OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Item Number: 2

Review of Fiscal Year 2008 Mid-Year Budget Monitoring Report

OVERVIEW

The Chief Financial Officer issued the Fiscal Year 2008 Mid-Year Budget Monitoring Report on January 23, 2008, 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 November 16, 2007.

The report notes that the impacts associated with the Soledad Mountain Road landslide and the Southern California wildfires have been analyzed, and increased costs necessitate budget adjustments to ensure the General Fund budget remains in balance.

The IBA reviewed the Mid-Year Report, comparing information to the Auditor's recent Monthly Financial Report, and also reviewed issues that were identified during the development of the budget, and at the time of the First Quarter Monitoring Report.

In summary, this report offers supplementary information to explain departmental projections, and recommends holding off on requested budgetary adjustments, including any action with respect to the reserves at this point in time. We further suggest an updated mid-year review based on seven periods of actual data be provided to the full Council by the end of February or early March, and necessary actions be taken at that time. While we are supportive of balancing departmental budgets impacted by costs related to the wildfires (Police, Fire, and Environmental Services), we were not able to clearly identify these impacts for this fiscal year in the Mid-Year report.

FISCAL/POLICY DISCUSSION

Issues Related to Budget Monitoring and Adjustment Process

We have noted in recent reports (Year-End Status and First Quarter Monitoring) the importance of providing the Council with as accurate and up-to-date budget information as possible through current year budget monitoring and reporting. This was accentuated with the Comptroller's release of the "End of the Year results for Fiscal Year 2007" which reported an unexpected windfall of $40 million, increasing the General Fund reserve. While a positive result this time for the reserves, accuracy in the budget process should be the overriding goal.

A review and update of expenditure and revenue allocations is critical at key junctures throughout the year. Fiscal Year 2008 budget allocations were developed in early 2007 in preparation for the release of the Mayor's Proposed Budget in April 2007, and some minor technical modifications were made in May 2007. The annual budget is only an expenditure plan for the upcoming year based on the best information available at the time. Actual experience is what clearly defines the budget throughout the course of the year.

Budget projections based on information in the first quarter are naturally not as meaningful as those provided later in the year as significant expenditure and revenue collections occur. For instance, post holiday sales tax receipts received by the City in March can alter revenue projections significantly, as can the first installment of property tax receipts which become available in late December. Similar patterns exist on the expenditure side. It can be a challenge to balance timely reporting with the ebb and flow of information and the staff time required for analysis.

Additional information on the impact of the wildfires alone resulted in a wide swing in projections between the First Quarter and Mid-Year Reports, as shown in the chart below:

General Fund Status Fiscal Year 2008			
	FY 2008 Revised Budget	FY 2008 Year-End Projection (First Quarter)	FY 2008 Year-End Projection (Mid-Year)
Revenues	$1,106,330,952	$1,100,949,582	$1,107,591,168
Expenditures	1,115,999,292	1,097,904,014	1,126,225,250
Net Balance	($9,668,340)	$3,045,568	($21,634,082)

We would also point out that this year's Mid-Year projections are based on 4.5 months of actual experience (July 1 through November 16) rather than six months as called for in Council Policy 000-20. Last year's Mid-Year review reflected data through mid-December.

This Council Policy, entitled "Annual Council Programming", last amended in February 2005, specifies that **"No later than the third week in January, the City Manager shall present to the Mayor and City Council the Financial Status and Forecast Report.** This report shall be a more in-depth, comprehensive overview of current year fiscal status, and shall also contain more refined expenditure and revenue forecasts for the upcoming fiscal year, **based on the availability of 6 months of current year expenditure and revenue data**."

It is highly unlikely that projections reflective of data covering six months of actual experience could be developed and reported to the City Council by the third week of January. To get to Budget and Finance Committee by January 30th, this monitoring report could only reflect 4.5 months of actuals due to a two month process for analysis and report writing. Unless this process can be compressed, a report reflective of six months of actuals, which is preferable, would likely not be available until late February/early March. **The Budget & Finance Committee should explore with the Mayor's Office how this process and related timing could be refined and the Council Policy revised, so that the Mid-Year Report could be based on six months of actual experience.** Pushing the Mid-Year Report back several weeks may be a worthwhile tradeoff for better data.

Finally, we would note that the Mid-Year Report requests a net appropriation of $8.7 million from the unallocated reserve (as detailed in the chart) to cover projected deficits in seven service areas. (Not all departments projecting a deficit are recommended for adjustment at this time.)

Appropriation Adjustment Requested in Mid-Year (in millions)	
Total Deficit in Departments identified for Adjustment	($17.3)
Revenue previously appropriated for ESD (January)	$3.0
Expenditure Adjustment Requested	($14.3)
Revenue Adjustment Requested	$5.6
Net Adjustment (Reserves)	**($8.7)**

The report further states that several departments are projected to be under budget at year-end by $6.4 million. Attachment 1 summarizes the projected deficits and surpluses by department. The reserves request for balancing the budget at mid-year does not take into consideration all of these projected savings. Also, it is our understanding that the request does not take into consideration the current projection of excess revenue totaling $1.2 million, nor does it appear to include the proposed repayments to the Development Services Enterprise Fund and the Recycling and Refuse Disposal Funds of $1.3 million, for disaster-related expenses.

If all of these items are considered as offsets to the projected deficits, the reserves request would be reduced to $3.4 million, as indicated in the chart.

Possible Alternative Appropriation Adjustment	
(in millions)	
Total Departments Projecting a Deficit	
Departments identified for Adjustment	($17.3)
Other Departments not identified for Adjustment	($1.1)
Transfer identified to reimburse NGF	($1.3)
Revenue previously appropriated for ESD (January)	$3.0
Total Departments projecting a Surplus	$6.4
Projected overbudget revenue	$1.3
Revenue adjustment requested	$5.6
Net Adjustment	**($3.4)**

For all of the reasons discussed above, we recommend no action at this time on the requested budget adjustments. We further recommend an updated Mid-Year Review based on seven periods be provided to the full Council in late February or early March and that necessary actions be taken at that time.

General Fund Expenditures

The following chart combines the actual prior year expenditure activity, along with the FY 2008 Revised Budget, the FY 2008 Actual Expended and Encumbered (to date), and the FY 2008 Year-End Projections based on first quarter data and the Mid-Year Report. By consolidating this information, one can easily compare changes over last year.

GENERAL FUND EXPENDITURE STATUS AS OF NOVEMBER 16, 2007

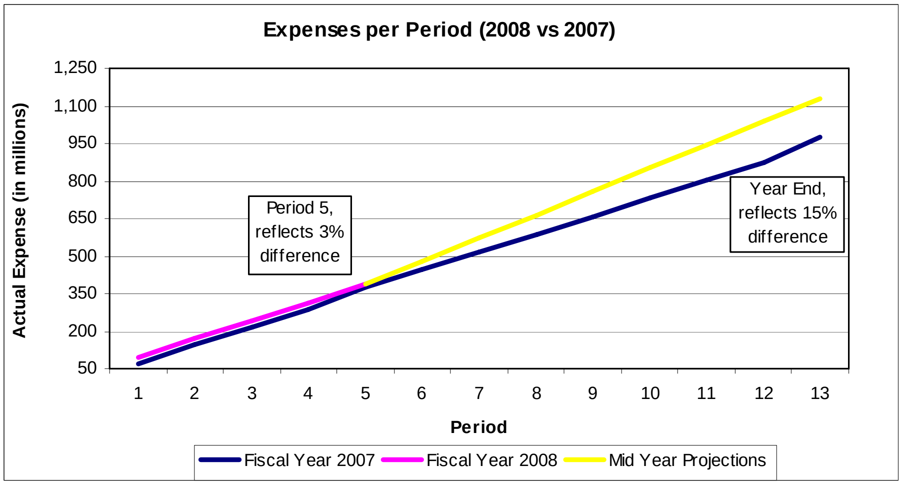
FY 2008 Mid-Year Report (Period 5; 38% of year)

Account Group	FY 2007 Actual Expenditures	FY 2008 Revised Budget	Actual Y-T-D Expended Plus Encumbrances	% of Budget Expended	FY 2008 Year-End Projection (First Quarter)	FY 2008 Year-End Projection (Mid-Year)	Surplus/ (Deficit)
Salaries	$ 461,211,470	$ 499,191,888	$ 187,542,374	38%	$ 486,123,972	$ 495,430,521	$ 3,761,367
Fringe Benefits	254,201,849	271,645,420	100,396,468	37%	277,359,187	279,011,093	$ (7,365,673)
Supplies & Services	218,782,282	272,087,565	107,757,292	40%	258,398,978	280,890,429	$ (8,802,864)
Data Processing	33,103,746	37,074,493	10,627,409	29%	39,329,630	36,015,740	$ 1,058,753
Energy/Utilities	29,708,573	25,791,406	10,628,585	41%	26,303,701	26,165,555	$ (374,149)
Outlay	13,888,764	10,208,520	2,779,916	27%	10,388,546	10,406,215	$ (197,695)
TOTAL	$ 1,010,896,684	$ 1,115,999,292	$ 419,732,044	38%	$ 1,097,904,014	$ 1,127,919,553	$ (11,920,261)
			Add Reimbursements to Non-General Funds:			$ 1,129,225,253	$ (13,225,961)

**Source of FY 2007 Actual (Unaudited) data: City Comptroller's Year-End and Charter Section 39 Report for Period 13, Fiscal Year 2007*

***Totals may differ to Mid-Year Report due to rounding*

To date, the General Fund has expensed and encumbered $419.7 million. In comparison, $416.0 million had been expensed and/or encumbered for the same time period last year. Fiscal Year 2007 concluded the year with expenditures and encumbrances totaling $1,010.9 million. Although similar spending patterns have occurred to date, the Mid-Year Report is projecting a considerable increase over last year as shown in the chart to the right. The year-end projection for Fiscal Year 2008 is $1,127.9 million, reflecting a deficit of $13.2 million, approximately 1.2 percent of the revised budget. **The report should clearly state that although the anticipated net deficit is $13.2 million, per the Charter, saving in the salaries category may not be used to mitigate deficits in other expenditure categories.** Excluding the savings in salaries, the actual estimated deficit is $17.0 million.



SALARIES AND WAGES

The Mid-Year Report projects savings of $3.8 million in salaries and wages. It is our understanding that this projection includes disaster-related expenses. This is significantly less than the $13.1 million in projected savings estimated in the First Quarter Report. The projections have been corrected since previously stated in the First Quarter to include the anticipated 2% salary increase for sworn police personnel that was scheduled for December 29, 2007. The following departments are experiencing significant salary variances:

- Police Department is projecting a $2.4 million salary surplus
- General Services is estimating a total salary surplus of $1.3 million, which primarily includes savings due to vacancies in the Storm Water Pollution Prevention and Streets Divisions
- Fire Department is anticipating the most significant salary deficit of $1.6 million, primarily associated with the wildfires.

Although Fire Department is projecting a significant salary deficit, we do not believe an appropriation adjustment from the reserves should occur. As previously stated, the general fund is projecting a surplus in total for this category; if an increase to appropriations were to be made, the surplus would similarly increase. If needed, an adjustment from a department projecting salary savings (Police or General Services) could happen.

Also, throughout the report, salary savings attributed to vacancies is referenced. However, information on number of vacancies is not included in the report. **The IBA recommends that future monitoring reports include the number of vacancies per department.**

FRINGE BENEFITS

The two categories that are responsible for the General Fund's projected deficit are Fringe Benefits and Supplies and Services. The year-end projected deficit for Fringe Benefits is $7.4 million. **In our review of the First Quarter Report, the IBA questioned the projections for significant deficits and believed additional analysis was needed. Staff concurs with our comments and will be providing additional analysis including possible rate adjustments in the Year-End Report. Accordingly, the IBA is reluctant to include any appropriation adjustments for Fringe Benefits until this analysis is completed, and only after rate changes have been implemented.**

Also, the IBA believes it is important to identify the savings associated with health care reforms instituted in the Fiscal Year 2008 Budget. To date, no detailed information on savings-to-date has been provided.

SUPPLIES & 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 5 (or 38% of the year), the Storm Water Pollution Prevention Division expended $1.1 million and encumbered an additional $2.6 million (or 16.1%) of its total Fiscal Year 2008 budget. Additionally, the Division has expended 38.3% ($2.3 million) of the $6.1 million carried over from Fiscal Year 2007.

Year-end projections are estimated to reach $21.9 million. In order to fulfill those projections, Storm Water would have to spend an average of $2.3 million each period for the remainder of the Fiscal Year, which seems optimistic compared to expenditure trends to-date. In Fiscal Year 2007, Storm Water spent just 56.6% of its total budget. While the Division was able to encumber and carry over funds into this year, it is unlikely that they will be able to spend all current and prior year monies by year-end**. The IBA requests that additional information be provided specifically showing the amount of Storm Water funds to be expended, separate from amounts to be encumbered by year-end. Consideration should be given to the reallocation of funds not needed by year-end to other, more pressing needs, especially disaster-related expenses, given the pace of Division expenditures.**

City Planning and Community Investment Department (CPCI): CPCI is projecting a $1.1 million negative year-end expenditure variance. $500,000 of this deficit is related to expenditures for consultant fees for the Grantville Community Plan amendments, which has not yet been authorized by the City Council.

The Fiscal Year 2008 Budget includes $400,000 for the purpose of updating Community Plans, specifically for the communities of Uptown, Old San Diego, Greater North Park, and Greater Golden Hill. Additionally, on December 4, 2007 the City Council approved $800,000 from the General Fund Appropriated Reserve for the completion of the Otay Mesa Community Plan. With the $800,000 related to the Otay Mesa Community Plan and the $500,000 for the Grantville Community Plan proposed in the Mid-Year Report, a total of $1.3 million will be expended on community plans in Fiscal Year 2008 that were not included in the Fiscal Year 2008 Budget. The IBA recognizes that the updating of the community plans is vital and that the identification of funding of the City's community plan updates has been an ongoing challenge. A more comprehensive plan which prioritizes all of the community plans for funding should be developed and incorporated into the annual budget process.

The action to approve a consultant agreement for this purpose is forthcoming to the City Council. The IBA recommends that actions to appropriate funds from reserves be included at the time the consultant agreement comes forward to allow the City Council to concurrently evaluate the project and its funding.

The additional deficit to CPCI's budget is related to anticipated expenditures for the Small Business Enhancement program (SBEP). The Small Business Enhancement program was created in 1995 to provide continuing support to small businesses in the City. To fund the SBEP, the City Council at the time reduced business tax certificate fees for business with 12 or fewer employees. Revenue for this program is impacted on an annual basis by the number of small businesses obtaining or renewing their business licenses. The current allocation process for the funds is fifty-percent to the Citywide business assistance program and fifty-percent to the Business Improvement District programs.

The City Council took action in January 2007 to authorize the appropriation and expenditure of $688,000 in SBEP funds for purposes of funding an agreement with the Business Improvement District Council. It is unclear at this time if the actions already taken by the Council will address the projected deficit, or if additional budgetary actions are required. Historically, actions related to trueing up the SBEP funds have occurred during the Year-End Adjustments.

DISASTER ESTIMATES

The Mid-Year Report describes estimated expenditures totaling $50.5 million for both the wildfire and landslide disasters, with $7.6 million incurred through November 16, 2007. Unfortunately, the report is unclear as to the amount projected for expenditure prior to the end of the fiscal year, though it is assumed that departmental projections include these impacts. **Since disaster relief and recovery efforts will extend beyond the current fiscal year, the IBA recommends that additional detail be provided on the breakdown of estimated expenditures by fiscal year. The IBA requests that staff**

provide an additional report, prior to year-end that includes more detailed and updated information on the disasters. Relevant information that should be included: updated estimates by department; estimates by fiscal year; and historical data on past experience with the timing of disaster reimbursements.

It should be noted that Attachment II to the Mid-Year Report reflects General Fund Projected Expenditures by Department, and also includes a category entitled "Additional Wildfire Expenses" of repayment to non-General Fund departments with $500,000 to Development Services, and $805,700 to the Recycling and Refuse Disposal Funds, for total projected expenditures of $1,305,700. It is unclear if these amounts are included in the "Disaster Estimates" shown in Table 6, and it appears that no appropriation adjustments are being requested at this time to allow these reimbursements to take place. A description of these costs has not been provided, beyond the footnote on Attachment II, which states "Anticipated repayments to non-general funds for building permit, demolition permit, waste disposal, and recycling fee waivers." **To the extent these costs are for disaster-related expenses, appropriation adjustments should be requested to ensure these funds are reimbursed in a timely manner from the General Fund.**

Environmental Services Department **–** The Environmental Services Department (ESD) is projected to end the fiscal year with over-budget expenditures of approximately $6.9 million, related to the debris removal program resulting from the wildfires. Total debris removal expenses are estimated at $8.4 million; however, ESD estimates that $1.5 million can be absorbed within the existing budget, resulting in a $6.9 million liability. Of that amount, $5.8 million is expected to be funded through State reimbursements, leaving $1.1 million to be funded by the General Fund.

The City has already received a $3 million advance from the State, and City Council approved an appropriation increase in both revenues and expenditures for this amount on January 22, 2008. An additional $3.9 million in expenditures will need to be appropriated to allow ESD to complete debris removal. However, the recent Council action also authorized the Comptroller to appropriate and expend an additional $2.2 million if additional funds are advanced by the State. As such, it is our understanding that the request for appropriation of additional revenue from the State, should be in the amount of $600,000, reflecting the difference in the earlier estimate (approved by Council) of $2.2 million and the revised estimate (identified in the Mid-Year) of $2.8 million.

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, even in those categories that are expected to fall short of initial budget estimates, such as sales tax and franchise fees.

GENERAL FUND REVENUE STATUS AS OF NOVEMBER 16, 2007

FY 2008 Mid-Year Report (Period 5; 38% of year)

Revenue Category	FY 2007 Actual Receipts	FY 2008 Revised Budget	FY 2008 Year-End Projection (First Quarter)	FY 2008 Year-End Projection (Mid-Year)	Change from First Quarter	Mid-Year Surplus/ (Deficit)
Property Tax	$ 360,400,407	$ 385,688,853	$ 387,115,105	$ 391,805,306	$ 4,690,201	$ 6,116,453
Sales Tax	225,841,450	239,485,958	236,029,635	229,130,717	(6,898,918)	(10,355,241)
Transient Occupancy Tax	80,702,830	85,184,936	85,390,733	85,390,733	0	205,797
Franchises	64,633,832	69,431,697	68,644,666	68,544,095	(100,571)	(887,602)
Safety Sales Tax	7,940,313	8,401,528	8,054,401	8,014,079	(40,322)	(387,449)
Motor Vehicle License Fees	8,101,184	7,938,333	7,448,461	7,513,575	65,114	(424,758)
Property Transfer Tax	9,307,713	7,570,860	9,576,145	9,554,858	(21,287)	1,983,998
Other Revenue	*incl. below*	68,706,741	68,706,741	68,747,723	40,982	40,982
Departmental Revenues	296,306,098	233,922,046	229,983,695	238,890,082	8,906,387	4,968,036
TOTAL	**$ 1,053,233,827**	**$ 1,106,330,952**	**$ 1,100,949,582**	**$ 1,107,591,168**	**$ 6,641,586**	**$ 1,260,216**

The most significant revenue changes from the First Quarter Report are the reductions to projected Sales Taxes of $6.9 million, and an estimated increase to Departmental Revenues of $8.9 million, with $6.5 million of this related to revenues expected to be received by the Environmental Services and Fire Departments for disaster-related expenses.

Sales Tax – Sales tax revenue is projected to end the fiscal year approximately $10.4 million under-budget. As indicated in the Mid-Year Report, this is largely due to weaker spending in the new vehicle, construction material and home remodeling sectors. Even further troubling is that the current projection does not include actual data on sales tax receipts over the holiday season, which will be received by the City in March. Early indications have been that holiday sales were weaker than in previous years. **We have the following questions regarding sales tax:**

- **What is year-to-date growth rate and how does this compare to the revised growth projection for the remainder of the fiscal year?**
- **What are the sales tax projections relative to budget in other California cities?**

Property Transfer Tax – Property transfer tax is projected to end the fiscal year at approximately $9.5 million, a growth of 2.6 percent over FY 2007 unaudited actuals. However, the FY 2008 budget assumed a 5% reduction, following an actual reduction of nearly 21% in FY 2007, causing the year-end projection to be over-budget by nearly $2 million. As housing prices and sales have continued to fall throughout the calendar year 2007, the cause of this rebound is unclear. We recommend further investigation to ensure that growth projections for the remainder of the fiscal year are consistent with the expected outlook. In addition, it may be interesting to see actual growth rates over last several years compared to the annual growth in home sales.

Franchise Fees – Franchise fees are projected to end the fiscal year approximately $900,000 under-budget, primarily due to lower than expected revenues from the Refuse Hauler Franchise Fee. **We request additional information on the cause of this projected revenue reduction.**

Booking Fees – The Mid-Year General Fund revenue projections continue to assume that the City will receive booking fee reimbursement from the State. The report indicates that the City is working with the County to resolve the booking fee issue, which was brought about by a change in State law that allows Counties to receive booking fee reimbursements directly from the State. As indicated in the report, negotiations with the County may result in a reduction of $5.2 million to both revenues and expenditures. **However, the IBA is growing increasingly concerned with the lack of resolution regarding this issue, and we request an update on the actual status of negotiations with the County.**

Departmental Revenues - Revenue in the Environmental Services Department (ESD) is projected to end the year at $6.5 million due to anticipated State funding for debris removal associated with the wildfires, totaling $5.8 million. As mentioned in the Disaster Estimates section, City Council has already approved a $3.0 million increase in General Fund appropriations for ESD, reflecting the initial advance of funds from the State. With that same action, the Council also authorized the Comptroller to appropriate and expend an additional $2.2 million should additional funds be received from the State. As such, it is our understanding that the only additional appropriation request for additional revenue from the state should reflect the difference in the earlier estimate (approved by Council) of $2.2 million and the revised estimate (identified in the Mid-Year) of $2.8 million.

<u>Non-General Fund Projections</u>

The IBA believes additional clarity should be provided on the status of the Non-General Funds. Although it is important to note how projections are aligning with budgeted figures, the IBA believes that it is more important that a fund be balanced by year-end. The Mid-Year briefly notes that some of the Non-General Funds will be in deficit at year-end; however, information on mitigation is not specific. Also, in some instances, fund balance is referenced, but no information on the amount available in fund balance is provided. The following chart depicts changes to the projected year-end balances of the Non-General Funds included in the Mid-Year Report.

Year End Status for Non-General Funds

Fund Name	Projected Revenues	Projected Expenditures	Surplus/ (Deficit)
Central Stores Internal Service Fund	$24,224,834	$24,420,144	($195,310)
Golf Course Enterprise Fund	$15,351,399	$13,102,360	$2,249,039
Information Technology Fund	$15,946,380	$14,634,499	$1,311,881
Library Grants Fund	$505,131	$607,395	($102,264)
Los Peñasquitos Canyon Preserve Fund	$203,598	$221,130	($17,532)
Commission for Arts and Culture	$152,036	$900,141	($748,105)
City Airport Fund	$5,114,951	$3,752,895	$1,362,056
Development Services Enterprise Fund	$47,728,468	$51,209,456	($3,480,988)
Facilities Financing Fund	$2,117,065	$2,329,164	($212,099)
Municipal Parking Garage Fund	$3,247,369	$2,107,856	$1,139,513
PETCO Park Fund	$16,489,161	$16,887,021	($397,860)
QUALCOMM Stadium Operating Fund	$16,440,461	$17,567,260	($1,126,799)
Redevelopment Fund	$3,454,193	$3,701,506	($247,313)
Solid Waste Local Enforcement Agency Fund	$725,219	$793,724	($68,505)
Risk Management Administration Fund	$9,026,825	$8,147,645	$879,180
Emergency Medical Services Fund	$6,911,100	$6,604,718	$306,382
Unlicensed Drive Vehicle Impount Fees Fund	$1,122,771	$1,310,598	($187,827)
E&CP Internal Service Fund	$23,555,897	$24,242,630	($686,733)
Energy Conservation Program Fund	$2,450,420	$2,121,234	$329,186
Equipment Internal Service Fund	$49,820,560	$49,499,621	$320,939
Publishing Services Internal Service Fund	$5,210,218	$5,300,295	($90,077)
Recycling Fund	$21,507,882	$21,663,845	($155,963)
Refuse Disposal Fund	$36,476,362	$33,144,149	$3,332,213
Sewer Funds	$373,137,081	$390,928,584	($17,791,503)
Utilities Undergrounding Program Fund	$2,013,923	$1,455,003	$558,920
Water Department Fund	$426,056,849	$406,340,011	$19,716,838

It is not uncommon for a fund to have a surplus at year-end; however, it is the general practice that only enough revenue be collected to support the fund. An exception to this practice could be the build up of fund balance to support a planned, multi-year capital improvements program.

The IBA is concerned about the stated use of fund balance when no information on these balances is included. For instance, in Fiscal Year 2007, the Development Services Fund had to take drastic measures, including reduction-in-force, and ended the year with a positive balance. Currently, the fund is projecting a $3.5 million deficit by year-end.

The IBA recommends that the status of fund balance be provided. If sufficient fund balance is not available, how will these deficits be mitigated?

PETCO Park Fund – The PETCO Park Fund began FY 2008 with a fund balance of approximately $2.6 million. Expenditures were budgeted in excess of revenues by nearly $1.8 million, anticipating a commensurate draw down in the fund balance. Currently, expenditures are projected to end the fiscal year just $398,000 greater than revenues. The Mid-Year Report indicates that this is due to prior year appropriations that are not planned to be spent. It is possible that this could result in excess funding in the PETCO Park Fund, which could be transferred back to the General Fund.

QUALCOMM Stadium Operating Fund – The QUALCOMM Stadium Fund began FY 2008 with a fund balance of $2.4 million. Expenditures were budgeted in excess of revenues by approximately $2.3 million, anticipating a proportionate draw down in the fund balance. The Mid-Year Report projects year-end expenditures in the QUALCOMM Stadium Fund to exceed revenues by just $1.1 million due to reduced personnel expenditures and projected over-budget expenditures. It is possible that this could result in excess funding in the QUALCOMM Stadium Fund, which could be transferred back to the General Fund.

Water and Sewer Funds – The Mid-Year Report projects the Water and Sewer Funds to end the fiscal year significant under-budgeted expenditures due to the timing of capital improvement projects. The Report indicates that for both the Water and Sewer Department, capital improvement projects budgeted in FY 2008 will not be fully expended by year-end. The Mid-Year Report projects under-budget expenditures in the Sewer Funds of approximately $148.1 million, $116.5 million of which is due to delayed CIP expenditures. The Water Fund is projecting under-budget expenditures of approximately $197.5 million, the majority of which is due to delayed CIP expenditures. The reasons for the projected delay in CIP expenditures in unclear.

The IBA requests the following information from both the Water and Sewer Department:

1) **List of specific CIP projects for which the FY 2008 Budget will not be fully expended**
2) **Impact on the City's ability to comply with the DPH Compliance Order (Water) or the Final Consent Decree (Sewer) as a result of the delayed CIP expenditures**

Requests for Appropriation Adjustments

Based on our review, the IBA questions the appropriateness and/or timing of the following appropriation adjustments:

- Appropriation Adjustments already previously approved (or upcoming): This includes the $2.2 million of the proposed $2.8 million revenue adjustment for Environmental Services previously approved by Council on January 22, 2008; the appropriation adjustments totaling $90,000 for Council Administration and the IBA, which was approved January 8, 2008; and the upcoming City Planning and Community Investment action for $500,000.

- Appropriation Adjustments for projected salary and wages deficits: First, a department's appropriations should not be adjusted based on net deficits. Salary and Wages should be excluded from this calculation, since per the Charter, these savings are not allowed to cover deficits in other expenditure categories. For instance, the proposed appropriation adjustment of $1.5 million for Police Department includes projected salary savings of $2.4 million. Secondly, transfers of appropriations between departments may be more appropriate given that as a whole, the General Fund is anticipating a salary savings of $3.8 million.

- Appropriation Adjustments for projected fringe benefit deficits: The Mid-Year Report identifies a structural under-budgeting of the fringe accounts and states that adjustments may be requested in the Year-End Report, once the effects of the fringe expense rate adjustment discussed are determined. However, based on our calculations, both the appropriation adjustments for Police and Fire-Rescue will provide funding for fringe accounts. The IBA believes that adjustments impacting fringe should be postponed pending the completion of any possible rate adjustments.

- Appropriation Adjustments for disaster-related expenses: As we noted previously in our report, the IBA recommends additional information be provided prior to the approval of any proposed disaster-related appropriation adjustments. Detailed information should be provided, by department, on amounts projected for this fiscal year by expenditure category.

Attachment 2 of this report details General Fund departmental budgets and year-end projections by expenditure category.

Other Areas of Concern

In this section, the IBA includes areas of discussion that have previously been raised 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, however no information to date has been provided.

- The IBA requests 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.

- In regard to **benefits in excess of IRS 415b limits**, what is the status of payments made-to-date and projections for the remainder of the year?

- The City Council adopted the City Reserve Policy in November 2007. With its approval, an appropriated reserve of $7 million was established. During the development of the policy, the City Attorney opined that **a separate fund should be established to comply with Charter Section 91**, which calls for a General Reserve Fund to meet cash obligations to be used only in the event of an emergency. The City Reserve Policy described that a separate fund would be established and funded for this purpose, but it appears that a new fund has not yet been created. Additional action may be needed by the City Council to authorize the creation of a new fund. Separately, clarifying language is needed in the Appropriation Ordinance to allow for the expenditure of funds from the appropriated reserve by resolution of the City Council. Without this clarification, the Appropriation Ordinance would need an amendment, and two public hearings, to allow for use of the reserve, which was not the intention when the policy was developed. The IBA recommends that any Council actions needed to fully implement the Reserve Policy be brought forward with the Mid-Year Budget Adjustments, if possible.

CONCLUSION

The IBA reviewed the Mid-Year Report, comparing information to the Auditor's recent Monthly Financial Report, and also reviewed issues that were identified during the development of the budget, and at the time of the First Quarter Monitoring Report. In our report, we have raised a number of issues and requested additional technical information.

In summary, this report offers supplementary information to explain departmental projections, and recommends holding off on requested budgetary adjustments, including any action with respect to the reserves at this point in time. We further suggest an updated mid-year review based on seven periods of actual data be provided to the full Council by the end of February or early March, and necessary actions be taken at that time.

While we are supportive of balancing departmental budgets impacted by costs related to the wildfires (Police, Fire, and Environmental Services), we were not able to clearly identify these impacts for this fiscal year in the Mid-Year Report.

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Attachments:
1. Projected Surplus/(Deficit) by Department
2. Summary of Projections vs Budget by Expenditure Category