
OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Item Number: 4

Review of FY 2011 Mid-Year Budget Monitoring Report

OVERVIEW

The Chief Financial Officer issued the Fiscal Year 2011 Mid-Year Budget Monitoring Report on February 23, 2011. The Mid-Year Report describes the current status of revenues and expenditures, and their year-end projections, based on actual (unaudited) data from July through December 2010.

Due to technical issues related to the transition to the City's new SAP computer system, no First Quarter Budget Monitoring Report was issued for Fiscal Year 2011. The Mid-Year Report is the City's first comprehensive financial status report, including year-end projections, since the fiscal year began last July.

The IBA reviewed the Mid-Year Report and also compared information to the City Comptroller's Financial Performance Report for Period 6, dated February 23, 2011. The Comptroller's report is also the first of these usually monthly reports issued in FY 2011.

The March 2, 2011 Budget and Finance Committee meeting is planned to serve as the first of two required public hearings to begin the process to amend the budget, as recommended in the Mid-Year Report. Following the Committee meeting, the City Council will be asked to hold a second public hearing, after which the Council will consider the adoption of a resolution to authorize the requested budget amendments. Assuming no changes are made to the requested budget amendments, the Council will be asked to introduce and adopt an ordinance to amend the Annual Appropriations Ordinance, consistent with the adopted resolution.

FISCAL/POLICY DISCUSSION

This IBA report provides additional information in specific areas the IBA researched and received more in-depth explanations. In some areas, additional background or context has been provided, and the primary focus is the General Fund.

The Mid-Year Report indicates that General Fund revenues are projected to be \$1.5 million over budget estimates, while General Fund expenditures are projected to be \$3.6 million less than the adopted budget. Together, the net year-end projection is a surplus of \$5.1 million for the General Fund. Within specific General Fund departments, however, some expenditure categories will exceed the adopted budget, and require Council authorization for changes to the budget to be enacted.

Recommended Changes to Budget Monitoring Process

Changes to the budget monitoring process were recommended by the IBA during Fiscal Year 2010, both in the IBA's Report on the FY 2011 Budget (No. 10-43) and in the IBA's report related to the FY 2010 Year-End Appropriation Adjustments (No. 10-48). Last year, the delay in implementing corrective actions to balance the FY 2010 budget negatively impacted the Council's ability to finalize its decisions for the FY 2011 budget.

The IBA's recommended changes included ensuring that immediate action is taken through mid-year budget adjustments, when a year-end deficit is projected in the Mid-Year Monitoring Report. In addition, it was recommended that solutions should be proposed immediately for eliminating a year-end deficit if a deficit is reflected in the Year-End Monitoring Report, and that the City Council should be given sufficient opportunity to provide input on proposed solutions. The recommendations further outlined that proposals for eliminating any projected current year deficit should be provided to the City Council in advance of the Council's first scheduled meeting on budget deliberations/decisions on the upcoming fiscal year budget.

Many of these recommended changes to the Budget Monitoring Process were incorporated into a revised Budget Policy which was adopted by the City Council earlier this fiscal year.

In keeping with these recommended process changes, the Mid-Year Report includes recommendations to amend the General Fund budget to address projected deficits in the Fire-Rescue and Environmental Services Departments. Additional budget adjustments may be needed prior to the end of the fiscal year. The IBA supports the recommendations to address these projected deficits at this time.

General Fund Revenue

The FY 2011 Mid-Year Report projects total General Fund revenue to end the year approximately \$1.5 million over budget. The IBA has reviewed these projections and met with Financial Management, and believe that the year-end General Fund revenue projections are sound and appropriately conservative. As expected, property tax revenues are projected to end the fiscal year under budget due to a larger than expected decline in assessed value, and continued refunds due to property reassessments and appeals. The Mid-Year Report projects that property tax revenues will end the year approximately \$7.9 million under budget.

This decline in property tax is offset by increases in both sales tax and transient occupancy tax (TOT), which are projected to end the fiscal year \$17.0 million and \$3.0 million, respectively. Total City TOT revenues are projected to end the year \$5.7 million over budget. Of this amount, \$3.0 is allocated directly to the General Fund, while the balance is transferred to the General Fund from the TOT Fund.

Both sales tax and TOT have seen strong receipts in the first half of the fiscal year, as economic conditions have begun to improve. However, year-end projections remain conservative. In the first two quarters, sales tax receipts have grown by 9.1% and 4.4% respectively, while current projections for the remaining two quarters of this fiscal year assume just a 2.0% growth rate. Year-to-date, TOT revenue has grown by 7.1% over the same period last year, while projections for the remainder of the year assume a 0% growth rate. While these projections are notably conservative, the economic recovery remains fragile and positive growth has not been sustained for a long enough period of time to warrant a more aggressive outlook.

As noted in the Mid-Year Report, gains in the major revenues are almost fully offset by declines in departmental revenues, which are projected to end the year \$11.2 million under budget. The two largest items impacting this shortfall are \$3.2 million in Proposition 1B revenue that was not received from the State, and \$2.6 million in unrealized parking meter revenue associated with the Parking Meter Utilization Plan, which has not been implemented. Adjusting for these items, departmental revenues are projected to be \$5.4 million under budget. The IBA recommends that further information be provided on the causes of these departmental revenue shortfalls, particularly the reimbursements to the Facilities Division and Engineering & Capital Projects, and traffic citations in the Police Department.

General Fund Expenditures

Fire-Rescue

The Mid-Year Report reflects a projected deficit within the Fire-Rescue Department of \$3.4 million “associated with vacation time, payout of annual leave in-lieu of taking vacation and over expenditures in overtime”. Upon initial review, the IBA expressed

concern as to the possible relationship of the projected deficit and the estimates for cost savings associated with the current practice of removing eight engine companies from service (brown-outs) each day.

In our discussions with Fire-Rescue staff, the IBA understands that 1) overtime expense will increase when Fire-Rescue staff uses more vacation time than expected, and 2) more requests for pay in-lieu of leave may be incurred to compensate for reduced overtime opportunities. With respect to other factors leading to increased overtime expense, the Fire-Rescue Department indicates add-on (special) pays are now being accounted for within overtime expense, rather than being segregated as a separate line item. If so, the use of overtime may appear to be overstated. At the present time, the IBA does not believe that the projected deficit within Fire-Rescue is related to or caused by the practice of engine brown-outs, but our office intends to monitor this area.

Citywide Program Expenditures – Election Costs

The Citywide Program Expenditures (Citywide) budget is comprised of various programs and activities that provide benefits and services Citywide. Costs for Citywide Elections are included in the Citywide budget. The FY 2011 budget for elections was initially \$200,000. On June 28, 2010, the City Council authorized the transfer of \$1.2 million from the General Fund Appropriated Reserve for the purpose of funding the proposed ballot measures in FY 2011, which brought the FY 2011 budget for Citywide Elections to \$1.4 million. At that time, several ballot measures were under consideration, justifying the \$1.2 million estimate.

The Comptroller's Period 6 Financial Report shows expenditures-to-date of \$778,000 for Citywide Elections, and the Mid-Year Report projects savings of \$400,000 for Citywide Elections. However, final cost estimates of the November 2010 elections have not yet been received by the City Clerk's Office and therefore, savings for this area may not be as much as currently reported. The City Clerk has indicated that the final invoices for November 2010 election services are expected from the County of San Diego's Registrar of Voters are in mid-March. November 2010 election activities included three ballot measures with an estimated cost of \$250,000 per measure and two run-off elections (for Council Districts 6 and 8) at an estimated cost of \$200,000. This brings the total estimated amount of November 2010 election activities to \$950,000, well below the \$1.2 million initial estimate. It is important to note other election-related costs this fiscal year included costs for signature verifications for the referendum petition that occurred in December 2010. Projected costs for this service are currently unknown and the City Clerk expects to be invoiced by the County for this in early March.

City Council Infrastructure Funds and Related Requests

During discussion at the February 7, 2011 City Council meeting on the reimbursement to the Isaiah Project for providing portable restroom facilities to the homeless in the Downtown area, the Council requested that the Mayor's staff bring forward remaining

projects to which individual Council Offices had previously committed infrastructure funding. At that meeting, staff stated a list of outstanding projects and fund balances would be developed for possible docketing at a future City Council meeting. At this time, the status of this request is unclear. The IBA understands that three requests for funding totaling \$2,000 are currently pending. The budget amendment process recommended in the Mid-Year Report provides an opportunity for the Council to request that the Mayor incorporate these funding requests in the budget amendment, if the City Council wishes to do so.

General Fund Appropriated Reserve

The FY 2011 Adopted Budget included \$4,101,681 for an Appropriated Reserve for the General Fund. As summarized in a January 31, 2011 memo from CFO Mary Lewis, three actions by the City Council utilized funding from the Appropriated Reserve, reducing the available balance to \$2,466,868. These uses included \$1.2 million for the November 2010 election, \$434,813 to restore vernal pool funding for Park and Recreation, and \$22,500 to reimburse the Isaiah Project for portable restroom facilities.

To provide increased appropriations for projected deficits in specific departments, the Mid-Year Report recommends the remaining balance of the Appropriated Reserve be re-allocated to the Fire-Rescue and Environmental Services Departments. The use of the Appropriated Reserve does not increase the amount of the General Fund budget in total, but instead allocates already authorized appropriations from the Appropriated Reserve to these two departments. The use of the Appropriated Reserve for this purpose, however, eliminates its availability for other uses for the remainder of the year. Also, as revenue projections exceed budget estimates by just \$1.5 million, excess revenues are not a viable funding source.

Status of General Fund Reserve

The IBA is concerned about the delay in the issuance of the FY 2010 Year-End Report from the City Comptroller. The data contained in the Year-End Report assists in the evaluation and analysis of department activities, and permits comparison of current year activity with prior year results.

In addition, a key component of the Year-End Report is the final status of the General Fund reserves for FY 2010. At this time, the City has been unable to report the status of the General Fund reserves, and it is unclear as to whether the current reserve target goal of 7% has been attained and/or maintained. Providing a financial status and recommending a course of action without this key information is disconcerting, as there is no ability to assess and determine if additional contribution to the General Fund reserve may be necessary to achieve or maintain a desired target level, or alternatively, if the target has been surpassed.

CONCLUSION

The Chief Financial Officer issued the Fiscal Year 2011 Mid-Year Budget Monitoring Report on February 23, 2011. Due to technical issues related to the transition to the City's new SAP computer system, no First Quarter Budget Monitoring Report was issued for Fiscal Year 2011. The Mid-Year Report is the City's first comprehensive financial status report, including year-end projections, since the fiscal year began last July.

In keeping with the changes made to the Budget Monitoring Process, the Mid-Year Report includes recommendations to amend the General Fund budget to address projected deficits in the Fire-Rescue and Environmental Services Departments. The IBA supports the recommendations to address these projected deficits at this time.

The IBA has reviewed the revenue projections and met with Financial Management, and believe that the year-end General Fund revenue projections are sound and appropriately conservative. The IBA recommends that further information be provided on the causes of departmental revenue shortfalls, particularly in the Facilities Division and Engineering & Capital Projects, and also related to traffic citations in the Police Department.

The IBA understands that three requests for Council infrastructure funding totaling \$2,000 are currently pending. The budget amendment process recommended in the Mid-Year Report provides an opportunity for the Council to request the Mayor incorporate these funding requests in the budget amendment, if the City Council wishes to do so.

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