

REVIEW OF FISCAL YEAR 2007 MID-YEAR BUDGET ADJUSTMENTS

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Report Overview

In its review of the Mayor's Proposed Fiscal Year 2007 Budget (IBA Report No. 06-18), the Independent Budget Analyst recommended several new steps be added to the next year's budget process beginning in the Fall of 2007, including quarterly budget status reports, in addition to the City Auditor's monthly reports required under Charter Section 39.

The Fiscal Year 2007 Period 1-4 Budget Monitoring Update (Report No. 06-191), issued on November 29, 2006, provided a period-to-date assessment of the expenditures and revenues of general fund and non-general fund departments compared to budget, and a status of major and other revenues for the fiscal year. The report included actual (unaudited) expenditure and revenue data from July 1, 2006 through October 20, 2006, and should be considered the first quarterly report of the fiscal year. The report indicated that recommended appropriation adjustments would be included in the mid-year report in addition to revised revenue projections.

Three reports have been issued related to the mid-year status of the City's General Fund, which can be regarded as the second quarterly report. Report No. 07-031, dated January 29, 2007, describes the status of General Fund Revenues, and was presented to the Budget and Finance Committee at its meeting on January 31, 2007. Two additional reports, issued February 21, 2007, included Report No. 07-41 Fiscal Year 2007 General Fund Expenditure Monitoring, and Report No. 07-42 Fiscal Year 2007 Mid-Year Budget Adjustments. These two reports were presented to the Budget and Finance Committee at its meeting on February 28, 2007.

This IBA report reviews significant issues contained in these three reports and makes alternative recommendations for City Council consideration when approving the requested Mid-Year Budget Adjustments. Additionally, possible impacts to the upcoming Fiscal Year 2008 Budget are identified. It is anticipated that the City Council will consider this item at its meeting on March 19, 2007.

The Mid-Year Budget Adjustments Report for Fiscal Year 2007 requests changes to the Fiscal Year 2007 budget for these purposes:

- 1) Modify departmental expenditure and revenue budgets based on year-end projections and on new needs for expenditures not anticipated in the Fiscal Year 2007 budget.
- 2) Adjust the Fiscal Year 2007 budget to correct errors or make structural changes that were identified after the final Fiscal Year 2007 Budget was approved.
- 3) Implement the approved actions for Business Process Reengineering (BPR).
- 4) Increase the General Fund revenue budget to account for projected over budget revenues.
- 5) Reallocate salary appropriations to a reserve account to ensure that General Fund salary savings are available at year-end.
- 6) Repay the Environmental Services Department enterprise funds for activities that were inappropriately budgeted and charged to those funds, based on the legal requirements of the funds as reported by the Office of the City Attorney.
- 7) Return funds to the Water and Metropolitan Wastewater Departments for expenses charged in Fiscal Year 2003 by General Fund departments, based on the findings of the audit conducted by Mayer Hoffman McCann.

This report will review each of the above requests in order, and provide additional information where possible, and may include revised or additional recommendations for City Council consideration.

Discussion of the Requested Budget Adjustments

City Charter Section 71 prescribes that in July of each year the City Council must pass an appropriation ordinance, which becomes the City's legal budget spending authority for the fiscal year. The Appropriation Ordinance establishes a comprehensive framework for management of the budget throughout the fiscal year, including the proper delegation of Council authority, and appropriates specific budget dollars for the fiscal year. On July 31, 2006, Ordinance O-19522 was adopted as the Fiscal Year 2007 Appropriation Ordinance.

In recent years, the Appropriation Ordinance had become quite lengthy, and included a broad delegation of authority to the Auditor and Comptroller and the Financial Management Department to administratively implement budget adjustments to Council-approved appropriations. During the Fiscal Year 2007 budget process, a thorough review of past documents was undertaken. The review placed an emphasis on returning the authority for budget adjustments to the City Council, determining the appropriate delegation of authority, and successfully reduced the size and complexity of the Ordinance. In doing this, budget adjustments typically handled administratively in the past may now require specific action by the City Council, such as the appropriation of excess revenues for a specific fund, or departmental program or purpose. On the other hand, significant efforts were made to appropriately budget for anticipated departmental expenditures, including categories that may have been historically

underfunded. It is hoped that efforts to budget at appropriate levels will minimize the need for ongoing budget adjustments throughout the fiscal year, and that requests to the City Council for budget adjustments will be only for items that were truly unanticipated in the budget process, or when unforeseen circumstances have affected assumptions that formed the basis of the budget.

In prior years, adjustments to the budget were requested at the conclusion of the fiscal year, in an effort to ensure a balanced budget by adjusting revenue and expenditure amounts to align with actual levels, and re-allocate or modify departmental budgets as needed. In a change from past practice, efforts will be made to identify needed budget adjustments periodically throughout the fiscal year. This change will provide information in a more timely manner as soon as issues arise that may affect the budget. It is hoped that the exchange of budget information on a regular basis will allow the City Council to participate in the process of identifying possible solutions, instead of being presented with a single recommendation on a myriad of requested adjustments at the end of the fiscal year, where minimal time exists for full discussion.

Issues of Citywide importance that impact the requested budget adjustments will be discussed first, including the vacancy factor and retiree health trust fund.

Vacancy Factor

As described in the Mid-Year Report, the vacancy rate for the General Fund through Period Six is 8.79%, an increase of 0.5% from Period Four and 3.55% higher than the 5.24% budgeted vacancy rate for Fiscal Year 2007.

It should be noted that the Fiscal Year 2007 General Fund Budget included a vacancy factor of \$38.7 million, which was comprised of a reduction to salary and fringe amounts of \$27.8 million and \$10.9 million, respectively. General Fund departments are conservatively estimated to generate an additional \$14.7 million in salary savings, which amounts to an additional 3% of the General Fund salary budget of \$495.6 million, excluding the additional funds saved from related fringe benefits.

GENERAL FUND VACANCY FACTOR				
Selected Departments	FY 2007 BUDGETED VACANCY FACTOR	FY 2007 PROJECTED SALARY AND FRINGE SAVINGS *	FY 2007 COMBINED VAC FACTOR AND SAVINGS	TOTAL Savings as % of Vacancy Factor
City Attorney	(\$1,284,569)	(\$280,028)	(\$1,564,597)	122%
City Auditor	(704,656)	(1,525,697)	(2,230,353)	317%
Engin & Capital Projects	(190,732)	(1,883,509)	(2,074,241)	1088%
Fire	(11,473,397)	1,961,507	(9,511,890)	83%
General Services	(971,258)	(4,028,865)	(5,000,123)	515%
Library	(453,286)	(782,093)	(1,235,379)	273%
Park and Recreation	(1,591,706)	(1,078,215)	(2,669,921)	168%
Police	(19,310,722)	(3,401,143)	(22,711,865)	118%
TOTAL DEPTS LISTED	(\$35,980,326)	(\$11,018,043)	(\$46,998,369)	131%
Total General Fund	(\$38,706,266)	(\$14,735,997) **	(\$53,442,263)	138%
Depts Listed as % of General Fund	93%	75%	88%	

* Reflects departmental estimates - FM projections may vary.

** Salary savings only - does not include fringe savings.

It is important to review the vacancy factor assumed in the General Fund Budget together with these estimated salary savings to realize the magnitude of the impact to departmental budgets and operations. As shown in the table, General Fund departments are likely to achieve a combined vacancy factor and salary and fringe savings totaling \$53.4 million, which represents over 7.1% of the General Fund budget for total salary and fringe expenditure categories. Eight of the major General Fund departments comprising over 93% of the total budgeted vacancy factor are reflected here to show which departments have been most impacted. The vacancy factor and additional salary and fringe savings have been achieved for almost all departments because of directives to hold positions vacant early in the fiscal year while re-organization and business process reengineering efforts are underway.

As presented in the Mayor's Five Year Financial Outlook, it is planned for many of these vacant positions to be removed from the upcoming Fiscal Year 2008 Budget, except in the areas of Public Safety. By removing these vacant positions, it will not be possible to build in a vacancy factor of the same magnitude in the Fiscal Year 2008 Budget, or expect additional salary savings on par with current levels during the next fiscal year, for non-Public Safety areas.

Retiree Health Trust Fund

In the Fiscal Year 2007 Proposed Budget, the Mayor stated his desire to begin funding a reserve to cover the future costs of retiree health benefits (also known as Other Post-Employment Benefits or OPEB). Upon the recommendation of the IBA, the City Council concurred with this recommendation and voted to add the \$5 million requested by the Mayor into the Fiscal Year 2007 Annual Budget.

Based on supporting data to the Mid-Year Report, it appears that funds have not been set aside incrementally over the course of the year thus far to meet this \$5 million budget by year-end. Further, it is unclear whether or not the projections in the report assume that the entire \$5 million will be set aside in the last few remaining months of the year or not. At this time, the Financial Management Department is unable to confirm if the \$5 million is assumed to be achieved as part of their year-end projections. If these expenditures are not a part of the underlying assumptions of the Mid-Year Report, the projected year-end surplus is overstated. However, it is our understanding that this will be clarified at the earliest opportunity and that the \$5 million will be set aside into a trust fund by the end of the year in accordance with the budget, even if it reduces the projection for the year-end surplus.

The IBA is concerned that if this account has been under-projected in the Mid-Year Report, this may create problems for departments across the City. Especially for departments that are already projecting a deficit in their other fringe accounts, increasing the year-end projection for this fringe account will only exacerbate the total projected deficit. As examples, the Police Department and the Fire-Rescue Department are already projecting deficits in fringe, and are proposed for appropriations increases in this action to correct that projected deficit. Additional requests may be needed prior to year-end for the Office of the City Attorney. **The IBA suggests that the CFO advise the City Council on whether or not additional appropriation increases might be necessary for these, or any other departments, if their projected fringe deficits are larger than reported in the Mid-Year Report.**

Request # 1) Modify the following departmental expenditure and revenue budgets based on year-end projections and on new needs for expenditures not anticipated in the Fiscal Year 2007 budget

FISCAL YEAR 2007 GENERAL FUND EXPENDITURE ADJUSTMENTS	
Description	TOTAL Increase/(Decrease)
Budget Adjustments	
City Attorney	\$796,000
City Planning & Comm Invest	203,000
Citywide Program (Special Promo)	(4,112,000)
Financial Management	15,000
Park & Recreation	644,000
Police	3,822,000
San Diego Fire – Rescue	3,593,000
Tax and Revenue Anticipation Notes	4,000,000
Public Liability Fund from Citywide	3,500,000
Total Budget Adjustments	\$12,461,000
Revised Recommendation:	
Fire-Rescue Salary Increase – fund from excess salary appropriations	(\$1,359,731)
Revised General Fund Net Increase	\$11,101,269

Budget changes (increases and decreases) for several departments are requested to mitigate projected over expenditures or to support new expenditures identified this fiscal year, since the adoption of the Fiscal Year 2007 Budget, as shown in the chart to the left. All requests are for the non-personnel category, except for the Fire-Rescue Department. As explained later in this report, due to the large salary savings being experienced throughout the General Fund, it is recommended that excess salary appropriations be re-allocated to the Fire-Rescue Department in the amount of \$1,359,731, eliminating the need to increase the total General Fund budget by this amount.

Departmental revenues for the General Fund are expected to be less than budgeted levels by approximately \$10.7 million, with changes expected among the seventeen departments listed in the accompanying table. Most notably, changes to Service Level Agreements have affected many departments, due to cancellation of these agreements since the adopted budget which will discontinue the receipt of revenue for these services.

FISCAL YEAR 2007 GENERAL FUND REVENUE PROJECTIONS			
Department	FY2007 Budget (in millions)	FY2007 Projection (in millions)	Change (in millions)
EOCP	\$1.7	\$0.6	-\$1.1
Personnel	0.6	0.0	-0.6
Purchasing & Contracting	0.8	0.0	-0.8
Comm & Leg Svcs	1.0	0.8	-0.2
City Auditor	3.0	2.5	-0.5
City Treasurer	17.1	16.5	-0.6
Debt Management	0.8	0.4	-0.4
Financial Management	1.9	1.7	-0.2
City Planning	3.0	2.8	-0.2
Comm & Econ Dev	3.4	3.0	-0.4
Real Estate Assets	32.5	33.3	0.8
Park & Recreation	18.8	18.3	-0.5
Special Projects	0.9	0.3	-0.6
Police	24.6	23.7	-0.9
Fire	14.7	14.4	-0.3
General Services	67.5	65.8	-1.7
City Attorney	8.0	5.5	-2.5
Other/Misc	37.4	37.4	0.0
Total Departmental Revenues	\$237.7	\$227.0	\$10.7

City Attorney

An expenditure appropriation increase of \$796,000 is requested to mitigate the increased spending on contracts for temporary employees, court and litigation related activities, and additional unbudgeted expenses for cell phone and data processing services. Projected salary savings of \$613,000 are recommended for transfer to the salary reserve account.

The City Attorney's Office projects a higher shortfall in its non-personnel accounts totaling \$1.1 million, with approximately \$300,000 attributable to a possible over expenditure in fringe expense. However, appropriation adjustments for fringe expenses have not been recommended at this time.

A revenue budget reduction of \$2.5 million has been requested due to the change in billing practices for SLAs and reduced legal work for the Water and Metropolitan Wastewater Departments. The SLA revenue is expected to be \$3.8 million below budget this year but is offset by litigation awards revenue that has surpassed the budget of \$1.6 million by \$1.3 million.

The IBA is concerned, in general, with department projections where salary savings are expected to occur without commensurate savings in fringe benefits. Since salary and fringe expenditures either occur together, or do not occur at all in the case of vacancies, it is curious that a department would experience an over expenditure in one category with concurrent savings in the other.

As a separate matter, in a memo dated March 2, 2007, Council President Peters requested the CFO and the City Attorney identify outstanding legal costs that could impact the City's General Fund for the remainder of the fiscal year, so the City is prepared to address these expenditures.

Park and Recreation

Park and Recreation has historically been underfunded for new facilities and related activities. Additional funds were included during the Fiscal Year 2007 budget process specifically to address the costs related to new facilities expected to open during the year, though additional funding, required for new facilities that opened in prior years, was not provided. As the IBA has previously noted, it is important to provide for ongoing operations and maintenance costs when the City builds new facilities. If the City cannot afford to operate and maintain them, they should not be built. \$1.9 million and 16.02 full-time equivalents (FTEs) were added to the budget at the direction of the City Council, specifically for new facilities in the current fiscal year.

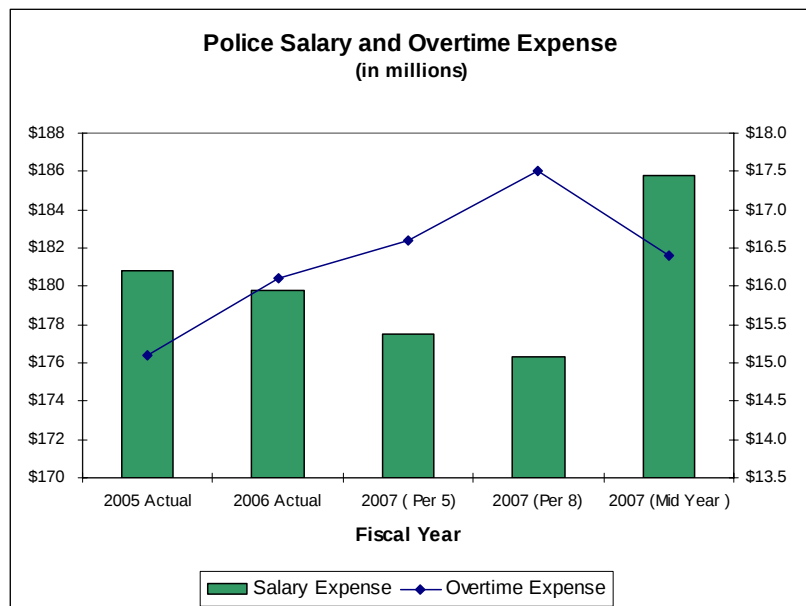
The IBA recommends appropriate staffing, and operations and maintenance levels for Park and Recreation facilities be fully evaluated to ascertain the costs of any backlog of underfunded or unfunded facilities for consideration for the Fiscal Year 2008 Budget.

Park and Recreation estimates salary savings of \$1.3 million due to vacant positions, while an increase of \$644,000 has been requested for expected over expenditures in the non-personnel category. Increased costs are due to waste removal services previously funded by the Refuse Disposal Fund, increased costs for downtown restroom maintenance due to the Living Wage Ordinance, and unbudgeted new facilities costs.

Earlier this fall, the Blue Level Swim program was proposed for elimination, and it came to light that the Park and Recreation Aquatics Program has operated with a significant financial deficit over the last several years. This fiscal year, revenue shortfalls for the pools are estimated at \$458,000, due to competition from other pool locations and reduced hours of operation. No changes have been implemented or are expected for the City's pool program for this fiscal year and Park and Recreation has been able to continue these services by using savings from other areas. **The IBA recommends a full fiscal analysis of the Aquatics Program be done as part of the Fiscal Year 2008 Budget to finally address the ongoing deficit in the Aquatics Program.**

Police Department

The IBA has reviewed historical information for the Police Department and believes that the year-end projected savings identified in the Fiscal Year 2007 Mid-Year Report are conservative. Salary expenses for the Police Department have reflected a declining trend over the last few years, with average salary costs per pay period dropping even more during the current fiscal year. In contrast, overtime costs have increased, and show signs of continuing to grow.



The Mid-Year Report projects a year end salary expense of \$202.2 million; a salary savings of \$4.2 million, over and above the budgeted vacancy factor. In Fiscal Years 2005, 2006, and 2007 (as of Period 5), the Police Department has experienced an average salary expense of approximately \$6.9 million per pay period (excluding overtime), which equates to a year end expense of roughly \$179 million. In order for the projections in the report to be achieved, an average of \$7.1 million must be expensed per pay period, which is an increase of \$200,000 per pay period over current experience. Information as of Period 8 (February 2007) validates a projection based on an average pay period expense of \$6.8 million, even less. Therefore, based on historical data as well as current Police Department staffing levels, the IBA believes the Police Department will not achieve an average pay period expense of \$7.1 million and will far surpass the additional salary savings projected in the Mid-Year Report. Using Period 5 Year-to-date information, the IBA believes the Police Department is likely to expend closer to \$194.1 million (including salary expenses of \$177.5 million and \$16.6 million in overtime) for a savings of \$12.3 million over and above their budgeted vacancy savings, which is \$8.1 million more than reported in the Mid-Year.

The Fiscal Year 2007 Budget included an additional \$2.5 million in funding for information technology. This was a structural budget fix that occurred to enhance clarity and transparency in the Police Department's Budget. Unfortunately, it is projected that a significant deficit will

occur by year end (28%). In conjunction with the data processing budget, DPC establishes the rates and recommends the budget for telephone services. This is an additional area in which the Police Department is significantly underfunded. As of Period 5, nearly 93% of telephone services have been expensed.

The IBA recommends that additional review of the Police Department's information technology budget (including telephone services) be performed as part of the Fiscal Year 2008 budget process.

Also, since no funding was provided to support the opening of the Northwestern Facility, which opened March 10, 2007, the expenses associated with operating this facility for approximately four months (i.e. utilities, data processing) will cause further deficits in the Department's budget.

Fire-Rescue Department

The IBA previously raised concerns about the \$11 million vacancy factor for the Fire-Rescue Department, which in essence eliminated any benefit of increases to appropriations of \$8 million for overtime costs, and is pleased to see actions are being taken to adjust the Fire-Rescue Department for an above-average factor. The Mid-Year Report projects a deficit of approximately \$1.4 million, primarily as a result of this high vacancy factor.

The IBA recommends the \$1.4 million salary deficit for the Fire-Rescue Department be funded from salary savings re-allocated from other departments, reducing the amount to be placed in the Citywide Salary Reserve Account.

The IBA notes that the back-up materials provided by the Financial Management Department show the Fire-Rescue Department has different projections than those reported in the Mid-Year Report. The Department's information differs as follows:

- Salary and Wages are projected to be \$100.9 million (a deficit of \$1.0 million compared to the Mid-Year Report's deficit of \$1.4 million).
- Fringe Benefits are projected to be \$52.9 (a deficit of \$2.0 million compared to the Mid-Year Report's deficit of \$0.6 million).
- The Mid-Year Report calls for an adjustment of \$3.6 million for personnel and non-personnel expense deficits, but the Department does not request an adjustment for projected deficits in the Supplies & Services and Data Processing accounts. The Department has requested to wait until the third quarter adjustment to determine if any further budget adjustments may be required.

If the Department's projections are accurate, the actual adjustment needed by year end may be \$4.2 million (compared to the requested \$3.6 million) for projected deficits in salary and wages (\$1.0 million), fringe benefits (\$2.0 million), and non-personnel expenses related to the UASI Grant (\$1.2 million).

As a point of comparison, in the Fiscal Year 2006 Year-End Budget Adjustments, the Fire-Rescue Department required an increase to General Fund appropriations of \$5.9 million for operation services including personnel-related costs due to terminal leave payouts, special pay and overtime. Of this amount, \$1.6 million was to be mitigated by Federal Emergency Management Agency reimbursement, and the remaining \$4.3 million was to be funded by citywide General Fund savings and/or excess revenues.

Because of this continuing trend, the IBA recommends the Fiscal Year 2008 Budget for the Fire-Rescue Department be carefully reviewed and augmented as necessary to eliminate the annual need for mid-year budget adjustments for anticipated recurring costs.

City Auditor and Comptroller

In its projections, the Auditor Department has reflected the City Auditor position to be vacant for the remainder of the fiscal year. This is inconsistent with the need to move quickly on recruiting and filling this critical position. Projections also included the filling of 18 positions during the months of January and March, though it is unclear if any of the new hires would be assigned to the City's internal audit function. In spite of these new hires, the department projects total savings of \$1.5 million at year-end. While salary appropriations have not been recommended to be removed from the Auditor's budget, and efforts to hire would not be hampered by these projections alone, it is important to stress that efforts should be made to recruit and staff key positions which may be crucial to the City in its remediation efforts.

Additionally, the Auditor Department submitted a request for an appropriation adjustment for property tax administration costs of \$1.2 million. In the past this type of budget adjustment could have been handled administratively by the appropriation of additional property tax revenues in excess of budget, which offset these costs. However, changes to the Appropriation Ordinance for Fiscal Year 2007 did not delegate this level of authority to the Auditor & Comptroller, thus requiring City Council action to rectify. The Mid-Year Report describes that funds budgeted for this purpose are reflected in the Auditor Department, however, the requested appropriation increase is shown as an increase to the Citywide Program Department. It is suggested that budget adjustments should be made to the department where the costs were initially budgeted and incurred, and not elsewhere. This will allow all interested parties to understand the full amount of funds budgeted and expended for a particular program or purpose, and eliminate confusion on where costs are to be found.

Tax and Revenue Anticipation Notes (TRANS)

The Mid-Year Report requests an expenditure appropriation increase of \$4 million due to increased borrowing costs. The accompanying Mid-Year Expenditure Monitoring Report cites (page 4) the need to borrow as a private placement (rather than in the cheaper publicly traded markets), rising interest rates and the City's inability to complete its outstanding CAFRs. At the Budget Committee meeting on February 28, 2007, the CFO and the Financial Management Director offered the following comments in an effort to clarify:

- The Fiscal Year 2007 budgeted interest expense was based on the FY 06 budgeted figure; however, in FY 06, TRANS were utilized as a line of credit and funds were only drawn when needed thereby incurring less interest expense.
- In Fiscal Year 2007, recognizing a positive arbitrage opportunity, the City took the entire TRANS allocation (\$142 million) at the beginning of the year which increased interest expense. The IRS allows municipalities (only with TRANS) to borrow at tax-free rates and reinvest at taxable rates, keeping the difference. According to Mary Lewis, Director of Financial Management, in her comments at the Budget Committee meeting, interest expense was more than offset by associated interest earnings (estimated to be more than \$5 million over the Fiscal Year 2007 budgeted amount).

- TRANS were issued as a private placement rather than in the cheaper publicly traded markets.
- Interest rates were higher than anticipated.

Neighborhood Code Compliance

The Neighborhood Code Compliance Division transferred to the Development Services Department in Fiscal Year 2007. Due to the transfer, a few management and administrative positions are no longer required. The large expenditure savings is due to the eleven vacant positions. Neighborhood Code Compliance is currently projecting a 14 percent salary savings for Fiscal Year 2007. This is in addition to the 5.4 percent vacancy rate that was factored in the Fiscal Year 2007 budget.

The department plans to hire the following six vacant field positions prior to year end: (2) Code Compliance Officers, Sr. Combination Inspector, Combination Inspector I, Sr. Zoning Investigator, and Zoning Investigator I.

Real Estate Assets

The Real Estate Assets Department is currently projecting a 15 percent salary savings for Fiscal Year 2007. This is in addition to the 0.7 percent vacancy rate that was factored in the Fiscal Year 2007 budget. The salary savings is due to three vacant unclassified Asset Managers that are anticipated to be filled by the end of the fiscal year.

One of the Mayor's goals for the Real Estate Assets Department is to update expired leases that have the potential to increase revenue. This will allow the City to realize the maximum financial potential of its leaseholds. New policies are in the process of being established for new leases and lease extensions. Changes to the City Lease policy and updates to Council Policy 700-10, Disposition of City-Owned Real Property, will be heard at the Committee on Land Use and Housing in 2007.

Request # 2) Adjust the Fiscal Year 2007 budget to correct errors or make structural changes that were identified after the final Fiscal Year 2007 Budget was approved.

Many of the mid-year budget adjustments are characterized as corrections to the current year budget, or cases where departments were inadequately funded in the budget in certain areas, including data processing, energy or fringe benefits. Some adjustments may need City Council action due to the changes in the Appropriation Ordinance, and may have been handled administratively in the past. Many non-General Fund Departments would have previously had the ability to administratively increase their authorized budgets and expend additional revenues if excess funds were received.

While supporting Council approval of these adjustments, the IBA recommends that efforts be made to address the necessary mid-year budget corrections in the Proposed Fiscal Year 2008 Budget to avoid repeating these problems next year.

Request # 3) Implement the approved actions for Business Process Reengineering (BPR).

Business Process Reengineering

Previous requests for City Council actions to approve specific business process reengineering efforts have included authorization to the City Auditor to adjust expenditure and revenue appropriations as needed in order to implement, as shown here.

Human Resources BPR

2. Authorize the City Auditor and Comptroller and the City Attorney to prepare the necessary documents to implement the BPR recommended organizational changes:
 - Authorizing the Auditor and Comptroller to adjust expenditure appropriations to reflect the creation of three Group Human Resources Manager positions in Public Safety, Public Works, and the Neighborhood and Customer Services Group.
 - Authorizing the Auditor and Comptroller to adjust revenue appropriations associated with the creation of these Group HR Manager positions.
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Information Technology BPR

Authorizing the Auditor and Comptroller to adjust expenditure appropriations to reflect the creation of four Group Information Technology Manager positions in Public Safety, Public Works, Land Use and Economic Development and the Neighborhood and Customer Services Group.

Authorizing the Auditor and Comptroller to adjust revenue appropriations associated with the creation of these Group Information Technology Manager positions.

While it is helpful to know the amount of the cumulative budget adjustments and the impact to each department because of approved BPRs, additional Council action does not appear to be necessary. However, since BPR adjustments to the budget have not yet been made, it is unclear if individual departments have incorporated these adjustments into their projections and fully understand possible impacts that may occur during the remainder of the fiscal year. Several departments expecting over expenditures in the non personnel area may be further impacted by the BPR adjustments as shown in the Mid-Year Report, which show reductions to budgeted non-personnel areas, because of approved BPRs. The next financial status report should reveal these impacts, if they exist.

Request # 4) Increase the following General Fund revenue budgets to account for projected over budget revenues.

Status of General Fund Revenue

The Mayor has requested an increase to the Major General Fund Revenue budget by \$10.5 million. This amount will partially offset the impacts of the requested budget increases/(decreases) and budget corrections. This adjustment, combined with other requested revenue budget adjustments will increase the total General Fund revenue budget by \$6.2 million, the amount of over budget revenue that is projected at this time. The Major General Fund Revenue budget will not be increased by the entire \$16.9 million of projected budget surplus due to under budget revenue projections in other departments throughout the General Fund. Revenues will continue to be monitored and additional revenue budget adjustments may be requested in future monitoring reports.

FISCAL YEAR 2007 GENERAL FUND REVENUE PROJECTIONS			
Revenue Source	FY2007 Budget (in millions)	FY2007 Projection (in millions)	Change (in millions)
Property Tax	\$344.2	\$363.0	\$18.9
Sales and Use Tax	234.9	228.6	-6.3
Transient Occupancy Tax	72.9	78.4	5.5
Franchise Fees	64.6	64.9	0.3
Property Transfer Tax	14.9	8.4	-6.5
Safety Sales Tax	8.2	8.2	0.0
Vehicle License Fees	9.3	9.4	0.2
Other Revenue	36.8	41.7	4.9
Major Revenue Total	\$785.7	\$802.6	\$16.9
Total Departmental Revenues	\$237.7	\$227.0	-\$10.7
Total General Fund Revenues	\$1,023.4	\$1,029.6	\$6.2

Major revenues are projected to exceed the Fiscal Year 2007 Budget by \$16.9 million, while departmental revenues, especially Service Level Agreement (SLA) billings, are expected to be below Fiscal Year 2007 Budget amounts. The net result is a total projected General Fund revenue surplus of \$6.2 million, as shown in the table.

Request # 5) Reallocate salary appropriations to a reserve account to ensure that General Fund salary savings are available at year-end.

Citywide Salary Reserve Account

As described earlier in this report, salary savings have been projected in several General Fund departments. Some departments experiencing salary savings due to vacant positions are also expected to over expend in non-personnel accounts for a variety of reasons. Charter Section 73 prevents funds budgeted for salaries to be used for other purposes.

Charter Section 73: Transfer of Appropriations

Upon the written recommendation of the Manager, the Council may at any time transfer all or part of an unencumbered balance of an appropriation to a purpose or object for which the appropriation for the current year has proved insufficient, or may authorize a transfer to be made between items appropriated for the same Department or office; provided, however, the Council shall have no authority to transfer all or any part of the salary account during the fiscal year to any other purpose, save and except in the event of a public emergency, and then only for the purpose of insuring the safety and lives and property of the inhabitants of The City of San Diego.

In order to ensure that projected salary savings in the amount of the requested increases to fringe and non-personnel appropriations, are realized at year-end, the Mayor has recommended that salary appropriations be moved from General Fund operating department budgets and placed in a salary reserve account in the Citywide Program Expenditures Department. This has been recommended to ensure these funds will be available for placement in the General Fund Reserve at year-end, and will have no net impact on salary appropriations in the General Fund.

Reallocation of Salary Appropriations to Reserve Account	
Department	Salary Increase/(Decrease)
City Attorney	(\$613,000)
Park and Recreation	(644,000)
Police	(3,822,000)
Citywide Salary Reserve	5,079,000
IBA Recommendation:	
Fire-Rescue	\$1,359,731
Citywide Salary Reserve	(\$1,359,731)
TOTAL	\$ -
<i>Balance of Salary Reserve</i>	<i>\$3,719,269</i>

IF the requested salary reserve account is created, the IBA recommends that salary appropriations first be re-allocated to departments with expected over expenditures in salaries (currently the Fire-Rescue Department), minimizing the amount to be transferred to the salary reserve account. By doing this, amounts to be appropriated from the General Fund reserve for the salary category will be reduced and the General Fund budget will not be increased by as much. Based on discussions with the City Attorney and the CFO, there appear to be no obstacles to implementing this revised recommendation.

Some may consider the transfer of projected unexpended salary appropriations to a salary reserve account unnecessary at this time. Because all General Fund revenues in excess of expenditures will fall to the General Fund reserve at fiscal year-end anyway, the benefit in creating a salary reserve account is unclear. As many departments are experiencing high levels of vacancies and related savings in personnel costs, it is highly unlikely that these savings will not be available at the conclusion of the fiscal year, especially in the absence of concerted efforts to hire new employees and fill vacant positions. In fact, the IBA is concerned that taking actions to remove these appropriations from specific department budgets will, in essence, be equivalent to a hiring freeze which is not the intended purpose.

Request # 6) Repay the Environmental Services Department enterprise funds for the following activities that were inappropriately budgeted and charged to those funds, based on the legal requirements of the funds as reported by the Office of the City Attorney.

The amount of General Fund expenses inappropriately charged to the Environmental Services Department's Recycling and Refuse Disposal Funds this fiscal year, based on the legal requirements of the funds as reported by the Office of the City Attorney, is estimated at \$2.0 million, as detailed in the chart to the left. The IBA supports all efforts for costs to be appropriately charged to the benefiting funds and departments.

RETURN TO ENVIRONMENTAL SERVICES FUNDS	
Item	Amount
REFUSE DISPOSAL & RECYCLING	
Environmental Library	\$24,000
Bay & Beach Barrel Collection	120,000
Mission Bay, Shoreline and Park & Rec Collection	138,000
Lead Safe Neighborhoods Program	912,000
Budget, Revenue Development and Administration	
Safety & Training	
Facilities Maintenance	
Organizational Development	761,000
Automated Container Mgmt	
Internal Hazardous Waste	
Computer Support	
TOTAL	\$1,955,000

Request # 7) Return funds to the Water and Metropolitan Wastewater Departments for expenses charged in Fiscal Year 2003 by General Fund departments, based on the findings of the audit conducted by Mayer Hoffman McCann.

RETURNS TO WATER FUND	
Item	Amount
FY 2003	
"Kiddie Hall" Day Care Facility	\$280,000
Equal Opportunity Contracting Program	238,475
Lobbying Contract Costs	79,629
Career Development and Mentoring Program	35,085
Special Training for EOCP	11,017
TOTAL FY 2003	\$644,206
FY 2006	
Reservoir Concessions	\$1,700,000
Reservoir Maintenance Labor	150,000
Chollas Reservoir Water	190,000
Chollas Reservoir Operations and Maintenance	600,000
TOTAL FY 2006 (already approved)	\$2,640,000

In the Fiscal Year 2006 Year-End Budget Adjustments, \$2.64 million, as detailed in the accompanying chart, was authorized for return from the General Fund to the Water Fund, due to the Grand Jury findings on Service Level Agreements with the enterprise funds.

Additional actions have been taken during Fiscal Year 2007 to provide repayment to the Water Fund for current year reservoir recreation costs, previously funded by the Water Department, estimated at \$1.5 million. These costs will now be paid by the General Fund.

COSTS SHIFTED FROM WATER TO GENERAL FUND	
FY 2007	
Reservoir Recreation (already approved)	\$1,498,250
Chollas Reservoir Water	190,000
San Dieguito River Valley JPA Dues	270,000
TOTAL FY 2007	\$1,958,250
GRAND TOTAL	\$5,242,456

In addition, the General Fund must return \$1.1 million of expenses charged to the Water and Metropolitan Wastewater Departments in Fiscal Year 2003, based on the findings of auditors Mayer Hoffman McCann. This amount is comprised of \$644,206 to be returned

to the Water Fund, and \$428,692 to be repaid to the Sewer Fund.

The amount of General Fund costs due to Water and Sewer Fund repayment or the appropriate shift of payment responsibility to the General Fund totals \$5,671,148. The Mayor has recommended the return of funds and shift of costs as part of his ongoing effort to maintain the integrity and focused use of water and wastewater department funds.

RETURNS TO SEWER FUND	
Item	Amount
FY 2003	
Equal Opportunity Contracting Program	\$254,302
Lobbying Contract Costs	87,353
Career Development and Mentoring Program	73,407
Special Training for EOCP	13,630
TOTAL FY 2003	\$428,692

As with Request #6, the IBA supports all efforts for costs to be appropriately charged to the benefiting funds and departments.

General Fund Reserve

As stated in the Mid-Year Report, the requested \$6.2 million increase in the revenue budget will partially offset the \$11.6 million in requested new expenditure appropriations, and a \$5.4 million gap remains between the projected revenue surplus to be appropriated and the additional expenditure appropriations requested in this report. An allocation of \$5.4 million of General Fund reserves is requested to balance all General Fund budget adjustments.

Based on the IBA's revised recommendation related to the funding of the projected salary deficit for the Fire-Rescue Department in the amount of \$1,359,000, the request for new expenditure appropriations would be reduced accordingly to \$10.3 million, and would require an allocation from the General Fund reserves of \$4.0 million versus the \$5.4 million requested.

The Mayor has requested that anticipated salary savings of \$5.1 million be set aside in a salary reserve account that will be allocated to the General Fund reserves at year-end along with General Fund savings remaining in departments. The IBA's recommendation reduces the salary reserve account to \$3.7 million, if it is established.

The year-end contribution to the reserves from surplus projected revenues and expenditure savings (including the salary savings to be set aside in reserves) is currently projected at \$12.2 million. Based on the IBA's review, it is expected that savings will be greater than this amount, though an estimate has not yet been made.

The Mid-Year Report indicated that the General Fund reserves balance was currently \$36.2 million, and did not include the \$7.2 million reserve contribution budgeted as part of the Fiscal Year 2007 Budget. However, the CFO's General Fund Reserve table, dated January 16, 2007, reflected a balance of \$49.2 million, including the \$7.2 million. Excluding the \$7.2 million, a discrepancy of \$5.8 million exists among these figures. The IBA is not able to reconcile this inconsistency. The table above illustrates this discrepancy and includes an additional \$1.4 million difference for the reduced withdrawal for appropriation increases under the IBA's proposal.

ESTIMATE OF GENERAL FUND RESERVE	
Item	Amount (in millions)
Mid Year Report	
Current Balance	\$36.2
Appropriation Increases	(5.4)
Projected savings (inc. salary reserve)	12.2
FY 2007 Budget contribution	7.2
Estimated Year-End Reserve	\$50.2
IBA Estimate	
Current Balance – CFO 1/16/07	\$49.2
Appropriation Increases – revised	(4.0)
Projected savings (inc. salary reserve)	12.2
Estimated Year-End Reserve	\$57.4

The IBA supports efforts to bolster the levels of the General Fund Reserve, and reiterates its position that a comprehensive reserve policy should be created and formalized, and should consider the needs for the Public Liability and Workers Compensation Funds.

Audit Committee Support

With the creation of the Audit Committee, there will be a need for an additional committee consultant for the Council Administration budget and possibly an additional professional staff member to advise the Audit Committee. Any costs that may be incurred this fiscal year may be absorbed by the savings currently expected in the Council Administration budget.

The IBA recommends that the costs for Audit Committee positions, as determined to be necessary, be absorbed within the current Fiscal Year 2007 Budget, and be added to the Fiscal Year 2008 Budget to ensure sufficient resources are available for these important functions.

RECOMMENDATIONS

Listed below are a summary of the IBA's recommendations:

1. The IBA suggests that the CFO advise the City Council on whether or not additional appropriation increases might be necessary for departments, if projected fringe deficits are larger than reported in the Mid-Year Report.
2. The IBA recommends appropriate staffing, and operations and maintenance levels be identified for new Park and Recreation facilities that were underfunded or unfunded in prior years. This underfunding contributed to the need for a mid-year adjustment for Park and Recreation and should be evaluated for correction in Fiscal Year 2008.

Furthermore, the City should not commit to moving forward with a new facility unless it can be definitively determined that it can afford to operate and maintain it.

3. The IBA recommends a full fiscal analysis of the Park and Recreation Aquatics Program be done as part of the Fiscal Year 2008 Budget due to the operating deficit in the program over the past several years.
4. The IBA recommends that additional review of the Police Department's information technology budget (including telephone services) be performed as part of the Fiscal Year 2008 budget process.
5. The IBA recommends the \$1.4 million salary deficit for the Fire-Rescue Department be funded from salary savings re-allocated from other departments, reducing the amount to be placed in the Citywide Salary Reserve Account. This will also reduce the amount needed from the General Fund Reserve from \$5.4 million to \$4.0 million.
6. The IBA recommends that efforts be made to address the necessary mid-year budget corrections in the Proposed Fiscal Year 2008 Budget to avoid repeating these problems next year.
7. If the requested salary reserve account is created, the IBA recommends that salary appropriations first be re-allocated to departments with expected over expenditures in salaries (currently the Fire-Rescue Department), minimizing the amount to be transferred to the salary reserve account.

While the IBA does not oppose the creation of the salary reserve account for setting aside salary savings for the remainder of the year, its necessity is not fully understood. The IBA is concerned its creation and use could be construed as a position freeze. If it is established as requested, the amount to be placed in the salary reserve should be reduced from \$5.4 million to \$4.0 million as discussed throughout this report.

8. The IBA supports all efforts for costs to be appropriately charged to the benefiting funds and departments, including the requested adjustments to repay the Environmental Services, Water and Metropolitan Wastewater Enterprise Funds.
9. The IBA supports efforts to bolster the levels of the General Fund Reserve, and reiterates its position that a comprehensive reserve policy should be created and formalized, and should consider the needs for the Public Liability and Workers Compensation Funds.
10. The IBA recommends that the costs for Audit Committee positions, as determined to be necessary, be absorbed within the current Fiscal Year 2007 Budget, and be added to the Fiscal Year 2008 Budget to ensure sufficient resources are available for these important functions.

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