objective and how it is achieved. Generally, we prefer managers whose position sizes and turnover are consistent with the level of information in the process within a portfolio.
- Philosophy: How market prices, investor behavior, security valuation and other factors influence the manager's investment strategy. Taking the time to understand the thinking behind an investment approach and whether it offers competitive advantage is critical to determining how appropriate a manager is for our platform.

- **Process:** The unique aspects of the investment approach being used today. The goal is to assure that the firm should be able to execute its philosophy well and with ongoing consistency. We also review the factors that might justify a decision by the manager to alter their process.
- **People:** Assuring that those making day-to-day investment decisions have the experience necessary to execute and adhere to the process. Typically, we seek managers or management teams that have been in place for five years. They should be backed up by stable, experienced investment staff. Our internal team conducts candid and consistent interviews with each candidate firm to assure that objective standards are met. The thoroughness of this and the process step is at the heart of what makes our due diligence efforts matter. The goal is to identify managers that meet the defined investment directive and have convinced us that their capabilities match our investment standards.

Step 4: Identify and approve final candidates

After collecting all pertinent information on each potential management candidate, the Due Diligence team makes final recommendations to the Investment Management Executive Committee. This group carefully reviews all data and insights presented to it, questions the Due Diligence team and makes a final judgment on whether a specific manager meets our quality standards. Only after careful review and discussion by the committee will managers be added to the platform. It is important to note that managers are never selected by default. If no manager fits the investment directive or meets other criteria, then no manager will be recommended for the platform.

The frequency of in-house or on-site visits depends upon the manager's philosophy and process. For instance, a more active manager with a small management and ownership base would warrant more office visits than an index fund managed by a very large, publicly traded firm. We will vary the face-to-face meetings based upon need.

Each manager is monitored and classified in one of the following four categories based upon information received by the U.S. Bank Asset Management Committee.

Recommended List

A manager resides in this category if they have been approved by the Asset Management Committee. This status indicates that there are no unexpected performance issues or structural issues with the firm or the investment management team. No extraordinary steps need to be taken.

Watch List

This is the status for those managers that have short-term issues. Typical issues that will prompt adding a manager to the Watch List include:

- Three consecutive, or three out of four quarters, of significant underperformance relative to the product's benchmark, adjusted for style issues, as set out in the manager selection process
- Extreme performance in any quarter that might be indicative of style drift or other process breakdowns
- Investment personnel turnover for which the Asset Management Committee is generally comfortable with but for which U.S. Bank wants to watch more carefully for three to six months

The most likely course of action will be to review the manager for one additional quarter before placing it back on the Recommended List. No manager will be on the Watch List for more than two consecutive quarters. At the end of two quarters, the manager must be moved back to Recommended status, moved to the Hold List or terminated.

When one or more of these issues arises, the Asset Management Committee will be notified before the internal monthly meeting is held. The issue will be addressed at the meeting, and parameters will be established to define whether the manager is to be placed back on the Recommended List, moved to the Hold List or recommended for termination.

Client accounts may remain with the manager in question, and new accounts may be added cautiously. The Asset Management Committee will increase the scrutiny applied to each manager on the Watch List as follows:

- Discuss the issue at hand with the portfolio manager/investment consultant and set clear causation; identify any process or operational changes needed in response to the issues; determine expectations for the coming quarter (these expectations will be communicated in writing, either at the Asset Management Committee meeting or as soon as is practicable)
- The manager will be notified of the change in status.
- Have at least one conversation with the portfolio manager/investment consultant between the time of the Asset Management Committee meeting and the end of the quarter
- Follow up with the manager following the end of the next quarter to address the specific issues

Hold List

A manager will be put on the hold list when there are more significant issues. These issues are considerable enough for the Asset Management Committee to recommend that no additional accounts be opened with the manager until the issues are resolved, and include:

- Changes in the portfolio outside of the firm guidelines
- Unanticipated and unprepared manager changes
- Severe or prolonged underperformance
- Hold List managers may come from the Watch List or directly from the Recommended List. No manager will be on any combination of the Watch and Hold lists for more than four consecutive quarters. At the end of four quarters, the manager must be moved to the Recommended List or terminated.

If a manager is moved to the Hold List, the Asset Management Committee will be notified immediately regarding as many details as possible and a schedule of upcoming calls or on-site visits will be provided. The issue(s) will be addressed at the next Asset Management Committee meeting, or sooner, if possible, and parameters will be established to define whether and when the manager is to be placed back on the Recommended or Watch lists, or is to be recommended for termination.

The following actions will be performed by the Asset Management Committee:

- A new analyst opinion will be written within the first month of this status change and updates will be made to the manager interview as new information is made available
- If the initial review is negative, the manager may be recommended for immediate termination
- The manager will be notified of the status change
- The Asset Management Committee will check with the manager at least monthly for updates while the manager maintains this status
- A search for a replacement will begin

Termination

Once a manager is placed on the Watch List, they will be more closely monitored and reviewed more frequently. Specifically, the Asset Management Committee is looking for improvement in the factor or factors that caused the manager to be placed on the Watch List and is watching the other factors for any signs of degradation.

A manager will be recommended for termination if the Asset Management Committee sees further degradation in the factors above or feels that there will not be any significant improvement.

While these are our standards, we also coordinate our activities with your investment policy statement when making any manager changes to your portfolio.



CITY OF CUPERTINO

Agenda Item

21-10081

Agenda Date:
11/15/2021 Agenda #: 3.

Subject: HdL Contract and Refund Error Report

Accept HdL Contract and Refund Error Report



ADMINISTRATIVE SERVICES DEPARTMENT

CITY HALL
10300 TORRE AVENUE • CUPERTINO, CA 95014-3255
TELEPHONE: (408) 777-3220 • FAX: (408) 777-3109
CUPERTINO.ORG

AUDIT COMMITTEE STAFF REPORT

Meeting: November 15, 2021

Subject

HdL Contract and Refund Error Debrief

Recommended Action

Receive HdL Contract and Refund Error Debrief

Discussion

HdL Contract

Economic Development is a City function that has had a history of moving back and forth between the Community Development and Administration Department. During the first quarter of FY 2020-21, a decision to move this function from the City Manager's Division to the Community Development Department was approved by the City Manager based on the alignment of the function with the Department's operational goals and objectives. While this operational change was made, it was decided the budgetary changes would not be incorporated until the FY 2021-22 Adopted Budget.

Prior to and during FY 2019-20, the City's Economic Development function was managed in-house by a part-time Economic Development Manager. Subsequently, the employee left City service to work with HdL, an economic development service provider. In FY 2020-21, the City had an effective contract with HdL in the amount of \$170,000 per year.

These factors and the transition period created a challenge for both Administration and Community Development Departments to effectively manage the contract, services being rendered, and budget simultaneously throughout the year. Invoices received were routed to various departments and were not entered into the system timely which made it difficult for the departments to monitor the budgetary performance throughout the year. FY 2020-21 required additional services related to COVID-19 and the property acquisition of 10455 Torre Avenue and it was not until the second half of FY 2020-21 that staff became aware of services rendered exceeding the contract amount (\$170,000). A contract amendment was brought before City Council, but was not approved and

additional information was requested. To date, the City has not remitted payments in excess of the contract amount.

The functional transfer, both from an operational as well as a budgetary standpoint, is an irregular occurrence and resulted from management turnover in recent years. Contract management remains an essential responsibility for departments. As the City moves forward with the proposed internal audit work program, procurement, including contract management, will be reviewed and the findings and observations for improvement will be communicated to the Audit Committee upon completion.

Refund Error

In FY 2020-21, candidates running for City Council were required to pay \$2,860 in estimated candidate costs. Actual costs amounted to \$2,576, resulting in a candidate refund amount of \$284 subsequent to the 2020 election. Responsible Administration Department staff entered the invoice entry amounts in error. Rather than entering \$284, the actual cost of \$2,576 was mistakenly entered. This was then routed to the Department staff responsible for invoice approval and finally to Finance for review, processing, and payment. The essential internal controls and checks and balances were in place and operating effectively; however, this appeared to be an issue of human error, an inherent limitation to internal controls. A candidate received the incorrect refund and promptly notified the City. City staff took the matter seriously and corrected the error timely.

Sustainability Impact

No sustainability impact.

Fiscal Impact

No fiscal impact.

Prepared by: Zach Korach, Finance Manager

Reviewed by: Kristina Alfaro, Director of Administrative Services

Approved for Submission by: Greg Larson, Interim City Manager

Attachments:

None.



CITY OF CUPERTINO

Agenda Item

21-10082

Agenda Date:
11/15/2021 Agenda #: 4.

Subject: Embezzlement Update

Receive Embezzlement Update



CITY OF CUPERTINO

Agenda Item

21-10083

Agenda Date:
11/15/2021 Agenda #: 5.

Subject: Proposed Audit Committee 2022 Schedule and Work Plan

Receive Proposed Audit Committee 2022 Schedule and Work Plan and Provide Input

CITY OF CUPERTINO - AUDIT COMMITTEE 2022 SCHEDULE AND WORK PLAN							
January 24, 2022	February 24, 2022	April 25, 2022	May 23, 2022	July 25, 2022	August 22, 2022	October 24, 2022	November 28, 2022
Approve Prior Meeting Minutes	Approve Prior Meeting Minutes	Approve Prior Meeting Minutes	Approve Prior Meeting Minutes	Approve Prior Meeting Minutes	Approve Prior Meeting Minutes	Approve Prior Meeting Minutes	Approve Prior Meeting Minutes
Treasurer's Report for Quarter Ending December 31, 2021	Internal Audit Update	Treasurer's Report for Quarter Ending March 31, 2022	Internal Audit Update	Treasurer's Report for Quarter Ending June 30, 2022	Internal Audit Update	Treasurer's Report for Quarter Ending September 30, 2022	Internal Audit Update
OPEB & Pension Section 115 Trust Performance Report for Quarter Ending December 31, 2021	Budget Format Review	OPEB & Pension Section 115 Trust Performance Report for Quarter Ending March 31, 2022	Budget Format Review	OPEB & Pension Section 115 Trust Performance Report for Quarter Ending June 30, 2022	External Audit Subcommittee and RFP Kickoff	OPEB & Pension Section 115 Trust Performance Report for Quarter Ending September 30, 2022	ACFR and AUP Draft Review/Update
Review of FY 2020-21 ACFR and Supplemental Reports		Annual Review of City Investment Policy				Annual Review of Pension and OPEB Trust Investment Policy	
		Committee Input to Independent Auditor on Interim Audit and AUP Engagements					
		Follow-up on Previous Fiscal Year Management Letter Items and Management Responses					

**Summary of Duties – Powers – Responsibilities of
Cupertino Audit Committee**

Source: Cupertino, CA Municipal Code, Chapter 2.88.100: Audit Committee

The powers and functions of the Audit Committee shall be as follows:

- A. To review the annual audit report and management letter;
- B. To recommend appointment of auditors;
- C. To review the monthly Treasurer's report;
- D. To recommend a budget format;
- E. To review City investment policies and internal controls of such policies.
- F. To recommend appointment of internal auditors;
- G. To review internal audit reports. (Ord. 20-2208, § 1, 2020; Ord. 1679, § 1 (part), 1995



CITY OF CUPERTINO

Agenda Item

21-10084

Agenda Date:
11/15/2021 Agenda #: 6.

Subject: Budget Form Review and OpenGov Study Session

Discuss Budget Form Review and Receive OpenGov Study Session



ADMINISTRATIVE SERVICES DEPARTMENT

CITY HALL
10300 TORRE AVENUE • CUPERTINO, CA 95014-3255
TELEPHONE: (408) 777-3220 • FAX: (408) 777-3109
CUPERTINO.ORG

AUDIT COMMITTEE STAFF REPORT

Meeting: October 27, 2020

Subject

Budget Format Review Update.

Recommended Action

Accept staff report.

Discussion

In FY 2019-20, Audit Committee Chair Eno Schmidt and Vice Mayor Paul established a sub-committee to review the City's budget format. Initial observations, suggestions, and questions were submitted to and responded by City staff (see attachment F2). On November 12, 2019, the sub-committee issued a formal memo (see attachment F3) to City staff discussing the conclusions and recommendations from the review process. City staff's responses to the November 12, 2019 memo are attached (see attachment F4). City staff's updates on budget format are provided below:

Adopted Budget

While the sub-committee concluded that the City's budget document meets or exceeds its peers in a variety of categories, the City continues to improve the budget document each year to make the budget easier to understand for residents. For FY 2020-21, the City has added the following sections to the budget document:

- Capital Improvement Program (Page 42)
 - Discussion of Capital Improvement Program funding and financial impacts
- Revenue Comparisons (Page 118)
 - Per Capita comparisons of total revenues, property tax, sales tax, transient occupancy tax, franchise fees, and building permits with neighboring jurisdictions
- Pension (Page 153)
 - Explanation of CalPERS pension plan, discount rate, and investment returns
 - Discussion on the impact of CalPERS discount rate and investment returns

- Discussion of the City's strategies to reduce pension cost volatility, including the Section 115 Trust

Budget at a Glance

The City received feedback from the sub-committee to reference the Transparency Portal in the Budget at a Glance. The City is working on its first interactive Budget at a Glance, which will bridge the gap between the traditional Budget at a Glance and the Transparency Portal.

OpenGov Transparency Portal

The sub-committee recommended that the City enhance the Transparency Portal by:

- Providing more context to major amount and changes and
- Interconnecting key communication elements on the budget to the Transparency Portal.

Based on the sub-committee's feedback, the City is currently working to provide more context to financial data in the Transparency Portal through the following initiatives:

- Interactive Budget at a Glance
 - Present the budget in a simple, visual, and interactive format
 - Provide more context to financial reports in the Transparency Portal
- Interactive Capital Improvement Program Budget
 - Illustrate progress of capital projects from a financial standpoint
 - Connect project narratives to interactive maps and financial reports
- Stories for important initiatives (e.g. CARES Act)
 - Provide updates on important initiatives
 - Connect initiatives to financial reports in the Transparency Portal
 - Gather feedback from the community
- Budget Story
 - Explain important financial concepts including revenues, expenses, departments, and funds
 - Provide answers to frequently asked questions about the budget
 - Serve as a starting point to users unfamiliar with government finance or the Transparency Portal

These initiatives will help the City improve its financial transparency and community engagement. In addition, the City will continue working to incorporate feedback from the sub-committee, City Council, and residents, into the format of its budget documents and reports.

Sustainability Impact

No sustainability impact.

Fiscal Impact

No fiscal impact.

Prepared by: Thomas Leung, Senior Management Analyst

Reviewed by: Kristina Alfaro, Director of Administrative Services

Approved for Submission by: Deborah Feng, City Manager

Attachments:

F2 – Sub-Committee’s Initial Comments on Budget Format Review

F3 – Sub-Committee’s Formal Memorandum on Budget Format Review

F4 – City staff’s responses to the November 12, 2019 Memo

AUDIT COMMITTEE

SUBCOMMITTEE ON THE ANNUAL BUDGET REPORT

Questions Regarding the Current Budget Report (Please provide written responses within two weeks):

1. Three Budget Reviewers for the GFOA Award evaluation had suggestions for improvement. **Please describe how, if at all, each of the suggestions for improvement were addressed in the budget for the fiscal year beginning July 2019.** Please provide evaluation at least on the below-listed two items.

Responses with respect to all of the suggestions by the GFOA Budget Reviewers would be appreciated.

- a. Reviewer ID S411 suggests under “Document-Wide Criteria” that the City
“Try to reduce the document size to around 400 pages.”

RESPONSE: The Budget Team continues to take this comment into consideration each year; however, it is a challenge to identify which specific sections can afford to be reduced by 100+ pages. This comment is not marked with an asterisk (*) and as a result, does not require implementation to ensure the budget award is received in subsequent years. If the Sub-Committee has specific recommendations as to which sections they would like to see reduced, and so long as all of the GFOA and CSMFO award criteria are not compromised, the Budget Team will be glad to accommodate.

- b. All three reviewers rated the presentation for category F9 “Impact of capital investments on operating budget” as being “Information Not Present” or “Does Not Satisfy”.

RESPONSE: Typically, operating, or General Fund, impacts are quantified via operating transfers; however, there were no budgeted operating transfers in FY 18-19 or FY 19-20 for Capital Improvement Program projects. The City’s General Fund will transfer excess fund balance at fiscal year-end (FYE) to the Capital Reserve (Fund 429) in accordance with its Use of One Time Funds Policy (page 85). FY 2019-20 was the first year the City’s budget document included a Capital Improvement Program (CIP) project summary (page 493). The Fund Balance Report (page 96) discusses the impact of revenues and expenditures/expenses on each particular fund’s fund balance, including the capital projects from the CIP budget. The Budget Team agrees that a more expansive narrative/discussion may be beneficial; perhaps in the forecast section near the end of the Financial Policies and Schedules section.

- c. How were the other suggestions for improvement by GFOA Budget Reviewers were addressed.

RESPONSE:

- Financial Structure, Policy and Process: Department org charts have experienced changes in recent years. Enhancing the aesthetics and understandability will be an area to address in FY 2020-21.
 - Financial Summaries: Categorized and forecasted summaries for all of the City's funds were included beginning on page 146. Additional information and charts can be included (similar to the General Fund); however, and as mentioned above, the Budget Team does keep the document's length in mind when determining what and what not to include.
 - Capital and Debt: See response to 1.b. above
 - Departmental Information: Total FTEs are included in each of the Department Budgets. This is also reiterated/duplicated/summarized on page 491 and presented historically as well. Performance measures are included as well as workload indicators (FY 2019-20 was the first year for presenting workload indicators)
 - Document-Wide Criteria: The Budget Team will add the state to the cover so long as it complies with branding requirements as established by the Communications Office.
 - Other Comments/Suggestions: No specific comments or suggestions noted for implementation.
2. With respect to the Transparency Portal and the use by Cupertino of OpenGov:

a. What are the goals of having the Transparency Portal?

RESPONSE:

- The Transparency Portal provides an accessible platform so that members of the public have access to the City's financial data in real time.
- This tool fosters communication and trust not only with the public, but amongst City staff.
- OpenGov's Budget Builder provides an effective tool for departments to compile, submit, review, and approve budget requests. It also serves as an important archive for the thousands of communications that occur during the budget process from one year to the next.

b. What key performance indicators (KPIs) for the Transparency Portal have been established by the City?

RESPONSE: The City does not have KPIs for the Transparency Portal. The Budget Team is open to establishing KPIs; however, success is measured by volume of external use

c. How has the City been doing relative to these KPIs?

RESPONSE: See response 2.b. above.

3. With regard to the City's link provided to OpenGov as to the Transparency Portal, in examining on non-departmental expenditures for the budget in 2019-2020, why is the actual for 2019-2020 equal to the budget for 2019-2020 (as of Sep 28, 2019)? See screenshot taken from this link:

https://cupertino.opengov.com/transparency#/28185/accountType=expenses&embed=n&breakdown=28459e6a-563e-4695-97d4-8a0d97d881e1¤tYearAmount=cumulative¤tYearPeriod=years&graph=bar&legendSort=desc&proration=true&saved_view=83847&selection=0816267C08601EE8C423B11CADCC4989&projections=null&projectionType=null&highlighting=null&highlightingVariance=null&year=NaN&selectedDataSetIndex=null&fiscal_start=earliest&fiscal_end=latest

RESPONSE: The City implemented a change in methodology for recording its operating transfers (non-departmental expenditures). Rather than recording/recognizing them on a quarterly/monthly basis, the City records/recognizes them all at once as soon as the budget is adopted by Council. Purpose: increased efficiency determining the amount and reason for each interfund transfer when preparing the Interfund Transfers footnote in the Comprehensive Annual Financial Report (CAFR) at year-end. In other words, rather than having hundreds of transactions/line items to tie to and from each of the funds, the gross transfer amounts can more easily be tied to the adopted budget, Council resolutions, etc.

- a. This raises the question, separate from the format of the data presented, how, if at all, is the data presented to the public on OpenGov reviewed for accuracy and completeness?

RESPONSE: The information presented in OpenGov is imported straight from the City's enterprise resource planning (ERP) system, New World System (NWS). All of the financial data is reviewed and reconciled on a weekly and monthly basis to ensure accuracy, completeness, cutoff, and existence.

- b. What process is followed? If there is a process, is the process memorialized in a written medium?

RESPONSE: Other than what has been discussed in the previous response, there is no formal process memorialized in a written medium. The Budget Team is open to recommendations and suggestions.

- c. What documentation is reviewed in the process of evaluating OpenGov information, and what management approvals are required prior to publication of the information?

RESPONSE: The information that is imported into OpenGov from NWS is subject to numerous controls and reviews, namely within the payroll, accounts payable, and

revenue collection process. These are processed and reviewed by multiple employees, signed off and authorized by management, on a weekly, bi-weekly, and monthly basis.

4. For Budget versus Actual in the OpenGov transparency portal (see above link in question 2), Non-departmental drops from 2018-19 Actual of \$19,376,088 to 2019-20 (Amended Budget) and Actual of \$10,539,557?

RESPONSE: Non-departmental revenues and expenditures/expenses include the City's operating transfers from one fund to the other. Prior year actuals are typically higher than subsequent year budget amounts for the following reason; the Adopted Budget does not include excess General Fund fund balance that is transferred to the Capital Reserve in accordance with the City's Use of One Time Funds Policy (page 85)

- a. Can we link to the "Department Operating Budgets" then to the Non-departmental section to help explain?

RESPONSE: That is certainly an option. We can also have a more expansive explanation in the non-department section to explain the purpose of each of the transfers.

- b. An explanation in the Budget message document for this particular question does not seem to be present. If it is, please indicate the location.

If such an explanation is not present, please suggest a location for it.

RESPONSE: Correct, other than including the non-departmental amounts within the fund's total budgeted amounts (page 31 for example), there is no expanded discussion on the transfers in the Budget Message section.

5. Can the subcommittee see the questions submitted by the public to the City related to the Transparency Portal/budget for the past year?

RESPONSE: The City has been frequently asked how much has been spent on the Regnart Creek Trail project. To the Budget Team's knowledge, no additional questions have been raised.

6. Since Opengov is being used as Cupertino's Transparency Portal, see these selected comments at the Opengov link:

- a. "Build Trust Through Effective Communication – Engaging with constituents and stakeholders is critical to every public agency's success. With OpenGov, leaders can analyze and communicate complex topics and decisions in a simple manner anyone can understand. Agencies are able to build trust with colleagues and residents by gathering input on key

initiatives and aligning budget and the strategic plan to both performance objectives and public expectations.”

- i. Question: What are the key complex topics and decisions made in Cupertino that (the City’s leaders) through OpenGov are communicating?

RESPONSE: The Budget Team has primarily utilized OpenGov’s Transparency Portal and Budget Builder software. We’ve also used this platform to present budget and prior year actual data at City Council Meetings. Additionally, we’ve used this tool to provide information to City Council on various subject like Capital Projects, salary and benefit costs. Moving forward, the Budget Team is excited to further complement the budget tools with the use of stories, an interactive platform to present and inform audiences on specific projects and initiatives.

- ii. How is the City using OpenGov (the transparency portal) by “aligning budget and the strategic plan to both performance objectives and public expectations”?

RESPONSE: The budget process establishes a public expectation and the Transparency Portal allows the public to view, in real-time, the City’s financial data.

- b. One possible idea is to (cross)link the “context” in the Budget message (for example the June 2019 Budget message) and other “context” in the Department Operating Budgets to some of the OpenGov Transparency portal modules, for major line items or major changes from previous years. The OpenGov transparency portal currently is filled with data and ability to compare but could benefit from adding convenient context. Is this something that Staff could do?

RESPONSE: Adding “notes” is definitely one way to increase context. The use of “stories” is also another tool available to the City that can obviously tell a story about a project, initiative, etc. Based on requests from Council, Commissions, Committees, the public, management, etc., staff can create and publish stories as necessary.

- i. Could Staff then introduce some of the OpenGov communication elements (see above questions and Opengov website for more)?

RESPONSE: Open Town Hall is a survey tool the City is looking into utilizing more consistently and frequently.

- ii. Palo Alto is using the “note” function (although only one posted) of the OpenGov. What does Staff think about using this functionality as a starting point for communications? See link here to Palo Alto:

https://paloalto.opengov.com/transparency#/18215/accountType=revenues&embed=n&breakdown=types¤tYearAmount=cumulative¤tYearPeriod=years&graph=bar&legendSort=coa&proration=true&saved_view=51273&selection=E7F4AA9C788A9B9A3D41A6865E3D305B&projections=null&projectionType=null&highlighting=null&highlightingVariance=null&year=NaN&selectedDataSetIndex=null&fiscal_start=2013&fiscal_end=latest

RESPONSE: Yes, we can add these notes to various saved “views” to provide context to the reader/audience.

7. The order in which one accesses the below Budget documents a. – e., can result in an entirely different set of questions. What is the intended order that key Budget documents should be examined by the public?:
 - a. Budget (500+ pages)
 - b. OpenGov (transparency portal)
 - c. Budget at a Glance
 - d. Budget message
 - e. Department Operating Budgets

RESPONSE: While the Budget Team’s preference would be the Adopted Budget (which contains the Budget Message and Department Operating Budgets), followed by the

Budget at a Glance, and then finally OpenGov, one of the advantages to having these multiple tools is that the order of preference can be determined by any reader/audience depending on their needs, interests, and desires. For example, a reader that isn't interested in getting lost in 500+ pages of details might prefer to a high level glad at the Budget at a Glance – and vice a versa. The moment a budget becomes adopted and printed, it's already outdated. That is what is great about OpenGov; it is a living constantly updating platform that addresses the common question, "I know how much was budgeted...how much have we spent?"

8. Following-up on Question 7., above, there are also Financial Policies and Schedules. Assuming that the above-listed Budget documents of 7.a. – 7.e. are not envisioned as being examined in any particular order (and if they are, we should make that clear to the public), please consider using items 7.d. and 7.e. as a contextual "bridge" between the Budget at a Glance and the Budget? Or perhaps there should be another intermediate step to the Transparency Portal which provides both context/bridge and the data? Should all of the above-mentioned budget items (7.a. – 7.e. and the Financial Policies and Schedules) be linked together in some way in the Transparency Portal?

RESPONSE: Agreed. Each of the tools discussed have pros and cons and readers/audiences may not be aware of them (e.g., one is detailed, one is high-level, one

is current, etc.). One of the ways we've tried to tackle this challenge is through events such as Budget & Bites and through social media engagement. The Budget Team is open to recommendations and idea to building this contextual "bridge."

9. In Financial Policies and Schedules:

- a. On p75 (p9 of 94 PDF) of the Fiscal Policies – Revenue Policies, the final policy listed states "Ensure that Enterprise activities remain self-supporting in the long-term." How does the City analyze compliance with this policy? Please provide examples?

RESPONSE: Governmental Accounting Standards Board and various interpretations of the standards do not appear to have a specific threshold for how "self-supporting" is defined. For example, there is not an exact threshold of 50% which would qualify a fund or activity to be reported as an enterprise fund. Compliance is continually monitored based on historical and/or current subsidized (General Fund assistance) activities.

- b. On p92 (p26 of 94 PDF), the Audit Committee is neither listed nor has a budgeted expenditure allocated. Can this be corrected? If so, please describe the process for including the Audit Committee here.

11 Commissions				
131 Telecommunication Commission	7,028	-	-	7,028
140 Library Commission	23,346	-	-	23,346
142 Fine Arts Commission	54,541	-	-	54,541
150 Public Safety Commission	22,738	-	-	22,738
155 Bike/Ped Safety Commission	1,244	-	-	1,244
160 Recreation Commission	51,443	-	-	51,443
165 Teen Commission	64,019	-	-	64,019
170 Planning Commission	109,787	-	-	109,787
175 Housing Commission	38,251	-	-	38,251
180 Sustainability Commission	37,951	-	-	37,951

RESPONSE: [We will ensure the Audit Committee and related staff time is added in the FY 2020-21 Proposed and Adopted Budget.](#)

10. Is there anywhere within the Budget documents where a member of the public can easily determine how much of Cupertino's annual budget is spent on compensation, benefits, and pension obligations for the City's employees? If not, please provide in table format, broken down by departments, the number of FTEs, and the absolute amounts spent on each department for compensation, benefits, and pension obligations. Please include City Council compensation.

RESPONSE: [The resolution on page 12 provides a financial overview by fund showing the City-wide account classification amounts \(employee compensation and employee benefits are included\). Page 40 and 41 of the Budget Message discuss the ongoing challenges of retirement benefits. Page 111 discussed the General Fund expenditures, specifically the majority of the City's employee compensation and employee benefits. The pages to follow within the All Fund Summary beginning on page 117, show the employee compensation and employee benefits totals aggregated at the fund-type level.](#)

The second (2nd) page of each of the Department budget sections shows a total FTE allocation. Shortly thereafter and near the front of each of the Department budgets, a total revenues and expenditures by account classification is reported. For example, Council and Commissions' Department budget on page 165 reports the total employee compensation and employee benefits totals for the year. Lastly, there is a saved view in the transparency portal titled "[Employee Compensation and Benefits](#)" that breaks out by department salary and benefits costs by department.

**AUDIT COMMITTEE
SUBCOMMITTEE ON THE ANNUAL BUDGET REPORT
November 12, 2019**

CONCLUSIONS AND RECOMMENDATIONS

1. Awards from respected Associations for Budget Presentation highlight and support the outstanding work being accomplished by the City Staff of Cupertino in the budget process:
 - a. Distinguished Budget Presentation Award by Government Finance Officers Association; and
 - b. Excellence Award for Fiscal Year Operating Budget by California Society of Municipal Finance Officers.
2. Comparison of budget documents from other cities as presented in September 25, 2019 Staff Report to the Budget Book Subcommittee of the Audit Committee, shows the City of Cupertino meeting or exceeding its peers in a variety of budget presentation categories. Use of the Transparency Portal and communication of Budget At a Glance are clearly within the peer leadership.
3. In the spirit of continuous improvement and building on the strong budget formats already in-place in Cupertino, here are some areas the Subcommittee recommends further investigation and possible adjustment be considered by focus on possible enhancements to the
 - a. Budget At a Glance
 - i. Adding modules such as the Ten-Year Staffing and Population Growth chart to highlight and explain significant changes or elements of the current budget; and
 - ii. Reference Transparency portal of OpenGov for supplemental key elements.
 - b. Transparency portal of OpenGov
 - i. Provide more context to major amounts and changes from year to year or budget to actual by
 1. Linking to the context already available in other budget documents or
 2. Creating new content if needed and posting.
 - ii. Interconnect or make more obvious some of the key communication elements on the budget already underway in Cupertino and as listed by OpenGov as one of the transparency portal's strengths. For example, OpenGov on its website states "Build Trust Through Effective Communication. Engaging with constituents and stakeholders is critical to every public agency's success. With OpenGov, leaders can analyze and communicate complex topics and decisions in a simple manner anyone can understand. Agencies are able to build trust with colleagues and residents by gathering input on key initiatives and aligning budget and the strategic plan to both performance objectives and public expectations."
 1. Link into OpenGov those initiatives already underway; and
 2. Explore other ways to implement and demonstrate through the portal.

PLEASE SEE SEPARATE SUBCOMMITTEE QUESTIONS SUBMITTED TO CITY STAFF WITH RESPONSES FROM STAFF

In particular the following City Staff responses warrant additional consideration and action based on responses provided: Questions 1b, 1c, 2b, 4a, 6a, 6b, 6bii, 8, 9b and 10.

Additionally, the response by City staff to Question 9a which asked about the current stated policy of “Ensure that Enterprise activities remain self-supporting in the long-term” seems to us to indicate as a minimum the word “Ensure” might be replaced with “Monitor” or even better a policy defining “self-supporting in the long-term” be adopted so that the City indeed could ensure that said policy is being implemented.

Respectively submitted
Budget Subcommittee of Cupertino Audit Committee
Councilman Darcy Paul
Cupertino Audit Committee Chair Eno Schmidt

Budget Format Review Update

Audit Committee Regular Meeting
October 27, 2020



CUPERTINO

Topics

1. Adopted Budget
2. Recommendations
3. Solutions
4. Next Steps

Adopted Budget

- Added CIP Financial Impacts Discussion
- Added Revenue Comparisons
- Expanded Pension Discussion

Recommendations: Bridging the Gap



Transparency Portal

Historical Data
Budget
Budget vs. Actuals



Budget Documents

Adopted Budget
Budget at a Glance

How We Bridge the Gap



**Transparency
Portal**

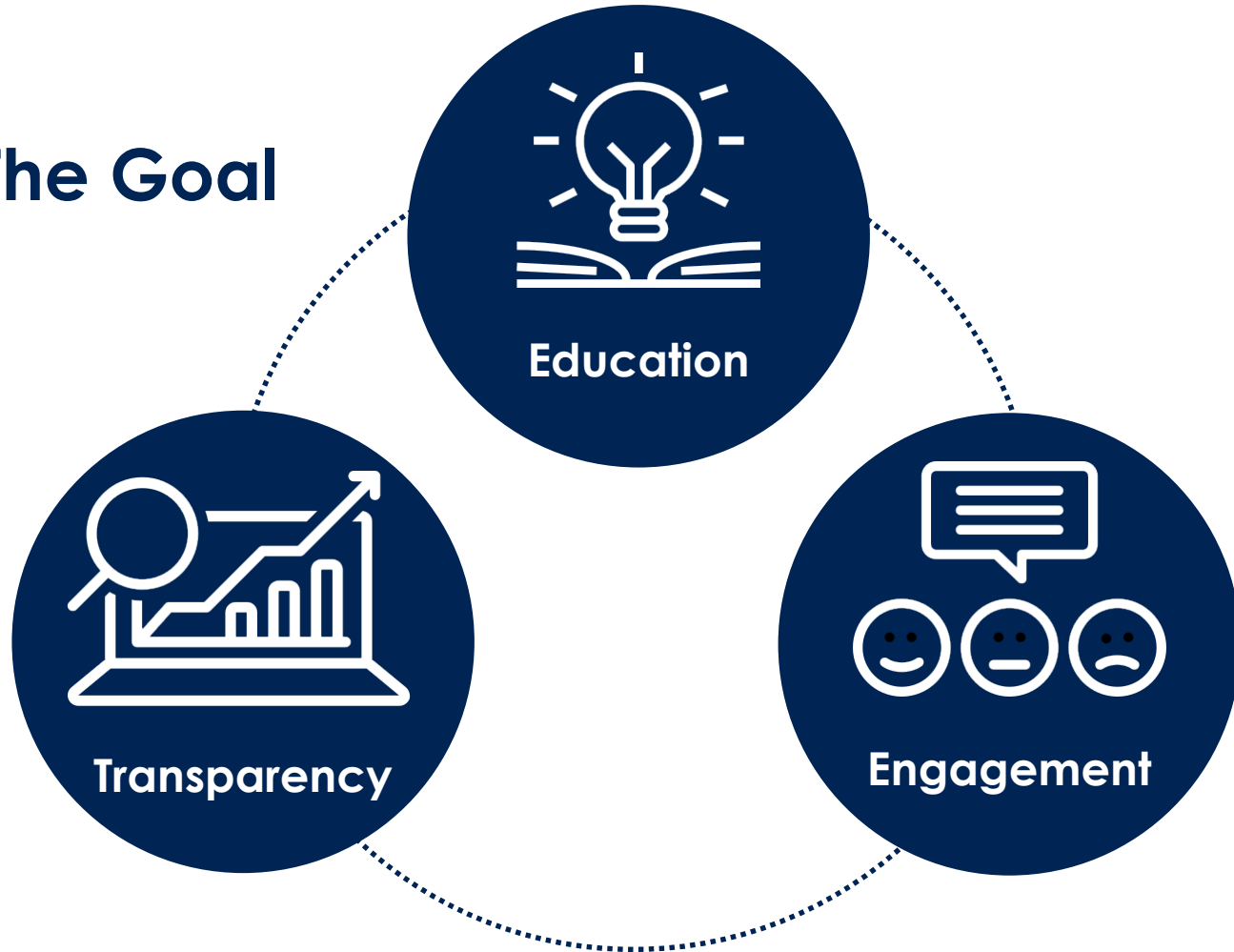


**OpenGov
Stories**

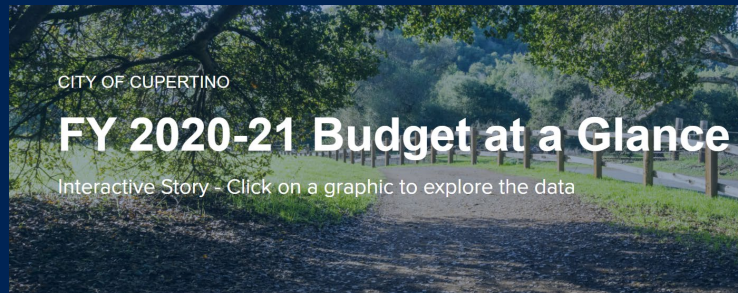


**Open Town
Hall**

The Goal

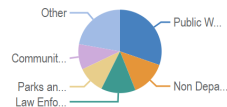


Interactive Budget at a Glance



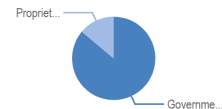
Expenses by Department - All Funds

Data Updated today



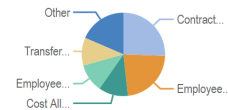
\$110,591,225.00

Expenses by Fund Type - All Funds



\$110,591,225.00

Expenses by Type - All Funds



\$110,591,225.00

Expenses in 2021

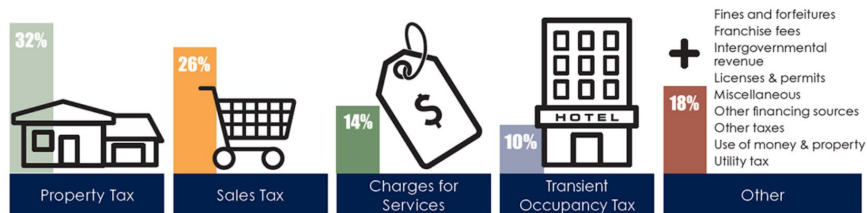
A Message

As the City of Cupertino enters a time of economic uncertainty, I am forecasting anything, be it the economy or the weather, is not an exact science. What we are doing, is preparing for the worst while taking steps to ensure the best.

The COVID-19 pandemic, and the ensuing lockdowns, has negatively impacted the City's revenue. For purposes of our budget forecast, we are anticipating at least a two-year recovery.

General Fund Revenues

Where does the City get its money?



Resident Tax Contribution Calculator

Would you like to know where your tax

Answer a few short questions to explore your tax dollars

Start

Restart

Back

Restart

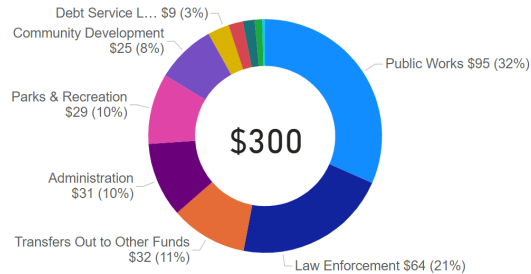
Do you own a home in Cupertino?

☐ Yes

☒ No

Next

How Your Tax Contributions Are Allocated (by Service)



Next

Interactive CIP Budget



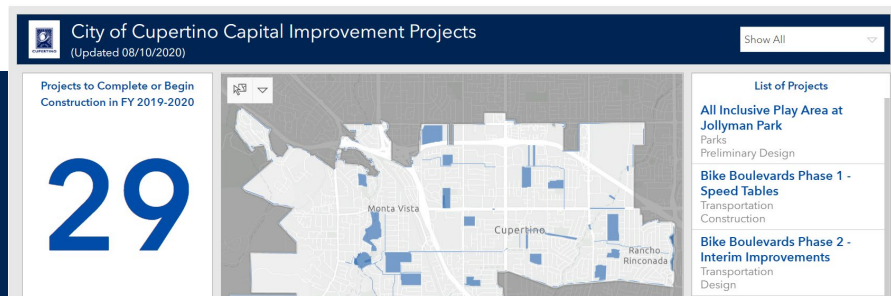
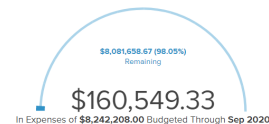
Project Description

Develop a design and construct an approx. 4,400 SF addition to the Library building for a "program room" that will seat up to 130 to library events. Using the "Perch" option from the Civic Center Master Plan.

Project Costs: Budget vs Actual

(99-077) Library Expansion

Data Updated today



Important Initiatives

CITY OF CUPERTINO

CARES Act

Using CARES Act Funds to Support the Community through COVID-19

What is the CARES Act?

The CARES Act provides for payments to State, Local, and Tribal governments navigating the impact of the COVID-19 outbreak; billion in funding through the Coronavirus Relief Fund.

CARES Act Feedback Survey

What do you think about this communication tool?

No deadline is currently set

Introduction

Feedback

Your Response

Outcome

Your Response

[Take the Survey](#)

What did you like the most about your experience?

What can we do to improve your experience?

Do you have any questions or comments?



Budget Landing Page



Timeline

- Interactive Budget at a Glance
- Resident Tax Contribution Calculator
- Interactive CIP Budget
- Important Initiatives
- Budget Landing Page

Next Steps

- Budget Format Review Subcommittee

Thank you!

Questions?



CUPERTINO

Questions Regarding the Current Budget Report

Audit Committee Chair Daisy Liang

1. Page 35 and 55 of the FY 21-22 Proposed Budget: Please add the Adopted Budget amounts for anywhere the FY18 and FY19 actuals are presented. This will allow a reader to understand where the actuals ended in respect to the amounts budgeted.

RESPONSE: The format of showing two years of actuals, prior year adopted, and current year adopted follows the criteria set forth by the Government Finance Officers Association (GFOA). Additionally, changing the size of the charts would result in the charts being significantly reduced in size and could make is less legible. As an alternative, staff could issue a separate appendix showing the prior year budget and actuals at the detailed account line item level and post on the City's website.

2. Page 42: The Non-Personnel Assumptions section discussed one-time special projects. Can we add links throughout the document for repeated information? Can we add onetime special projects as a saved "view" in OpenGov to allow the public to easily access the information?

RESPONSE: We can add a reference on page 42 to note that special projects are further detailed in the respective department narrative sections. Each page of the budget document has a link back to the Table of Contents. From there, a user can easily move to any section of the document they desire.

3. Page 81: The Basis of Budgeting section discusses the budget being split into nine departments. Can the document include a pie chart to show the departments percentages?

RESPONSE: General Fund expenditures by department is presented on page 36 of the Proposed Budget.

4. Page 93: What is the formula to calculate the \$19,000,000 for Economic Uncertainty reserve?

RESPONSE: The formula is noted on page 93 of the Proposed Budget document: "represents two months of General Fund (GF) expenditures excluding transfers out plus a two year drop in total general fund revenue of 13% or approximately 1.5 months, excluding the use of reserves." This can be estimated by using the "Financial Overview by Fund" chart on page 103.

Total GF Expenditures	\$ 88,138,778
(less transfers out)	\$ (11,251,984)
Subtotal	\$ 76,886,794
Expenditures (2 months)	\$ 12,814,466
Revenues (1.5 months)	\$ 9,372,611
Hypothetical Reserve Amount in FY 21-22	\$ 22,187,077
Actual Reserve Amount in FY 21-22	\$ 19,000,000
Difference	\$ (3,187,077)

In recent years, unassigned fund balance in General Fund has maintained high levels. That, coupled with the establishment of the Section 115 Trust (pension), City staff have not recommended increases to the Economic Uncertainty Reserve. In the event of economic uncertainty, further recommendations would be brought before City Council (e.g., increasing the Economic Uncertainty Reserve, utilizing the Pension Section 115 Trust, budget reductions, etc.).

5. Page 138: Can General Fund fund balance be added to the 20-Year General Fund Financial Forecast chart?

RESPONSE: Page 138 shows the revenues and expenditures and difference between the bars and the line represent changes in fund balance; these are emphasized on page 139. We could add a sentence nothing the beginning unassigned and total fund balance to provide additional context. That said, the General Fund fund balance forecast is discussed in detail beginning on page 155. Although having all of this information on one page would be ideal, it simply is not feasible. The forecast section is presented in a format consistent with the rest of the document and follows the flow/format of an income statement (revenue → expenditures → fund balance).

6. Page 148: What is “salary savings” as presented in the Five-year General Fund Expenditures Forecast chart?

RESPONSE: Salary savings is a common line item in budgets, particularly in forecast models. The City budgets for 100% of the authorized employee head count; however, throughout the year, savings is realized through turnover and attrition. This amount represents the anticipated savings from vacant positions and attrition throughout the fiscal year (cost of approximately 5 full-time employees).

7. Page 541: Where are the capital projects for FY 21-22 as well as any previously funded projects that have yet to be completed?

RESPONSE: The Capital Improvement Program (CIP) was not included in the Proposed Budget. It was first introduced to City Council at a study session on May 4, 2021, subsequent to the publishing of the Proposed Budget on May 1, 2021. The Final Adopted Budget will incorporate all financial information pertaining to CIP. Additionally, Public Works and the CIP team will be issuing a separate CIP Budget document as well.

Councilmember Moore

May 18, 2021

Format:

1. While Contingencies may not be an appropriate format issue to discuss, I think it should be removed and the reserve in the General Fund be appropriated as needed. The item has not been transparent from its inception in 2013 and looks like a slush fund with the largest share in the City Manager's budget. The Staff Report to City Council in June of 2013 neglected to mention that a new contingency amount of \$427k was even being appropriated and now the current format for the Budget shows \$3,773 for contingencies for the City Manager on p. 221, yet on p. 245 of the current Proposed Budget, there is \$593,250 appropriated in contingencies. Additionally, the City Manager is given authority to approve their spending on p. 244. This practice, and the whole contingency category, in my opinion, needs to end.

RESPONSE: City Council directed staff to reduce the City Manager Discretionary Fund to \$75,000 (a reduction of \$518,250) at the June 4, 2021 study session. City Council ultimately adopted the FY 21-22 Budget with a City Manager Discretionary Fund budget amount of \$75,000.

2. I do prefer the staffing tables used by Campbell and Sunnyvale for clarity.

RESPONSE: Noted. It will be challenging to incorporate similar staffing tables throughout each of the respective Program narratives. However, staff can create an appendix report for all positions and present by Department and Program.

3. I prefer the more detailed accounting which the City did in 2013 and other cities continue to do, referred to as the Account Level Summary.

RESPONSE: Noted. It will significantly increase the length of the document to show the account level detail throughout the document, but as an alternative, staff can create an appendix report for all budget and actuals at the account level detail.

4. I would like the previous comments from the last Budget Format Review Subcommittee (attached) added along with my comments and Daisy's for next week's City Council Budget Agenda item.

RESPONSE: Noted.

Content:

Proposed Budget is pretty easy to read and follow. Movement of money between funds along with department divisions and tasks moving between departments makes following the changes to department costs difficult to capture. Because some funding increased a great deal in 2020, it

would help to have a comparison back to 2019 in some instances (City Manager Contingency, for example, Proposed Budget p. 245)

1. Community outreach improvements to get input regarding the Proposed Budget goals and process.

a. Proposed Budget mentions input from the Audit and Fiscal Strategic Plan Committees, however neither has reviewed the Proposed Budget for input. Should these committees receive the Proposed Budget prior to coming to City Council in the future or is this process order better? The Fiscal Strategic Plan Committee is not codified and has no codified duty to review the Proposed Budget.

RESPONSE: The Audit Committee is tasked with reviewing the Budget Format and the Fiscal Strategic Plan has historically reviewed the City's financial forecast, which is an important component to the City's budget document. While input on the actual budget document is only received from the Community via public meetings, the City's budget team holds annual community engagement budget workshops and includes interactive budget reports throughout the year via OpenGov.

2. The organizational charts need to reflect the Cupertino Municipal Code (CMC)

a. Add date of organizational chart

b. Update the online chart

c. Update CMC to reflect current organizational structure (e.g. add I.T. Department)

d. This should probably not be a work plan item, but an ongoing process of CMC cleanup

RESPONSE: The organizational charts in the budget document are correct. They will need to be updated online and in the CMC. The date of the organization chart in the budget corresponds to the budget document itself; thus the organization chart corresponds to FY 21-22.

3. CMC mentions a potential Public Safety Department should Police and Fire be administered by the City. The City contracts out both. How is the Fire Department paid for?

RESPONSE: Santa Clara County Fire is funded via property taxes. Property tax revenues are generated from the 1% tax on property values. Of that 1%, the City receives 7% and Santa Clara County Fire receives 15%, with the majority of the 1% going to school districts.

4. City Manager discretionary spending was \$743 for 2020 yet the 2022 Proposed Budget is \$593,250. Additionally, the Program Overview states that the contingency budget for the City Manager requires the City Manager approval (Proposed Budget p. 244). I would recommend this amount be removed and a policy for oversight be put in place. The City Manager’s overall budget has increased from \$786,535 in 2019 (expenditures plus contingencies) to \$2,115,071 proposed for 2022. How is this increase accounted for? Review the City of Cupertino Purchasing Policy (2013) Code Sec. 3.22 and 3.23.

RESPONSE: The City Manager Contingency program was established to meet citywide unexpected expenses that may occur during the year. In FY 2013-14, a Contingencies expenditures category was added to each General Fund program to serve as a contingency for any unexpected expenditures that might occur during the year. Prior to FY 2020-21, the contingency amount was derived by taking 5% of the General Fund’s base materials and contract services to account for unforeseen events and/or activities that were not included in the respective fiscal year’s budget. In FY 2020-21, and in response to COVID-19, the contingency amount was cut in half to 2.5% of the General Fund’s base materials and contract services. Additionally, in FY 2020-21 The City Manager’s contingency established an appropriation specifically for Public Works’ unforeseen maintenance and repairs in an amount of \$280,000. The current 2.5% calculation is below GFOA’s best practice recommended range of 5-15%; however, once the Public Works unforeseen maintenance and repair contingency is factored, the contingency amount ends within the recommended range at 5%. In total, the City Manager’s contingency budget has remained relatively consistent year-over-year (YOY) as noted below:

Fiscal Year	FY 2017-18	FY 2018-19	FY 2019-20	FY 2020-21	FY 2021-22
Budget	\$505,000	\$593,661	\$486,353	\$551,827	\$593,250
Actual	\$240,365	\$127,480	\$279,337	\$283,384	\$ -

The City Manager budget unit within the Department of Administration (100-12-120) has increased from \$993,118 (adopted) in FY 2018-19 to \$1,521,821 (proposed) in FY 2021-22. This increase is due to 2.3 additional full-time employees being accounted for in this budget unit. City Council recommended and adopted a FY 21-22 budget with a City Manager Discretionary Fund of \$75,000.

5. Economic Development has switched to a contract service and has more than doubled in cost.

RESPONSE: The Economic Development budget is proposed to decrease from \$430,494 in FY 2020-21 to \$337,074. As the function becomes further defined, staff will bring forward budget recommendations to City Council for consideration.

6. Some committees use staff time (which seems to imply they have a budget amount) and are not codified: Economic Development Committee, Disaster Council, Fiscal Strategic Plan Committee. Needs clarification.

RESPONSE: Staff time allocations less than 5% are generally not charged to specific budget units. In other words, the City would not create a budget unit for Fiscal Strategic Plan Committee because less than 5% of a respective employee's annual time is required.

7. Multiple projects which are not approved in the City Council Work Plan show up in the Proposed Budget: New Logo, online store. Please remove these items from other headings such as "Contract Services" to a new heading which indicates they are Proposed Work Plan Items and not approved.

RESPONSE: All City Work Program items will be budgeted and shown as "special projects" in the final adopted budget. Recording activities in a unique account requires the creation of a new general ledger account. This is completed once the City Work Program is adopted and the projects are finalized.

8. Communications costs seems to be a separate area, could this be shown as a group?

RESPONSE: Combining these groups would decrease transparency and also sacrifice historical data comparisons. OpenGov's Transparency Portal now has a saved "view" so that the Office of Communications and the Multimedia budget units can be seen in a combined fashion.

[OpenGov Saved View](#)

9. It is unclear how much of the Cultural Events (\$402,137) items will occur, such as the 4th of July celebration. (PB p. 335-336), a similar item, Neighborhood Events (\$163,119) raises the same question (PB p. 350). Total events: \$565,256.

RESPONSE: Most of the 4th of July funds are spent the FY before the event, so the money in the FY 2021-2022 budget will go toward the July 4, 2022. The other events within this account are Memorial Park Summer Events and Shakespeare in the Park which we are planning for late summer/early Fall 2021, Tree Lighting which is in December 2021, Big Bunny 5K in March/April 2022, and other small events. The Festivals start in the Fall and continue to Spring. At this time, we are assuming those will happen.

10. Economic Development was \$89,910 for the 2019 actual expenditure and is now proposed at FY 2022 \$337,074 with a new contingency and materials amount of over \$60K with no staffing. Additionally, there is no codified Economic Development Committee which uses staff time. This area needs attention.

RESPONSE: The Economic Development budget is proposed to decrease from \$430,494 in FY 2020-21 to \$337,074. With the function likely moving “in-house,” staff are recommending a reduction in this budget unit of \$38,694. As the function becomes further defined, staff will bring forward budget recommendations to City Council for consideration.

11. Please explain the large increase in the BMR affordable housing fund PB p. 393 which shows an increase of revenue from 2019 actual of \$159,179 in taxes to 2022 Proposed Budget taxes of \$3,611,855. There is an allocation of \$600,000 shown for Homelessness and other Special Projects which has not been approved and the City Resolution to support the county Task Force on Homelessness indicated that the City would participate in a county-wide program which the City would likely be asked to contribute financially to.

RESPONSE: Estimated revenues increased due to one-time anticipated Housing Mitigation In-Lieu Fees for Cupertino Village and De Anza Hotel. The majority of this program’s budget increase is due to two (2) tentative City Work Program items: \$300,000 for Affordable Housing Strategies and \$300,000 for Homeless Services and Facilities. Although the Affordable Housing Strategies is slated for removal, a \$200,000 item for Homeless Jobs Program is slated to be added.

12. Code Enforcement has increased from \$508,167 in 2019 to \$1,202,392 proposed 2022. PB p. 406.

RESPONSE: Full-time employee (FTE) allocations have increased since FY 2018-19 which is contributing to the increase. Additionally, and because of these relatively large proportional staffing increases and changes in methodology, the amount of cost allocation charges increased from \$22,478 in FY 2018-19 to \$277,786 in the proposed budget year.

13. Facilities would be easier to track if grouped together, Facilities and Fleet next to Grounds, for example. Where are Stocklmeir, Byrne, Blech?

RESPONSE: The Department’s budget units/programs are organized in order of Division (xxx-XX-xxx). Because the Fleet or “Fixed Assets Acquisition” program is numbered 630-90-985, it naturally comes at the end. Changing the accounting structure would be an administrative challenge and make it more difficult to identify fluctuations year over year. A saved “view” on OpenGov has been created to see Grounds and Facilities budget units together.

[OpenGov Saved View](#)

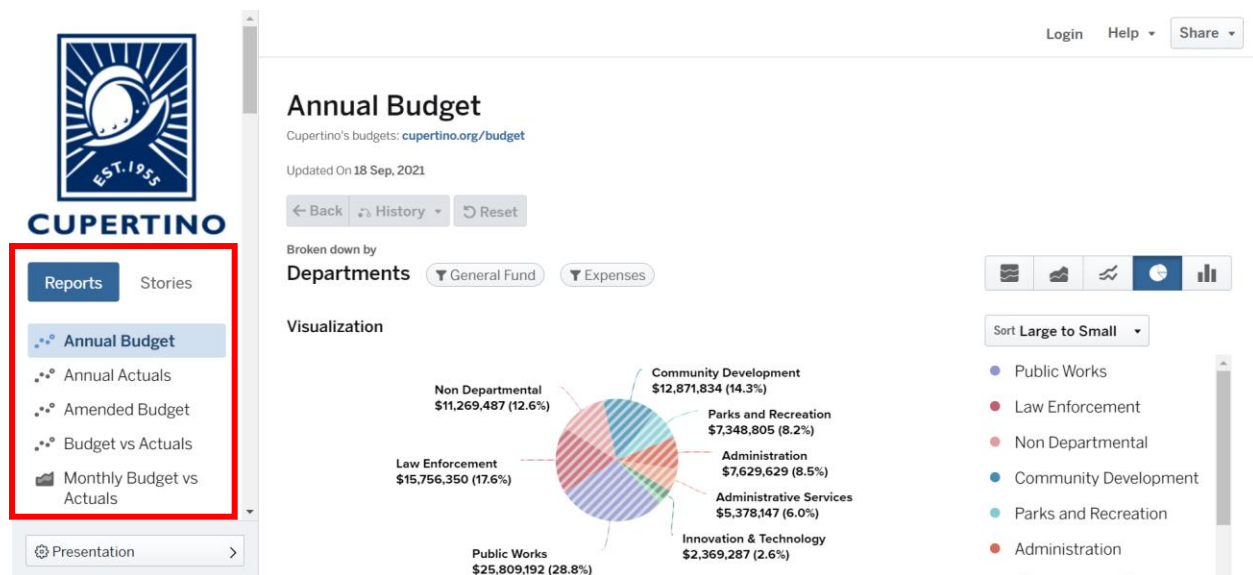
Stocklmeir, Byrne and Blesch are not occupied buildings that are in use. The Facilities budgets are for maintenance of city buildings that are in use. Any budget allocations for these three properties would be considered a special project with a specific scope. Additionally, The City's budget does not include a comprehensive list of the City's capital assets for two primary reasons: 1) it is not a requirement or recommendation by the Government Finance Officer's Association (GFOA) and 2) the City strives to keep the budget document as concise as possible. It is regularly recommended by GFOA to shorten the document as necessary and appropriate.

OpenGov: Navigating Reports and Stories

[OpenGov](#) is the City of Cupertino's financial transparency platform. It allows you to explore the City's current and historical financial data so you can see what is most interesting to you. You can drill down to a specific account or scale up to the big picture.

Reports

In the panel on the left, you'll see a list of reports. On the top left of a report, you'll see the title of the current report.



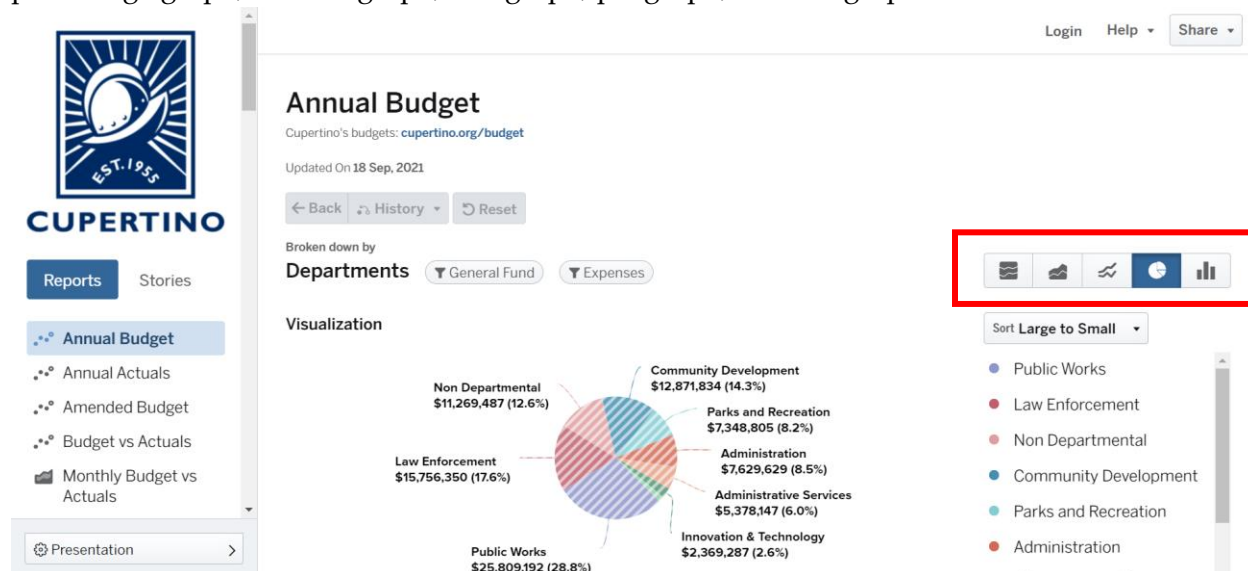
Important reports are described below:

- Annual Budget
 - Shows the Adopted Budget by fiscal year.
- Annual Actuals
 - Shows actual data by fiscal year.
- Amended Budget
 - Shows development of the budget from Adopted Budget to Amended Budget due to carryovers, encumbrances, and amendments.
- Budget vs Actuals
 - Shows budget to actual data. Shaded bars represent budget data and solid bars represent actual data.
- Monthly Budget vs Actuals
 - Shows actual data broken down by month. Also included is the annual budget.
- Staffing
 - Shows budgeted positions by fiscal year.

Visualization

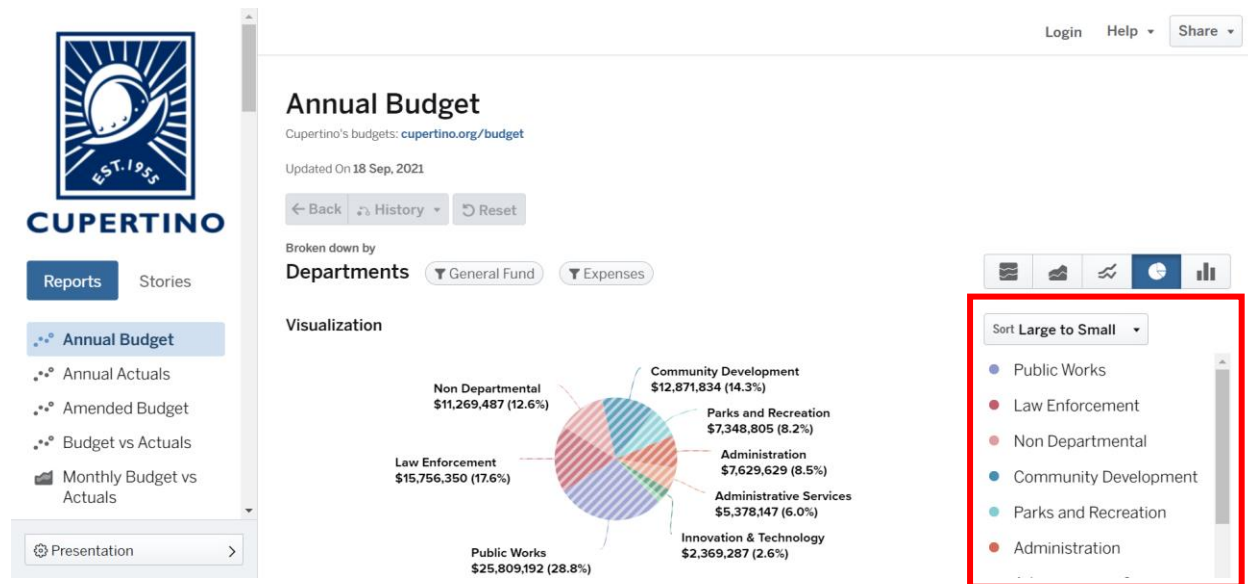
Each report has a visualization.

On the top right of the visualization, you can switch between graph types. The options include percentage graph, stacked graph, line graph, pie graph, and bar graph.

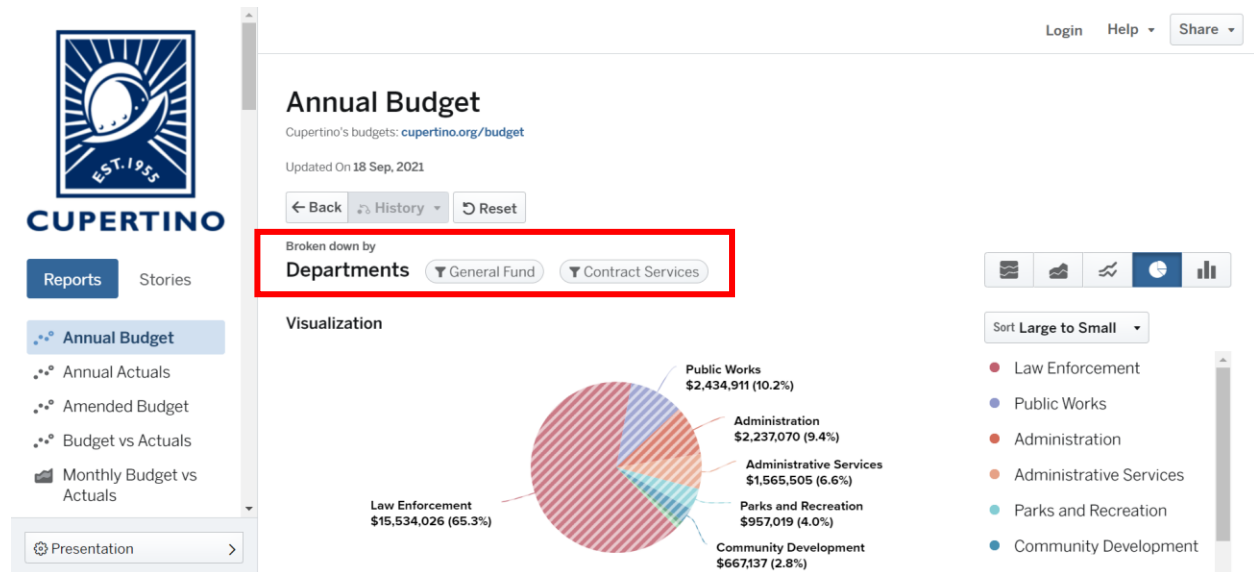


Legend

Each visualization has a legend on the right. Click on a category to filter the visualization.



At the top of the visualization, you can see how the report is broken down and filtered. For example, the report below is broken down by Departments and is filtered to General Fund and Contract Services. Click on the filters to see more or make changes.



Data

Below the visualization, each report has a data table. The data table contains the raw data behind the graph. Click on a category to drill down and see more detailed information.

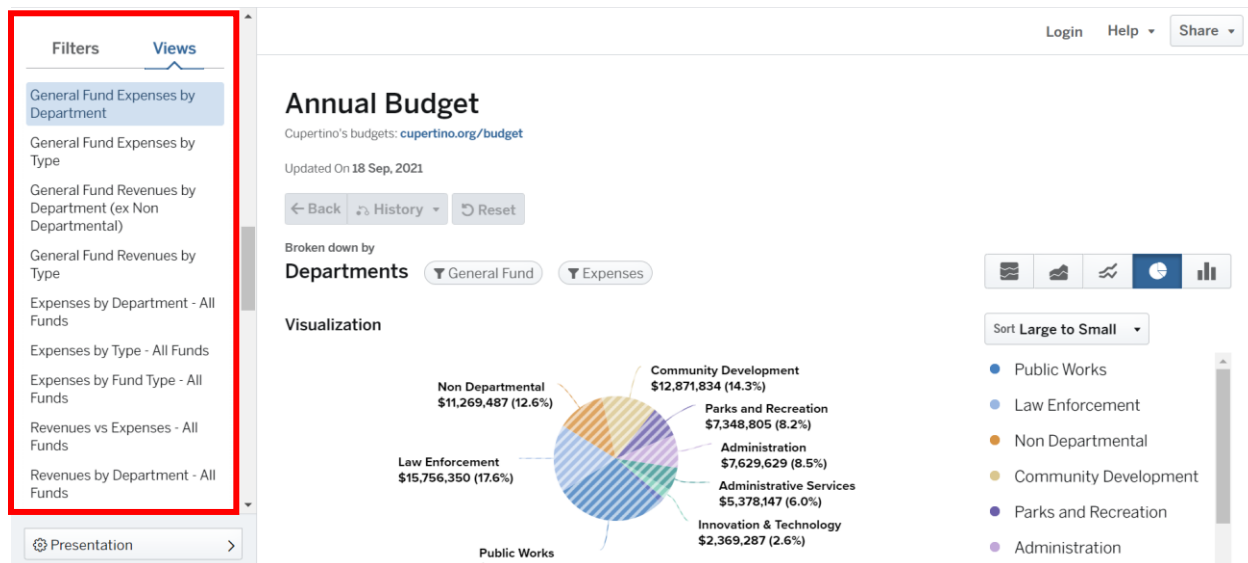
Data

Collapse All	2015-16 Adopted Budget	2016-17 Adopted Budget	2017-18 Adopted Budget	2018-19 Adopted Budget
Public Works	\$ 16,427,167	\$ 19,343,167	\$ 19,335,776	\$ 19,095,725
Law Enforcement	10,994,684	11,884,384	12,344,307	12,988,353
Non Departmental	11,610,985	12,971,373	15,767,734	11,358,912
Community Development	13,371,463	10,273,323	7,519,292	8,332,883
Planning	6,920,993	5,625,620	3,395,284	3,826,263
Building	6,136,080	4,365,248	3,736,495	3,616,855
Community Development	274,390	240,545	345,677	786,755
Code Enforcement	0	0	0	0

Below the list of reports in the panel on the left, you'll see the Filters and Views.

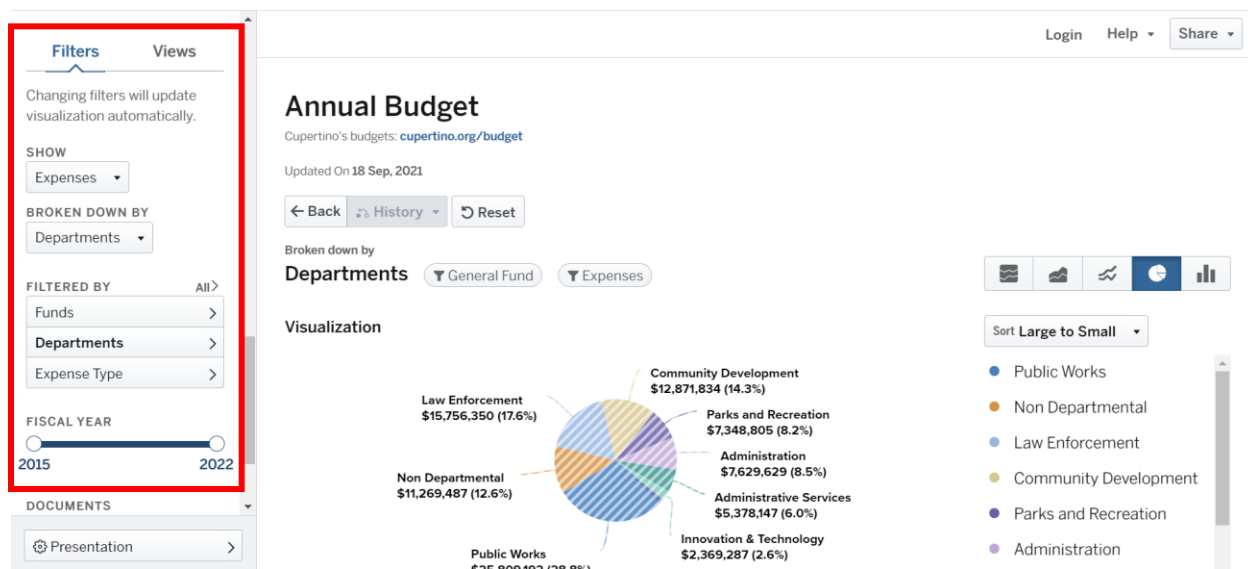
Views

Saved views are built into reports to allow you to navigate the data easily. Saved views are like bookmarks. The City has created saved views based on common questions it has received.



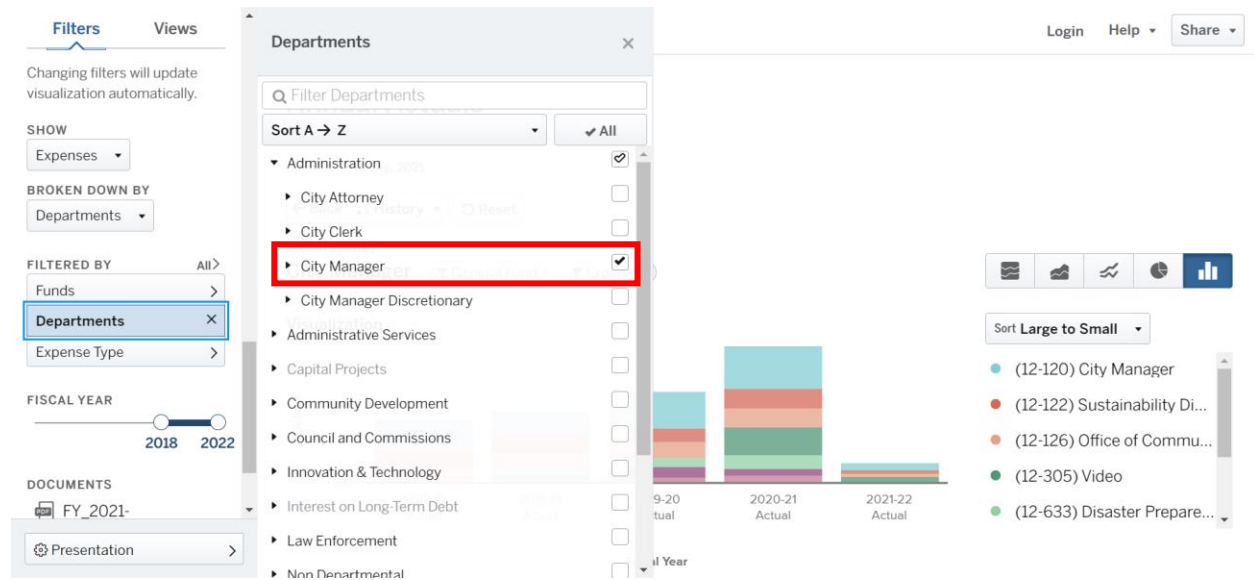
Filters

If the saved views don't answer your question, you can customize the filters yourself. You can choose whether you want to show revenues or expenses, how you want to break down the data, and how you want to filter the data.



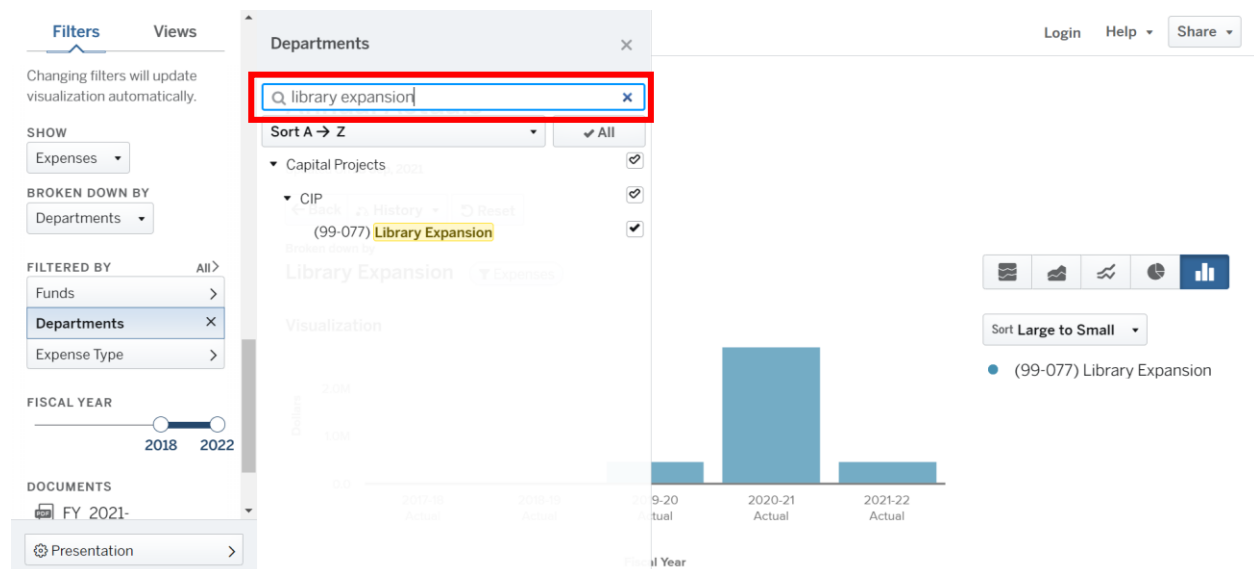
Adding or Removing Filters

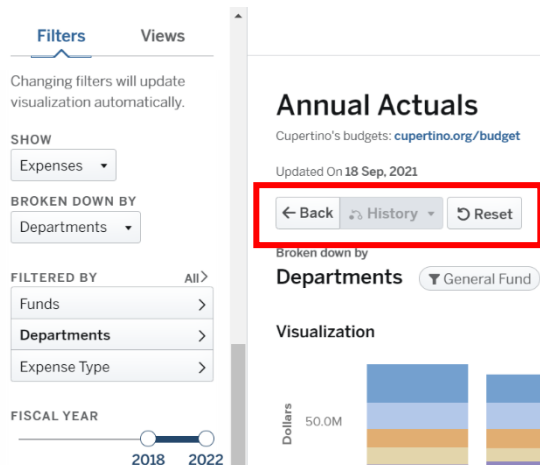
To add a fund, department, or revenue/expense type to the filter, check the box. To remove a fund, department, or revenue/expense type, uncheck the box. Click on a fund, department, or revenue/expense type to drill down to a lower level.



Search

If you can't find what you're looking for, you can use the search bar. In the example below, we search for "library expansion" under Departments. We can then check/uncheck "All" and check "Library Expansion."





Back Button

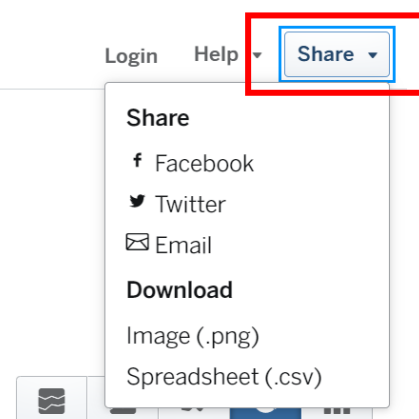
The Back button allows you to return to the previous state of the report.

Reset Button

The Reset button returns the report to the original default state.

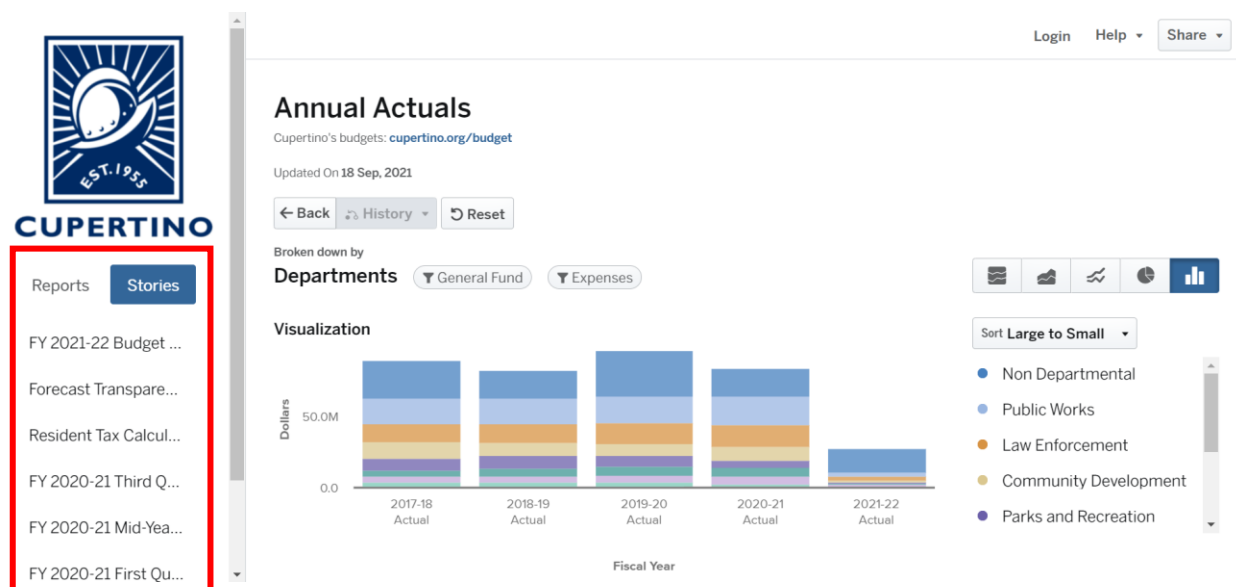
Share

The Share button allows you to share the report via Facebook, Twitter, or Email. You can also download the visualization as a .png image or download the data as a .csv spreadsheet.



Stories

In the panel on the left, you'll see a list of stories. Stories combine narrative with interactive charts. In a story, click on a graph to explore the linked report.



Below is a description of recent stories:

- Budget at a Glance
 - Brief overview of the City's budget.
- Quarterly Report
 - Update on the City's financial status at the end of each quarter.
- Forecast Transparency Tool
 - Allows residents to build their own forecast and gain a better understanding of the factors to consider and the decisions to be made.
- Resident Tax Calculator
 - Enables residents to estimate the amount of sales and property tax they contribute to the City, as well as how those revenues are spent.