
OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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City Comptroller's FY 2008 Year-End Report

OVERVIEW

On September 24, 2008, the Office of the City Comptroller will present its ***Year-End and Financial Performance Report for Period 13, Fiscal Year 2008*** to the Budget and Finance Committee. The Comptroller's Report is intended to serve as a summary of the financial activity for the fiscal year, ending June 30, 2008, with the primary focus on the City's General Fund. A goal of the Year-End Report is to achieve the monthly reporting objective as set forth in City Charter Sections 39 and 89.

Charter Sections 39 and 89 state: The Chief Financial Officer shall submit to the City Manager and to the Council at least monthly a summary statement of revenues and expenses for the preceding accounting period, detailed as to appropriations and funds in such manner as to show the exact financial condition of the City and of each Department, Division and office thereof.

The Comptroller's Report presents comparisons of both revenues and expenditures to:

- FY 2007 actual results (prior year)
- FY 2008 revised budget
- FY 2008 year-end projections, as reported by Financial Management

For FY 2008, the Year-End Report includes, as appendices, financial information for some of the City's component units, including its corporations, financing authorities, the Redevelopment Agency, and community facility and other special assessment districts.

FISCAL/POLICY DISCUSSION

The FY 2008 Adopted General Fund Budget totaled \$1.109 billion. In summary, the Year-End Report shows General Fund revenues of \$1.091 billion fell short of the estimates in the FY 2008 Adopted Budget by \$17.3 million. In addition, General Fund expenditures and encumbrances of \$1.114 billion, in total, exceeded the FY 2008 Adopted Budget by \$5.2 million. Encumbrances in the amount of \$36.0 million remained unexpended at fiscal year-end, and carried over to the current fiscal year, compared to \$28.3 million which remained unexpended at the end of the prior year (FY 2007).

Comparing actual results to the adopted budget (in contrast to the revised budget) provides an opportunity to determine the accuracy of the budget process and the appropriateness of the adopted budget. During the fiscal year, adjustments are made to the budget to account for new or changed circumstances that arise during the year that cannot be accommodated within the adopted budget, or could dramatically change expected results.

Adjustments to the budget during the fiscal year should be minimized and reserved for truly unanticipated events. Repeated annual adjustments to the budget which may be required each year for the same purpose suggest a budget that does not reflect or anticipate reality. Significant progress has been made over the past few years to correct budgetary issues, which in turn minimizes the need for budget adjustments and provides an improved estimate of revenues and expenditures.

Fiscal Year 2008 Budget Adjustments

In March 2008, the City Council approved the FY 2008 Mid-Year Budget Adjustments, increasing the General Fund budget by \$6.3 million. Subsequently, in June 2008, the Year-End Budget Adjustments reduced the General Fund budget by \$1.1 million, and authorized the reallocation of budgetary savings among departments. Additional budget adjustments requested throughout the year totaled \$18.5 million for increased costs for legal, investigation, and claims needs, as well as costs associated with the wildfires and the landslide, that arose during the year. Net budget adjustments for FY 2008 totaled \$23.7 million, or approximately 2% of the adopted budget.

The IBA recommends a continued effort to refining the annual budget process to increase accuracy in the development of the budget, which will help minimize the necessity for budget adjustments during the year. In addition, the IBA supports the option of reallocating budgetary savings among departments as an alternative to increasing the adopted budget using reserves as a source of funding.

Effect of FY 2008 Actual Results on FY 2009 Budget Estimates

The IBA assembled the following tables to compare the actual results for FY 2007, with the FY 2008 Adopted Budget, FY 2008 actual results and the FY 2009 Adopted Budget,

for both revenues and expenditures. The newly available FY 2008 actual data may provide additional insight as to the appropriateness of the FY 2009 Adopted Budget, and may highlight areas of concern that may need to be addressed during the fiscal year.

In total, the FY 2009 General Fund Adopted Budget for revenues reflects a 9% increase over the FY 2008 actual receipts.

Major General Fund Revenues (in millions)	FY 2007 Actual	FY 2008 Adopted Budget	FY 2008 Actual	FY 2009 Adopted Budget	% Change Actual 08 to Budget 09
Property Tax	\$360.4	\$385.7	\$384.3	\$411.1	+7%
Sales Tax	225.4	239.4	228.0	222.1	-3%
Transient Occupancy Tax	80.7	85.2	83.7	90.6	+8%
Fines & Forfeitures	36.4	35.1	31.8	34.5	+8%
Interest Earnings	11.6	7.7	13.1	9.6	-26%
Total Revenues	\$1,053.8	\$1,108.9	\$1,091.7	\$1,192.6	+9%

Sources: City Comptroller Year-End and Financial Performance Report for FY 2008 and FY 2009 Final Budget Document

The General Fund revenue table reveals two notable points. First, the FY 2009 budget for sales tax is less than the amount actually received in FY 2008. However, this is due to an anticipated reduction in the Triple-Flip reimbursement, and does not indicate a negative projection in FY 2009 sales tax revenue. This is reflected in the table below.

Sales Tax Revenue	FY 2007 Actual	FY 2008 Actual	FY 2009 Budget
Bradley-Burns Sales Tax	168,838,290	167,712,118	169,002,163
<i>% Growth</i>	<i>-1.04%</i>	<i>-0.67%</i>	<i>0.77%</i>
Triple-Flip Reimbursement	56,605,826	60,288,599	53,079,389
<i>% Growth</i>	<i>24.59%</i>	<i>6.51%</i>	<i>-11.96%</i>
TOTAL SALES TAX	225,444,115	228,000,718	222,081,552
<i>% Growth</i>	<i>4.35%</i>	<i>1.13%</i>	<i>-2.60%</i>

The Triple-Flip, enacted by the State in FY 2005, is a complicated revenue swap whereby the ¼ of the 1-cent Bradley-Burns Sales and Use Tax allocated to cities is shifted to the State, while cities are reimbursement with a like amount of property tax. This reimbursement grows at the rate of sales tax growth, and thus is budgeted as sales tax. However, the reimbursement is allocated in arrears, and involves a complicated process of true-up payments. These intricate mechanics resulted in projected decline in the Triple-Flip reimbursement in FY 2009. However, as shown in the table above, the FY 2009 growth in the Bradley-Burns sales tax portion is consistent with the budget outlook.

Secondly, the FY 2009 budget for Transient Occupancy Tax (TOT) reflects an 8.5% growth over FY 2008 actuals. While the FY 2009 TOT budget was developed using a projected 6.0% growth rate, actual TOT revenues came in lower than anticipated toward the end of the fiscal year. This means that TOT revenue will have to achieve higher levels of growth than previously anticipated to meet budget estimates. TOT revenue should be closely monitored in the months ahead.

In total, the FY 2009 General Fund Adopted Budget for expenditures reflects a 7% increase over the FY 2008 actual expenses. The Salaries & Wages category reflects an increase of 8.5% when comparing the FY 2009 budget to FY 2008 budget. But because actual expenditures in this category were less than budgeted in FY 2008, the percentage increase grows to 11% when comparing actual FY 2008 expenditures to the FY 2009 budget.

General Fund Expenditures (in millions)	FY 2007 Actual	FY 2008 Adopted Budget	FY 2008 Actual	FY 2009 Adopted Budget	% Change Actual 08 to Budget 09
Salaries & Wages	\$461.2	\$499.2	\$487.3	\$541.7	+11%
Fringe Benefits	254.2	271.6	275.1	283.9	+3%
Supplies & Services	195.5	264.5	247.5	291.4	+18%
Data Processing	29.6	37.2	34.7	38.1	+11%
Energy & Utilities	29.4	25.7	26.7	27.6	+3%
Outlay	13.2	10.8	6.8	9.9	+46%
Encumbrances	28.0		36.0		
Total	\$1,011.1	\$1,109.0	\$1,114.1	\$1,192.6	+7%

Sources: City Comptroller Year-End and Financial Performance Report for FY 2008 and FY 2009 Final Budget Document

In the IBA's Review of the Fiscal Year 2009 Proposed Budget, the expenditure categories were described in detail. At that time, the Supplies & Services category in the General Fund reflected an increase of 18%, with large budget increases related most significantly to funding for public liability, construction contracts, and debt payments, among other items. Because of this, the large percentage increase (+18%) shown above is not cause for concern, and appears consistent with our previous review. However, during that same review, our office recommended that the Equipment Outlay expenditure category be scrutinized and possibly reduced from the levels contained in the proposed budget, as a cost-saving measure. As can be seen from the table, Outlay expenditures for FY 2008 totaled only \$6.8 million, or 63% of the amount budgeted. The FY 2009 budget for Outlay remains at an elevated level of almost \$10 million, reflecting an increase of 46% over the FY 2008 actual expenditures. If necessary, this category is an area where expenditure controls can easily be put in place to restrict purchases to achieve budgetary savings during the year, in order to maintain and ensure a balanced budget.

Additional information related to projected revenues and expenditures for FY 2009 will be made available with the First Quarter Financial Monitoring Report in November.

General Fund Overtime

During the Committee’s discussion of the FY 2007 Year-End Report last year, Councilmembers raised questions about the level of overtime, and the possible connection between the number of positions and overtime costs, trying to determine if fewer employees were working more hours in order to deliver services, resulting in increased overtime costs.

While overtime information was not specifically discussed in the FY 2008 Year-End Report, the IBA assembled General Fund overtime expenditures for FY 2007 and FY 2008, and budgeted costs for FY 2009, in the table below. Approximately 90% of all General Fund overtime costs are incurred by the Police and Fire-Rescue Departments. Increases in overtime costs during FY 2008 can primarily be attributed to wildfire and landslide requirements.

General Fund Overtime Expenditures			
Department	FY 2007 Actual	FY 2008 Actual	FY 2009 Budget
Police	\$17,151,373	\$20,793,281	\$17,525,464
Fire-Rescue	14,105,745	18,669,008	16,372,827
All Others	3,474,014	4,598,476	2,580,707
Total	\$34,731,132	\$44,060,765	\$36,478,998
Police & Fire as % of total	90.0%	89.6%	92.9%

The Committee may wish to request additional information regarding overtime costs, if it continues to be an area of concern.

Status of General Fund Reserve

The City concluded FY 2007 with significant budgetary savings, which were described in last year’s Year-End Report as putting “the General Fund in a far better financial position...” and creating “an opportunity for the General Fund to replenish reserves and improve its cash position.” The report further stated that “a continued focus on budgetary savings is needed in order to achieve the goals set forth in the City Reserve Policy.”

Of the total \$23.7 million net increase to the FY 2008 budget described earlier, \$20.6 million was funded from the General Fund Reserve, which resulted in a reduction to the \$93 million reserve at the end of FY 2008. As a comparison, budget adjustments totaled \$29.7 million in FY 2007, with \$11.7 million coming from the reserve.

Status of General Fund Reserve		
	FY 2008 Initial	FY 2009 to date
Emergency	\$--	\$55,000,000
Appropriated	--	10,000,000
Unallocated	93,110,292	7,481,924
Total	\$93,110,292	\$72,481,924
% of General Fund	9.2%	6.1%
Policy Target	6.0%	6.5%

Sources: City Comptroller Estimated General Fund Working Capital (Unaudited) as of 9/20/2007 and 9/3/2008

Based on the current FY 2009 adopted budget, the total General Fund reserve should reach \$77.5 million to achieve the reserve target goal of 6.5%. At present, the reserve level is approximately \$5 million short, even when including the current \$10 million Appropriated Reserve. The Appropriated Reserve is intended to fund unanticipated, unbudgeted items that arise during the year. However, based on current reserve levels, **the IBA will not recommend items to be funded from the Appropriated Reserve**, unless additional information is obtained regarding revenues to be received in excess of budgeted levels, or that significant budgetary savings is expected, both of which could bolster the reserve.

The FY 2009 budget calls for a contribution of \$3,687,718 to be made to the General Fund reserve. Including this additional amount would bring the total reserve to \$76.1 million, or 6.38% of the total General Fund budget. This contribution will be made at year-end, subject to the availability of sufficient revenues, but still falls short of the policy target of 6.5%. This also assumes no expenditure from reserves occurs during the course of the year.

In addition, the City Reserve Policy calls for the Emergency Reserve to amount to 5% of the total General Fund budget. Again, based on the current FY 2009 adopted budget, the Emergency Reserve should be increased to \$59.6 million. It is the understanding of the IBA that adjustments to these reserve categories will occur at the end of the fiscal year, based on actual results, but it is important to keep in mind that the Reserve Policy will require increasing allocations be made due to an increasing General Fund budget, and also annual increases in the targets outlined in the Policy.

Review of Component Unit and Other Agency Financial Information

The Appendices provide information on various component units of the City in response to the Committee's previous requests. Although some of the information is not compiled by the City Comptroller's Office, the IBA believes that the Comptroller's Office could provide direction on the type of information needed to ensure consistency of data

presented, and format suggestions. As is, it is difficult to make comparisons between the various entities. This is especially true when reviewing the information provided by CCDC and SEDC. Appendix A-2 provides a detailed comparison of expenses to budget by line item for CCDC's administrative expenses. The format is similar to and consistent with the information presented in the Redevelopment Agency's budget. However, in Appendix C-2, SEDC presents a "total" line item and it is unclear how this compares to their approved budget. This is symptomatic of the problems identified in the recent performance audit completed on SEDC in which it was described that mismanagement was not evident because the information presented was at a "total" level and not broken down by various line items. Also, the IBA notes that information on the Housing Commission was not included in these appendices and could be included in future iterations of this report, if desired by the Committee.

CONCLUSION

The IBA has reviewed the *Year-End and Financial Performance Report for Period 13, Fiscal Year 2008* prepared by the Comptroller. The Comptroller's Report is intended to serve as a summary of the financial activity for the fiscal year, ending June 30, 2008, with the primary focus on the City's General Fund.

The IBA has compared the FY 2008 results with the FY 2009 Adopted Budget to shed light on possible areas of concern. Based on this review, close monitoring will be required for the major General Fund revenues, especially TOT. Because of the many budget adjustments that took place in FY 2008, the IBA recommends a continued effort to refine the annual budget process to increase accuracy in the development of the budget, in hopes of minimizing the necessity for budget adjustments during the year. In addition, the IBA supports the option of reallocating budgetary savings, in contrast to increases to the adopted budget using reserves as a source of funding.

Based on current reserve levels, the IBA will not recommend the use of the Appropriated Reserve, unless additional information is provided regarding revenues to be received in excess of budgeted levels, or that significant budgetary savings is expected.

The IBA appreciates additional information related to the component units and other City entities that has been provided, and suggests that the Comptroller's Office could provide direction on the format and the type of information needed to ensure consistency of data presented, if it is intended to be included on a regular basis. In addition, the Budget & Finance Committee may wish to request that financial information for the Housing Commission be included in future reports.

[SIGNED]

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