
OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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City Council Meeting Date: October 26, 2009

Item Number: S400

City of San Diego Proposed Budget Policy

OVERVIEW

On Monday, October 26, 2009, the City Council will be asked to approve the City of San Diego Proposed Budget Policy. The Budget Policy establishes guidelines for budget development, budget monitoring and fiscal planning, and sets standards for sound budgetary practices. The Budget Policy will serve as a useful tool to the City in maintaining and improving its fiscal health.

At its meeting of September 23, 2009, the Budget and Finance Committee voted unanimously to adopt the policy and forward it to the City Council with the following changes: 1) include Five-Year Financial Forecast to “Budget Development” line item; 2) incorporate a net statement of liabilities and impact of projected expenditures or underfunding on outstanding liabilities; and 3) include, under Expenditure Policies, the Payment on Retiree Health Care in relation to the Annual Required Contribution (ARC) outlined in the City’s CAFR.

In addition, it was requested that the IBA develop an option to amend the policy to address how information on service levels and performance outcomes could be improved and utilized as a driver of the budget process and related decisions.

FISCAL/POLICY DISCUSSION

In August 2006, the Kroll Report included in its recommendations financial and budgetary principles that the City had previously instituted, and suggested additions to

these principles. Specifically, the Kroll Report included in its recommendations the following budgetary guidance:

- *Ongoing expenditures should be supported by ongoing revenues;*
- *Capital projects should identify all future cost considerations and financial impacts, including direct and indirect costs for each Enterprise Fund;*
- *Activities supported by user fees should be fully cost recoverable;*
- *Discretionary General Fund revenues should not be earmarked;*
- *Increase the General Fund reserve to the range of 7-10%;*
- *Budget development should be guided by a long term or strategic plan proposed by the Mayor and adopted by the City Council;*
- *After adoption, annual budgets should be amended only for urgent needs; and,*
- *Specific funding sources should be identified to pay for these needs.*

Since the issuance of the Kroll Report, the City has made significant progress and has instituted many fiscal reforms. The Mayor has drafted and the City Council has adopted policies related to Reserves, Debt, User Fees, and the Prioritization of Capital Projects, which address several of the items identified in the Kroll recommendation noted above. The proposed budget policy intends to address the remaining items.

In response to the Budget and Finance Committee's direction, the following additions have been made to the proposed budget policy. The IBA's position for each recommended change is noted.

Impact on Net Liabilities – Proposed Language

"The Outlook shall present the most recent information, including any actuarial analysis, on the City's long-term liabilities, including the pension plan, retiree health (Other Post-Employment Benefits), deferred maintenance, workers' compensation, public liability and long-term disability. In addition, the Outlook shall describe the funding that is projected to meet these liabilities and the net remaining liabilities. For deferred maintenance, an assessment of needs shall be conducted periodically and shall determine priority projects for annual appropriations."

IBA Response: The proposed language fully addresses the Committee's direction.

Retiree Health Obligations– Proposed Language

"Funding of retiree health or Other Post-Employment Benefits (OPEB) shall be a priority of the City's budget. Payment of the full OPEB ARC is not legally required; however, disclosure of the Net Other Post-Employment Benefits Obligation (NOPEBO) liability is required, in accordance with GASB Statement 45, in the City's Comprehensive Annual Financial Report (CAFR). The City's budget, at a minimum, shall include the annual pay-

as-you-go healthcare cost. In addition, the specific levels of pre-funding future liabilities for OPEB shall be considered in the Five-Year Financial Outlook as part of the comprehensive analysis of all the City's funding priorities."

IBA Response: The IBA has expressed concern to the Financial Management Department regarding the added language for retiree health obligations.

The proposed policy language related to retiree health obligations is unclear as to the City's commitment to continue to fund these obligations at either the current level, or an increased level, in the future, and the City's intention on how it will address the unfunded OPEB liability is unspecified. The Outlook is necessary for financial planning. However, it does not set policy, as it is intended to be revised and updated each year. Relying on the Outlook as the method to outline City policy allows for discretion each year, and does not clearly describe the City's intentions.

To illustrate, the latest Outlook stated "that the City will continue to fund the current year post-employment healthcare obligation (pay-as-you-go) assuming an average growth of 12.6 percent for FY 2011-2015, and that the City will contribute \$25.0 million annually to the CalPERS Employer Retiree Benefit Trust to pre-fund future liabilities".

The FY 2010 OPEB Annual Required Contribution (ARC) has been reported at \$113.4 million. The City's budgeted contribution to fund these costs in FY 2010 totals \$57.1 million, or approximately 50% of the ARC. As described in the latest Outlook, the FY 2011 forecasted retiree health contribution of \$62.2 million represents 52% of the FY 2011 ARC. However, in contrast, the January 2008 Outlook described that the full OPEB ARC would begin to be paid in FY 2010 and continue thereafter. At that time, the OPEB ARC was projected at \$75 million.

The City Council may wish to discuss the funding strategy for OPEB in more detail, and suggest more specificity for inclusion in the budget policy. Alternatively, the Council may want to consider providing direction that a funding strategy for the OPEB liability be developed, separately from the budget policy.

The IBA has suggested to Financial Management that the budget policy could state that the City intends to fund annual pay-as-you-go costs and an amount for pre-funding future liabilities for retiree health, in total, at an amount which is at least 50% of the OPEB ARC. This would be consistent with current funding levels.

IBA Option - Use of Performance Measures

At the September 23 Budget and Finance Committee, the Committee motion included a request for the IBA to develop an option for possible inclusion in the budget policy that would explicitly connect Mayoral/Council priorities and related performance measures to the annual budget process.

It was suggested that the budget process could be altered to allow for the Council to pass a resolution or ordinance (by January 15 or February 1) stating desired service levels or performance outcomes, and as a result, the Mayor would be requested to create a budget to meet those goals, or to inform the Council if his proposed budget does not achieve all or some these desired service levels.

The proposed budget policy provides an opportunity to articulate a strong connection between the City's Strategic Plan, performance measures and annual budget decisions as well as outline a more strategic approach to goal setting and budget decision making between the two branches of government.

As requested by the Budget and Finance Committee, the IBA has developed a course of action to foster discussion to move towards a more fully integrated budget development process using performance measures and addressing the Council's priorities. This is provided as Attachment 1 to this report. It is recommended that this issue be referred to the Budget and Finance Committee for further discussion and action.

CONCLUSION

The IBA has reviewed the proposed budget policy, and provided feedback to the Financial Management Department. Many of the IBA's concerns and suggestions were previously addressed and incorporated. The Budget and Finance Committee requested additional language be included to more fully address the net impact of projected expenditures on the City's liabilities, and to describe how retiree health obligations are intended to be funded.

The IBA has expressed concern that the budget policy related to retiree health obligations is unclear as to the City's commitment to continue to fund these obligations at either the current level, or an increased level, in the future. The City Council may wish to discuss the funding strategy for OPEB in more detail, and suggest more specificity for inclusion in the budget policy. Alternatively, the Council may wish to consider providing direction that a funding strategy be developed separately from the budget policy.

Additionally, as requested by the Budget and Finance Committee, the IBA has developed a course of action to link performance measures to the annual budget process. It is recommended that the issue of linking performance measures to the annual budget process be returned to the Budget and Finance Committee and full Council as time allows and that the budget policy be revised accordingly at a later date.

[SIGNED]

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[SIGNED]

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Attachments:

- 1) Linking Performance Measures to the Annual Budget Process
- 2) City of San Diego Strategic Plan