
OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Review of Fiscal Year 2008 First Quarter Budget Monitoring Report

OVERVIEW

The Chief Financial Officer issued the Fiscal Year 2008 First Quarter Budget Monitoring Report on November 8, 2007, which describes the current status of revenues and expenditures, and year-end projections of revenues and expenditures, based on actual (unaudited) data from July 1, 2007 through September 21, 2007.

The report notes that the impacts associated with the Soledad Mountain Road landslide and the wildfires have not yet been completely analyzed, and will affect the budget analysis. Some initial information has been provided related to the expected magnitude of the financial impacts, and additional information will be presented in a later report.

The IBA reviewed the First Quarter Report, comparing information to the Auditor's recent Monthly Financial Report, and also reviewed issues that were identified during the development of the budget. This report is intended to identify potential areas for further review or to raise awareness with respect to particular areas in preparation for the next reporting period and for the Mid-Year Financial Status Report.

FISCAL/POLICY DISCUSSION

In general, the First Quarter Report estimates General Fund revenues to fall short of budget estimates by \$5.4 million, and that General Fund expenditures are expected to be less than budgeted levels by \$8.4 million, resulting in a net positive impact of \$3.0 million. However, based on a review of revenue receipts and expenditure activity to date,

it is our opinion that some revenue and expenditure projections do not take into account several impacts expected in the months ahead.

General Fund Revenue

The following chart combines the actual prior year revenue activity (as reported by the Auditor in the FY 2007 Year-End Report), along with the FY 2008 Adopted Budget, and the FY 2008 Year-End Projection. By consolidating this information, one can see that revenue growth over last year is projected to occur in those categories that are now expected to fall short of initial budget estimates, such as sales tax and franchises.

GENERAL FUND REVENUE STATUS AS OF SEPTEMBER 21, 2007					
FY 2008 First Quarter Report					
Revenue Category	FY 2007 Actual Receipts	FY 2008 Adopted Budget	FY 2008 Year- End Projection	Surplus/ (Deficit)	Variance %
Property Tax	\$ 360,400,407	\$ 385,688,853	\$ 387,115,105	\$ 1,426,252	0%
Sales Tax	225,841,450	239,485,958	236,029,635	(3,456,323)	1%
Transient Occupancy Tax	80,702,830	85,184,936	85,390,733	205,797	0%
Franchises	64,633,832	69,431,697	68,644,666	(787,031)	1%
Safety Sales Tax	7,940,313	8,401,528	8,054,401	(347,127)	4%
Motor Vehicle License Fees	8,101,184	7,938,333	7,448,461	(489,872)	6%
Property Transfer Tax	9,307,713	7,570,860	9,576,145	2,005,285	26%
Other Revenue	<i>incl. below</i>	68,706,741	68,706,741	-	0%
Departmental Revenues	296,306,098	233,922,046	229,983,695	(3,938,351)	2%
TOTAL	\$ 1,053,233,827	\$ 1,106,330,952	\$ 1,100,949,582	\$ (5,381,370)	0%

The most significant contributor to the expected shortfall is Departmental Revenues, specifically related to revenues to be received by General Services, Police, and Purchasing and Contracting.

General Services: Because of the large, diverse operations and the high-priority nature of the responsibilities contained in the General Services Department, it is suggested that future financial reports itemize divisional revenue and expenditure activities and projections. This would allow Street Division and Storm Water Pollution Prevention to be more easily monitored. General Services' revenues are described as being negatively impacted by ADA and facilities projects proceeding slower than anticipated. What factors are impacting this delay in implementation of ADA projects?

Police Parking Citation Revenue: Further information is planned to be provided in the Mid-Year Financial Status Report on the status of parking citation revenues. In reviewing past actions, it appears that the Fiscal Year 2007 Budget included additional revenue in this account based on supplemental parking

Parking Citations Revenue (in millions)		
Fiscal Year	Budget	Actual/(Est.)
2006	\$17.10	\$17.70
2007	\$19.30	\$17.90
2008	\$19.30	\$17.20

enforcement officers and the addition of positions for enforcement of street sweeping. However, it does not appear that this anticipated additional revenue was received last year, or will be in the current year. Are vacancies impacting this revenue category? Is data available on the number of parking citations that have been issued this fiscal year (monthly average) in comparison to recent years? If additional enforcement is not to be implemented, efforts should be made to reduce budgeted revenues in future years to eliminate this gap.

Purchasing and Contracting: Projected revenues for Purchasing reflect a shortfall of approximately \$1.0 million which has been attributed to fewer than anticipated contracts as a result of delayed bonding for the Water and Metropolitan Wastewater Departments. However, it appears that revenue estimates may also not have been properly adjusted during the budget process, in accordance with reorganization efforts. Further clarification in this area is requested in the Mid-Year Financial Status Report. If budgeted revenues are not achievable based on the new department structure, efforts should be made to reduce budgeted revenues in future years to eliminate this shortfall.

Other Revenues: The report projects that Other Revenues, including **Booking Fees** in the amount of \$5.2 million, are expected to be received as budgeted. Issues related to the receipt of Booking Fee revenue from the State of California, and the related payment to the County, remain outstanding. An update on this issue, including legislative efforts to resolve, has been requested for an upcoming Budget & Finance Committee. The outcome of this could have a significant impact on the General Fund budget this fiscal year.

General Fund Expenditures

The following chart combines the actual prior year expenditure activity, along with the FY 2008 Adopted Budget, and the FY 2008 Actual Expended (to date) and FY 2008 Year-End Projection. By consolidating this information, one can easily compare changes over last year.

GENERAL FUND EXPENDITURE STATUS AS OF SEPTEMBER 21, 2007						
FY 2008 First Quarter Report (Period 3; 22% of year)						
Account Group	FY 2007 Actual Expenditures	FY 2008 Adopted Budget	Actual Y-T-D Expended Plus Encumbrances	% of Budget Expended	FY 2008 Year-End Projection	Surplus/ (Deficit)
Salaries	\$ 461,211,470	\$ 499,182,982	\$ 111,381,031	22%	\$ 486,123,972	\$ 13,059,010
Fringe Benefits	254,201,849	271,654,326	60,370,865	22%	277,359,187	(5,704,861)
Supplies & Services	195,302,910	261,831,178	80,119,008	31%	258,398,978	3,432,200
Data Processing	29,328,720	37,245,579	8,957,443	24%	39,329,630	(2,084,051)
Energy/Utilities	29,425,581	25,655,302	7,519,798	29%	26,303,701	(648,399)
Outlay	13,195,796	10,761,585	1,403,810	13%	10,388,546	373,039
TOTAL	\$ 982,666,326	\$ 1,106,330,952	\$ 269,751,956	24%	\$ 1,097,904,014	\$ 8,426,938

SALARIES AND WAGES

Police Department: The Police Department projects salary savings in the amount of \$9.8 million. This comprises 75% of the total salary savings expected in the General Fund of \$13 million. Additional details are needed to verify these projections, including the actual number of vacancies (sworn and non-sworn) for the entire department. Based on our review, it appears that projections for ensuing months do not include the anticipated 2% salary increase for sworn personnel, which is scheduled for December 29, 2007. As of Period 3, 22% of the year had expired, and the Police Department had expended 22% of their Salaries and Wages budget. If this trend were to continue, it would appear that the Police Department would expend the full salary budget and experience no surplus or deficit; however, if the 2% salary increase for sworn personnel is not yet included, a possible deficit may occur by year-end. In addition, the 2008 vacancy factor appeared reasonable at the time the budget was adopted, given the level of vacancies being experienced by the department. Additional savings beyond this level was not anticipated. Further explanation should be provided as to the basis for the significant surplus projected for this category, as reported.

FRINGE BENEFITS

Based on our analysis of this account group, the IBA questions the projections for significant deficits shown in the report, and believes further analysis at the fund level is needed. A significant portion of the fringe accounts should be considered fixed costs and, although calculated on a per position basis, will not be impacted by the actual number of positions. For instance, the amounts required for Retirement and Offset Contribution, Retiree Health, Other Post Employee Benefit (OPEB), Workers Compensation, and Risk Management Administration have been determined during the budget process, and will not vary for the City as a whole. Rates are calculated in order to generate a specified amount of funds. For Fiscal Year 2008, these categories together reflect 75% of the total fringe budget. The remaining 25% of fringe benefits is affected by actual personnel levels.

Workers Compensation: Some rates may be adjusted during the year in order to generate the appropriate amount of funds for each purpose. As noted in the report, Workers Compensation rates may have been set too high, and are likely to be reduced in order to collect lesser amounts for this purpose. If adjustments are proposed to the Workers Compensation rates in the Mid-Year Financial Status Report, the IBA requests information on the current status of the Workers Compensation Fund and how any adjustments to the rates would impact the fund. It is important to review the budget of the Workers Compensation Fund to determine if original budget levels should be fully funded, based on actual activity to date.

Supplemental Pension Savings Plan: Additionally, the Fiscal Year 2008 budget for Supplemental Pension Savings Plan (SPSP) does not appear to have been based on Fiscal Year 2007 actual experience. Actual SPSP expenses have not varied from the past fiscal year. The Fiscal Year 2008 budgeted amount was almost \$2 million less than Fiscal Year 2007 levels, as shown in the accompanying table.

SUPPLEMENTAL PENSION SAVINGS PLAN (SPSP)				
Fiscal Year	Y-T-D Period 3	General Fund		
		Actual/ Projection	Adopted Budget	Deficit
2007	2,957,781	12,431,710	11,116,046	(1,315,664)
2008	2,948,482	12,392,626	10,553,603	(1,839,023)
Change	(9,299)	(39,084)	(562,443)	(523,359)
Police and Fire-Rescue Departments				
2007	698,755	3,056,455	1,381,466	(1,674,989)
2008	697,503	3,050,978	1,216,668	(1,834,310)
Change	(1,252)	(5,477)	(164,798)	(159,321)

*Amount for 2007 is unaudited; amount for 2008 is projected.

When reviewing the specific information for Police and Fire-Rescue, the IBA noticed that when the vacancy factor was applied, nearly all related fringe was reduced from the SPSP account, likely reducing it by too much. Alternatively, the impact should have affected approximately ten other fringe benefits accounts, which may be beyond the capabilities of the budget system. The IBA believes that the projected deficit in SPSP stems from the application of the vacancy factor, and not the level of participation.

Retiree Health Trust Fund: Contributions to the Retiree Health Trust Fund (\$25 million citywide) are projected to occur as a one-time expense during Period 6 (by November 30). Until that occurs, contributions are not yet in a special fund earning interest. Last year, the IBA expressed concern related to these contributions as it was unclear how and when the transfer of funds would occur.

SUPPLIES AND SERVICES

General Services – Storm Water: Approximately 83% of the budget for Storm Water Pollution Prevention is comprised of Supplies and Services, totaling \$19 million. Through Period 3, which accounts for approximately 22% of the Fiscal Year, the Storm Water Pollution Prevention Division has only expended and encumbered approximately 6.6% (\$1.42 million) of its Fiscal Year 2008 budget, and expended just 8.6% (\$524,000) of the \$5.6 million carried over from Fiscal Year 2007. The IBA raises the following issues:

- Will this division will be able to expend its entire budget by fiscal year-end?
- How much is anticipated in encumbrances by year-end?
- What is the status of funds carried over from Fiscal Year 2007?

DATA PROCESSING

Police Department: The report mentions that the projection “may not take into account the restructuring of certain General Fund data processing expenditures to the Office of the Chief Information Officer.” The IBA concurs with the assessment that the Police

Department's projected deficit for data processing may be overstated. During Fiscal Year 2007, the Police Department experienced a deficit in this expenditure category; however, the department is expending significantly less. As of Period 3 for Fiscal Year 2008, \$0.7 million has been expended, as compared to \$2.2 million for the same time last year. For the Mid-Year Financial Status Report, it may be advantageous for the CIO to review citywide projections for data processing to ensure their accuracy, especially in advance of any actions to request increases to the budget for this purpose.

Enterprise Fund Status/Projections

In the body of the report, additional information can be found on the Water Department, however no other enterprise fund departments (e.g. Metropolitan Wastewater and Development Services) are discussed. Information provided for these departments is only available in the attached tables. Similar issues seem to exist between the Water and Metropolitan Wastewater Departments, due to the City's inability to bond. Significant issues seem to be facing these departments in this fiscal year and should be detailed in future reports, including how the proposed reduction in bond funding will impact the department's capital improvement projects (i.e. which projects will not be done) and the City's ability to comply with applicable state and federal mandates.

It should also be noted that the Water Department had anticipated utilizing \$73.7 million in fund balance at the time their budget was developed; however their current projections reduce the amount that will be needed from fund balance by \$42.2 million to \$31.5 million.

Other Areas of Concern

The IBA also identifies the following areas of discussion that should be included in subsequent analyses:

- How does the City's inability to bond in the current fiscal year impact planned **ADA and deferred maintenance projects**?
- What is the status of **land sales**? The IBA has previously requested a quarterly update on the status of land sales. Information has become available recently that land sales completed during last fiscal year has generated funding which may be applied to the initiation of ADA projects.
- Proposed **health care reforms** were estimated to save approximately \$2 million citywide. The IBA recommended, and the Council subsequently approved, the inclusion of a portion of these savings (\$1.0 million Citywide, of which \$745,000 was attributed to the General Fund) in the Fiscal Year 2008 budget. It is unclear how these savings were factored into the final budget, and at what point the savings would be realized. What analysis has been performed that can provide specific information on savings-to-date from these reforms, and anticipated savings if similar reforms are applied to other labor organizations?

- **Prior Year Funds** - As described in the Auditor's Period 13 Year End Report for Fiscal Year 2007, \$28.3 million remained encumbered at year-end, and carried over to Fiscal Year 2008 as prior year funds. This amount was added to previous carryover/encumbered funds from prior years. In addition, the General Fund reserve was positively impacted at year-end by the release of approximately \$7.0 million in encumbered prior year funds. Because of this, the IBA has requested that details regarding the status of the expenditure of prior year funds be included in the quarterly and/or monthly reports to the City Council. The First Quarter Report does not include information related to prior year funds. The IBA's review shows that, as of Period 3, approximately \$9.48 million has been expended, while an additional \$1.7 million has become unencumbered, and may be available for release, or reprogramming. \$22.76 million in prior year funds remains encumbered, and should be reported on periodically.
- In the Fiscal Year 2008 Budget, the Mayor allocated \$500,000 to pay current year **benefits in excess of IRS 415b limits**. In the Mid Year Financial Status Report, the IBA suggests that staff provide a status update on payments made to-date and projections for the year. Future reports should also include a discussion of long-term plans to fund this liability.
- The IBA requests that information be provided in the Mid-Year Financial Report regarding the vacancy factor, including the Fiscal Year 2008 budgeted vacancy factor budget as compared to revised projections for 2008, and the actual vacancy factor experienced for 2007.
- The IBA requests that future quarterly financial reports include comparisons to prior year actual revenue and expenditure activity. These comparisons are a valuable tool, showing changes (both positive and negative) to last year's actual experience, in conjunction with comparisons to current year budgets.

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