

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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OVERVIEW

The Fiscal Year 2006 Summary Report, released by the City Auditor and Comptroller on September 20, 2006, offers a preliminary glimpse at the City's year-end financial results. The report provides actual (unaudited) data for General Fund revenues and expenditures, and details the various changes that have been made to the FY 2006 budget since it was adopted. The report also provides summary revenue and expense data for Enterprise and Internal Service Funds.

The IBA has reviewed the FY 2006 Summary Report and seeks to provide additional clarification on the year-end status of the General Fund. The Summary Report provides detailed financial information, including revenues by source and type, and expenditures by department, as well as current-year budget revisions for both revenues and expenditures. Through all of this useful detail, however, the "big picture" gets a little obscured. This report uses the data presented in the Summary Report to construct a more simplified, "big picture" summary of the Fiscal Year 2006 General Fund year-end financial status. In this way, the IBA report should be viewed as a companion to the Summary Report, with the former providing a high-level overview and the latter providing substantive detail.

FISCAL/POLICY DISCUSSION

Fiscal Year 2006 was a difficult and complicated year for the City's budget. The transition to the Mayor-Council form of government brought about restructuring and the creation of the Office of the Independent Budget Analyst. Significant budgetary revisions were approved in relation to the Kroll investigation and various legal expenses. The Unappropriated Reserve was accessed for the first time in recent history to fund unanticipated expenditures. In addition, the City's budget was still operating with the previous structural challenges, such as supplemental positions and revenue. Finally, the

Appropriation Ordinance, as in previous years, delegated broad authority to the Auditor and Comptroller.

As a result of these circumstances, numerous and sometimes significant revisions were made to the City’s adopted budget throughout the year. Many of these revisions came in the form of Council action, both throughout the year and with the 4th Quarter Adjustment in June 2006. Other revisions were done administratively, pursuant to the authority granted by the FY 2006 Appropriation Ordinance, including appropriation of over-budget revenue. The number of budget revisions, and the various ways in which they were implemented and reported, has made it difficult to “bridge” the gap between the FY 2006 Budget adopted in June 2005 and the current year-end results. This report provides a broad summary of the year-end financial results by first showing the budgetary revisions that have occurred throughout the fiscal year, and then comparing actual (unaudited) General Fund revenues and expenditures to the revised budget.

Throughout Fiscal Year 2006, numerous adjustments were made to the budget through Council action. For example, on April 24, 2006 the Council appropriated \$1.5 million from the Unappropriated Reserve in order to fund required Storm Water expenditures, increasing the Storm Water budget by \$1.5 million. In addition, changes to the budget were also made administratively, without Council action, based on the delegation of authority specified by the FY 2006 Appropriation Ordinance, which allowed the Auditor and Comptroller to appropriate revenues received in excess of budget. The table below shows how the adopted General Fund budget was revised based on these types of appropriation adjustments.

REVENUES	
Adopted Budget	\$867.0 million
Reserve Funds Appropriated	\$21.0 million
Excess Revenue Appropriated	<u>\$35.6 million</u>
Total Revised Budget	<u>\$923.6 million</u>
EXPENDITURES¹	
Adopted Budget	\$867.0 million
Various Adjustments	\$36.5 million
Administrative Adjustments	\$11.2 million
4th Quarter Adjustments	<u>\$8.9 million</u>
Total Revised Budget	<u>\$923.6 million</u>

1. The three budget adjustments categories shown in this table are taken from the FY 2006 Summary Report.

As this table shows, the FY 2006 General Fund budget was increased by \$56.6 million. These expenditure adjustments were funded by excess revenue and the draw of funds from the Unappropriated Reserve. Next, we compare the revised budget to actual year-end revenues and expenditures.

	<u>Revised Budget</u>	<u>Actual</u>	<u>Surplus/ (Deficit)</u>
Revenues	\$923.6 million	\$943.3 million	\$19.7 million
Expenditures	<u>\$923.6 million</u>	<u>\$913.1 million</u>	<u>\$10.5 million</u>
Surplus/(Deficit)	-	\$30.2 million	\$30.2 million

This table shows actual revenues exceeded the revised budget by \$19.7 million, while actual expenditures were less than the revised budget by \$10.5 million, for a total budgetary surplus of \$30.2 million. The final step in this analysis is to adjust the budgetary surplus for a few additional factors. These factors, described in greater detail in the Summary Report, are prior year savings, revenue returned to the Water Fund, and funds set aside to cover the City’s unrealized loss. These adjustments, described in greater detail in the Summary Report, are shown below.

Budgetary Surplus	\$30.2 million
Prior Year Savings	\$4.7 million
Revenue Returned to Water Fund	(\$2.3 million)
Unrealized Loss	<u>(\$0.7 million)</u>
Total General Fund Surplus	\$31.9 million

Adjusting for these factors results in a total surplus of \$31.9 million, which will be deposited into the Unappropriated Reserve. It is important to note that this substantial surplus was achieved only by drawing \$21.0 million from the Reserve to fund various over-budget expenditures throughout the fiscal year. Ending the fiscal year with such a large surplus is clearly positive, however, because it shows that the City was able to not only replenish the Reserve, but also make an additional contribution. According to the Summary Report, the ending balance of the Unappropriated Reserve as of June 30, 2006 is estimated to be \$44.8 million, \$8.8 million greater than the ending balance projected when the FY 2006 Budget was adopted.

Looking Ahead

Part of the difficulty in Fiscal Year 2006, as in prior years, was that budget adjustments were done in a piecemeal fashion, making it difficult to track the changes that occurred throughout the year. Often, Council would approve a “plan of action” without specifically making the commensurate change in appropriations. These and other budgetary changes requiring Council action would often accumulate over the course of

the year and then formally addressed in the 4th Quarter Adjustment. In addition, the broad authority granted by the Appropriation Ordinance allowed many budgetary changes to be made administratively.

Many of these issues have been resolved in Fiscal Year 2007. The majority of supplemental positions and supplemental revenues have been incorporated into the budget, which should result in more accurate budget estimates. The Appropriation Ordinance was revised to constrain the ability to make administrative adjustments to the budget. And, perhaps most significantly, the Appropriation Ordinance will be formally revised on a quarterly basis, allowing for a more transparent reconciliation between the adopted budget and midyear adjustments. In addition, the Mayor has stated that a revised midyear Budget will be released sometime later this year.

Despite the improvements to the process that have been implemented, there will continue to be challenges. The vacancy savings that were incorporated into the FY 2007 budget will need to be closely monitored to ensure that departments are not overspending their available budget, or conversely, acting as a *de facto* hiring freeze. The Business Process Reengineering effort will likely result in reorganization of City departments and the reprogramming of funds derived from City-wide savings. In addition, efforts to begin implementing the Kroll remediations are likely to have a budgetary impact. Finally, the City's policy on the level and use of reserves and the Public Liability Fund still need to be reviewed and amended to allow sufficient flexibility in funding unanticipated expenditures, while at the same time maintaining adequate reserve levels.

CONCLUSION

Fiscal Year 2006 was a challenging year for the City from a budgetary perspective. Numerous circumstances, including the transition to the Mayor-Council form of government, the prolonged Kroll investigation, tapping of the Unappropriated Reserve, and continued existence of supplemental positions has made it difficult to navigate from the adopted budget to the actual year-end results. Despite these challenges, the General Fund has fared rather well, accumulating a surplus that not only replenished the Reserve, but also makes an additional contribution. While many of the circumstances that plagued FY 2006 have been remedied, the current fiscal year will face new and additional budgetary challenges, such as implementation of Business Process Reengineering reforms and Kroll remediations, as well as new policies governing the use of the Unappropriated Reserve and Public Liability Fund.

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