

CITY OF OAKLAND
COUNCIL AGENDA REPORT

FILED
OFFICE OF THE CITY CLERK
OAKLAND

2004 MAY 26 AM 10: 05

TO: Office of the City Administrator
FROM: Budget Office
DATE: June 8, 2004

RE: Informational Report from the Budget Advisory Committee on Calendar Year 2004 First Quarter Activities

SUMMARY

This document transmits a report from the Budget Advisory Committee (BAC), for activities during the first quarter of Calendar Year 2004 (Jan 1 – March 31, 2004). BAC Chairperson Benjamin Fay is available to answer questions and/or provide additional information.

FISCAL IMPACT

This is an informational report and, therefore, contains no fiscal impacts.

BACKGROUND

On March 2, 1999 the Oakland City Council approved Resolution No # 74826 establishing the Budget Advisory Committee (BAC). This action combined the City Council's previously created Citizen's Budget Advisory Committee with the Business Budget Advisory Committee for the purpose of advising the City Council regarding the City's two-year policy budgets.

The BAC consists of 15 members, with four appointed by the Mayor, seven appointed by Councilmembers for each of the seven Districts, one by the Community and Economic Development Committee Chairperson, two by the Finance and Management Committee Chairperson, and one by the At-Large Councilmember. Meetings are held the third Monday of every month, with staff support provided by the Budget Office.

Finance & Management Committee

June 8, 2004

Item: 9

STATUS REPORTBAC Vacancies

The BAC currently has only one vacancy in the Mayor's office. A new member was appointed on May 18, 2004, to fill the District 5 vacancy.

BAC Activities

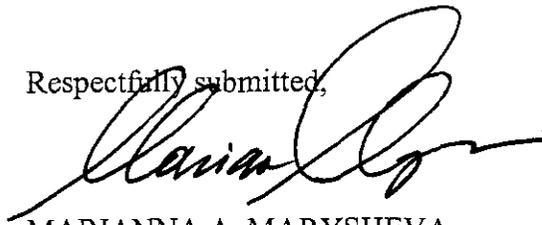
BAC members have been meeting with City associates and evaluating the City's contract process and how it can be improved to generate additional revenue. In addition, members have formed subcommittees to: 1) develop recommendations to address the problem of departmental overspending, and 2) review non-City funded (and yet City-related) contracts.

The Quarterly Report of the Budget Advisory Committee is attached here for your review. BAC Chairperson Benjamin Fay is available to answer questions and/or provide additional information.

RECOMMENDATION

Staff recommends acceptance of this report.

Respectfully submitted,



MARIANNA A. MARYSHEVA
Budget Director

Prepared by:
Scarlet Ku
Principal Financial Analyst, Budget Office and
Staff to the Budget Advisory Committee

Approved for forwarding to
Finance & Management Committee


OFFICE OF THE CITY ADMINISTRATOR

Attachment: Quarterly Report from the BAC

9
FINANCE & MANAGEMENT CMTE.

JUN 8 2004

Budget Advisory Committee Report for the First Quarter of the 2004 Calendar Year

May 17, 2004

The Budget Advisory Committee (BAC) hereby submits this report for the first quarter of the 2004 Calendar year. This report consists of two parts: first a recommendation on measures that can be taken to address the chronic problem of departmental overspending, and second a report on the status of our current and future projects.

Recommendations Regarding Departmental Overspending

Setting the budget is one of the most important duties and powers of the City Council. When departments do not stay within their budgets, they force a rebalancing of the budget and a reallocation of City resources outside of the City Council's budgeting process. In May of 2003, the BAC prepared a report on precisely this problem. (For ease of reference, a copy of the BAC's May 29, 2003 report is attached to this report.) Our report was instigated by the problems caused by the Police Department exceeding its budget by over \$13 million. We found that the problem had been existing for some time, but had been masked by increases in revenues that were used to pay for the excesses.

Unfortunately, this problem persists. At the end of the second quarter of the current fiscal year, the Police Department was on track to be 6% (\$9.1 million) over budget, the City Auditor was on track to be 14% (\$140,000) over budget, Cultural Arts & Marketing was on track to be 7% (\$550,000) over budget, and the Museum was on track to be 12% (\$680,000) over budget. Some of these overages, if they continue, will ultimately be more significant to the overall budget than others. If the Police Department continues on this track and ends the fiscal year 6% over budget, this will result in an overage of \$9.1 million, while if the auditor continues on this track and ends the fiscal year 14% over budget, the overage will be only \$140,000. Nevertheless, both overages would represent budgeting outside the budget process.

To address this problem, the BAC makes the following recommendations, which could help to keep the budget decision making within the City Council:

1. Every quarter each department's budget should be reviewed to determine whether it is on track to be on budget. If the review reveals that a department is on track to be either \$500,000 or 5% over budget for the year, then the department head must appear before the City Council to explain why the department is over budget. This should be integrated with the quarterly revenue and expenditure report.
2. Budgeting subcategories within departmental budgets should also be checked. Some departments may reallocate resources within the department, disregarding programs that the City Council wants funded. One category that often goes over budget, to the detriment of other programs, is personnel. We therefore recommend that personnel costs, including overtime, be specifically checked every quarter and reported in the quarterly

revenue and expenditure report. If expenditures are on track to be either \$500,000 or 5% over budget for the year, then the department head must appear before the City Council to explain why the department's personnel budget is over. For example, as of the end of the second quarter of the current fiscal year, the Police Department's budget for overtime was 12.5% over, which if it continued would yield an overage of \$2.5 million. For the Fire Department, although their overall spending was only 0.1% over budget, their budget for overtime was 22% over budget, which if it continued would yield an overage of \$4 million. (Unfortunately, we do not have numbers for the entire personnel budgets of the police and fire departments, and therefore cannot put the overtime in that context.) In line with the move to a programmatic budget, the Council should consider applying this triggering mechanism to some or all of the programs in a department's budget.

3. In order to prevent unanticipated increases in revenues from masking the failure of departments to stay within their budgets, increased revenues should not be automatically applied to budget overages. When there is an increase in revenues, the matter should be brought to the Council, and the Council should decide where the increased revenues should be spent.
4. When there is a revenue shortfall, the Council should be alerted as soon as possible, so it can consider where to reduce spending.
5. Department budget performance should be an important factor when determining the compensation of senior department managers.
6. The subcommittee also recommends that one-time increases in revenues only be spent on one-time projects, and not be tied to long-term costs such as increased programs, increased employee benefits, or more employees.

Current and Future Projects

The BAC is currently completing an extensive review of the City's contracting process. We have looked at the process for awarding contracts to purchase goods and services as well as less standard contracts, such as those for the use of City facilities, or to provide a service in conjunction with the City. We expect to have our findings and recommendations completed and a report prepared in the next couple of months.

We will then be reviewing our options for our next project. Suggestions are always welcome.

CITY OF OAKLAND
COUNCIL AGENDA REPORT

TO: Office of the City Manager
ATTN: Robert C. Bobb
FROM: Budget Office
DATE: May 29, 2003
RE: Report from the Budget Advisory Committee on its Analysis of General Purpose Fund Personnel Services Appropriation and Expenditure Trends

SUMMARY

Attached please find a special report from the Budget Advisory Committee (BAC) detailing its analysis of the General Purpose Fund Personnel Services Appropriation and Expenditure Trends. BAC Chairperson Adelle Foley is available to answer questions and/or provide additional information.

FISCAL IMPACT

This is an informational report and, therefore, contains no fiscal impacts.

BACKGROUND

In March 2003, the Budget Advisory Committee decided to undertake a short-term project analyzing trends in personnel services expenditures within the General Purpose Fund (GPF) over the last several years. Staff provided the Committee with the personnel services budget and unaudited actual expenditures data for the GPF from FY 1999-2000 to FY 2002-03 (actuals through February 2003).

KEY ISSUES AND IMPACTS

Over the last several weeks, the Budget Advisory Committee has put its energies toward understanding historical expenditure overruns in the General Purpose Fund (GPF). The group has embarked on a trend analysis of GPF personnel services appropriations and expenditures to identify factors causing overspending. The BAC's intention is that this report could inform the Council in its deliberations over the FY 2003-05 Proposed Policy Budget. The special report entitled "Expenditure Discipline in Oakland" is attached here for review. BAC Chairperson Adelle Foley is available to answer questions and/or provide additional information.

~~Item # _____
Special Session of the City Council
May 29, 2003~~

SUSTAINABLE OPPORTUNITIES

None.

DISABILITY AND SENIOR CITIZEN ACCESS

None.

RECOMMENDATION

Staff recommends acceptance of this report.

Respectfully submitted,

MARIANNA A. MARYSHEVA
Acting Budget Director

Prepared by:
Cheryl L. Taylor
Budget and Operations Analyst III
City Manager's Budget Office

Approved for forwarding to
Special Session of the City Council

OFFICE OF THE CITY MANAGER

Expenditure Discipline in Oakland

Prepared by the Oakland Budget Advisory Committee

May 29, 2003

“This is a plan for hard times that requires tough choices” reads the headline regarding the FY 2003-05 Proposed Policy Budget. Statements similar to these had one to believe that a loss of revenue due to the ailing economy is what has caused the recent and proposed cuts in services. In fact, in most budget communications, the focus has been on revenue shortfalls. However, upon closer examination, the surprising reality is that expenditure overruns and structural cost increases are a much larger issue than revenue shortfalls. This examination of General Purpose Fund (GPF) expenditures in the FY 2001-03 City of Oakland budget by the Oakland Budget Advisory Committee (BAC), a city-appointed citizen advisory group, analyzes how trends from this period carry over into the proposed two year budget set to start on July 1, 2003. This evaluation examines both revenue appropriations -- where funds come from -- and expenditure appropriations -- where they are spent. This document does not yet represent our complete review and analysis of the FY 2003-05 Proposed Policy Budget -- a large and complex document we received quite recently. However, we hope that our observations and recommendations will help prevent future budget crises.

Budget gaps have happened frequently throughout the City of Oakland's history, but have been absorbed by surpluses in recent years.

The City of Oakland has frequently overspent its GPF budget. In the past, however, the GPF had enough revenues to make up for these over-expenditures. The result has been lax spending discipline since overspending would always be covered. Recently, there have been two major adjustments to the budget in response to projected gaps between expenditures and revenues for the fiscal year ending June 30, 2003. The first was termed a mid-cycle adjustment in May-June of 2002; the second took place in January-February of 2003. We will examine these more closely. Our analysis will focus on the General Purpose Fund.

In FY 2002-03, budget gaps were almost entirely caused by excess expenditures, not revenue shortfalls

A simple analysis of the numbers shows that these two budget “gaps” were almost entirely the result of expenditure overruns, not shortfalls in revenue. Figure 1 clearly shows this for the May-June 2002 mid-cycle adjustment and the Jan-Feb 2003 budget adjustment.

The mid-cycle May-June 2002 adjustment, addressed a gap of slightly over \$28 million. According to city records, of this \$28 million, only \$1.3 million was due to revenue shortfalls while \$27.1 million was due to an expense overrun. This expense overrun was largely due to retirement increases (as a result of transferring public safety employees from the closed retirement system to the CalPERS system) and set-asides for civilian union contracts (a result of anticipated union benefit negotiations).

A second major adjustment was undertaken in Jan-Feb 2003. In this case as well, cost overruns of \$17.1 million far exceeded revenue shortfalls of \$2.8 million, and the overruns were also primarily personnel costs, in particular, overtime overruns. Both the Police and Fire Departments experienced significant overtime expenditure overruns. Although controls on spending may affect the final outcomes, both overruns are substantial, around 100 percent of the initially authorized amounts for overtime. **[It is important to note that, in the case of the fire department, the overtime costs have been offset by underspending within the department.]** In past years, there was considerable underspending on salaries (which is normally used to offset overtime spending, both in Police and Fire), as well as supplies and construction. After some evaluation by the BAC, it is not clear what impact this may have had to other public safety spending requirements within the Fire Department GPF budget this year. In the case of the Police Department, the overall expenditure projections affected many programs citywide during the January-February adjustment. It is important to note that our research shows that these are not one-time occurrences. Rather, similar overtime overruns for both departments, have *consistently* occurred for many years extending well before any impact from the September 11th terrorist attacks. It would appear that a robust economy allowed past cost overruns to be absorbed by excess revenue.

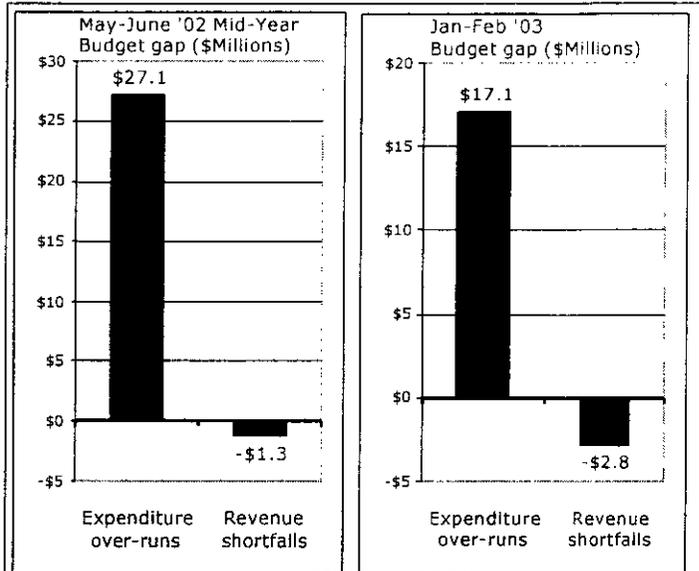


Figure 1: Comparison of the magnitude of expenditure overruns vs. revenue shortfalls in May-June 2002 and January 2003.

In January, the impact of a \$13.6 million projected over-expenditure by one department, forced a reduction in services in other important city programs such as, Parks and Recreation, Libraries, Community and Economic Development.

This projected cost overrun was brought forward through the budget adjustment process. The imperative of a balanced budget left the City Council little choice but to reallocate spending in a way other than originally approved by the elected City Council. Without expressing an opinion whether baseline Police overtime should be higher or lower, it is clear that these variances between what was authorized by Council and what was expended by the Police Department have been disruptive to other city services. Figure 2 graphically illustrates how the projected over-expenditure in the Police Department causes budget and service reductions in other departments. This is not how the City Council originally allocated resources among departments.

In Figure 2, the right-hand bars represent the projected overruns in January 2003. The left-hand bars reflect the actual adjustments bringing the budget back into balance. To provide a sense of scale, the *largest* cuts that were considered for Library -- around \$2 million -- are dwarfed by the size of the projected Police Department overruns of more than \$13 million. (In fact, the entire Library budget of about \$10 million is less than the projected Police over-expenditure.) Most departments shown below net out close to zero. The major exception is the Police Department, which nets to a \$7 million (5 percent) increase. We find relatively large reductions in Information Technology (-14 percent), Crafts and Cultural Arts (-13 percent) and Library Services (-7.5 percent).

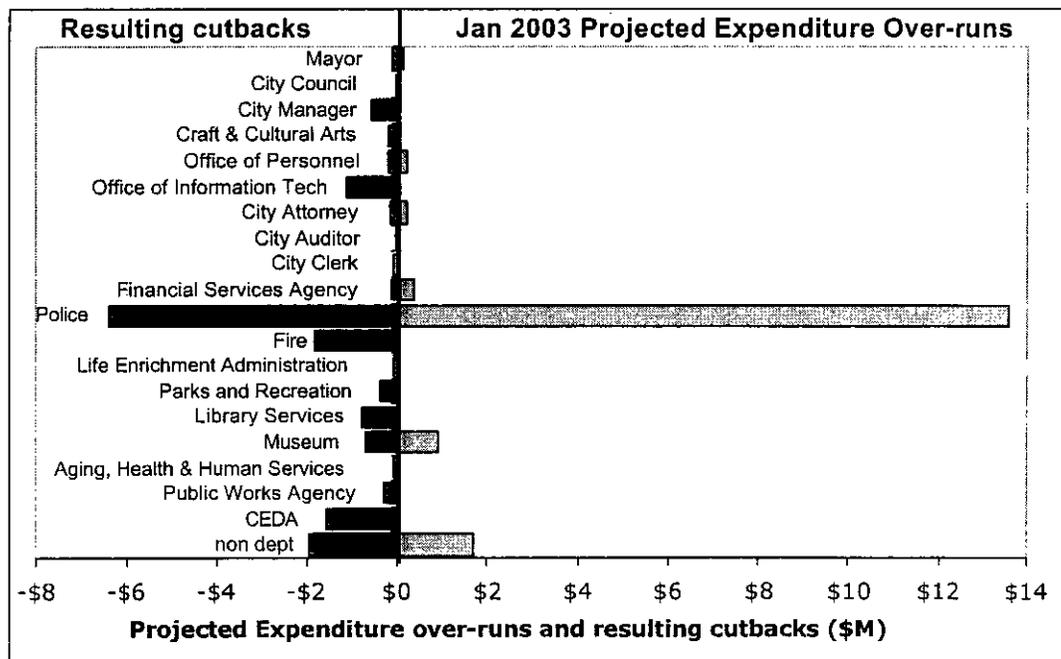


Figure 2: The bars pointing to the left are the resulting departmental cutbacks required to balance the projected expenditure over-runs shown pointing to the right. One can clearly see how some departments,

which had no projected over-runs, were cut back to compensate for the departments which did have over-runs.

Aside from the quality-of-life implications and looking only within the realm of public safety, the projected over-run has severely limited Council's latitude to fully consider options such as after-school programs and other important public safety programs, which may help in the long run to reduce crime in the first place.

Over-expenditures are caused primarily by increases in personnel costs.

Looking at the last full year of data, in FY 2001-02 personnel expenditures were about 8 percent over-expended in the (GPF). Projected expenditure over-runs in the FY 2002-03 budget were also caused by personnel expenses. Two main causes of increased personnel costs are as follows:

-Negotiated union wages and benefits

The full cost of personnel benefit increases, as important as they may be, are not being quantified. The fiscal impact of benefit increases are not fully disclosed to the City Council and considered in budget planning until after they are agreed to. By the time the labor cost increase was brought forward through the budget adjustment process to City Council and the public for consideration, it was already finalized. Regardless of the cost, the terms were already agreed to. The only option available to the City Council at that point was to cut services and enact revenue enhancements to offset the increase. This caused a major re-allocation in the goals and priorities initially set forth by the City Council.

-Departments overspending their budgets

Even after personnel benefits were increased by the union agreement, departments, especially Police, overspent their increased budgets. Although the City Manager's Budget Office has established a quarterly cycle of revenue and expense reporting, it is not clear this process has been regularly and rigorously adhered to, or that it has been effective. The BAC has had difficulty locating timely quarterly reports; nor do they appear easily available or in active use for discussion between Council and staff. At the departmental level, tracking and controlling expenditures requires tools that are accessible, staff who are trained to use them, and an across-the-board organizational commitment to using them.

In addition to overspending, discussions with different department representatives indicate that some did, not initially represent their full requirements to cover their costs in their budget submissions. For example, certain types of Police salary incentive "bump ups" were not fully quantified in the funding request. Months later, the reality of the departmental expenditures contributed to a budget gap and hasty reallocation of funds and cuts in services.

Again, in the FY 2003-05 Proposed Policy Budget, increases in appropriations are at least as important as revenue shortfalls

Despite the service and personnel cuts in the FY 2003-05 Proposed Policy Budget, overall spending in the first year is actually higher than the FY2002-03 budget adopted at mid-

cycle. The Proposed FY 2003-05 Budget includes the same union agreement increase, which contributed to the mid-cycle budget adjustment of May-June 2002. It now appears as a \$28 million baseline cost increase for salaries and benefits (including retirement), forcing reductions in programs as it did in FY 2002-03. In addition, Police overtime authorization is increased by \$5 million over the previous budget. A realistic overtime plan is an important step in the right direction, but the rising personnel costs are an ongoing, significant use of scarce funding.

On the revenue side, much attention has been placed on the loss of the Vehicle License Fee (VLF) backfill funding from the State. This clearly is an important issue. However the estimated loss of \$8.5 million is dwarfed by the increase in the two line items above totaling about \$33 million. An \$8.5 million loss in the VLF backfill by itself would have resulted in about a 1 percent shortfall of the total all funds budget, which would not have had the impact seen over the past several months and which is now being proposed. In addition, the \$8.5 million shortfall is mostly offset by \$7 million in proposed increases in fees and fines.

While directing blame on external factors is understandable, focusing attention on the national economy, which the City of Oakland has almost no control over, and on the reduction in the VLF backfill which Oakland may have only partial influence, may be distracting attention away from controlling costs which could be under the City's control given sufficient focus.

A closer look at the revenue budget also raises some concerns as well. To the extent there are revenue shortfalls that are due to short term economic cycles, the City needs to clarify whether the proposed changes are short-term or not. This applies to revenue enhancements proposed to take effect at the start of the FY 2003-05 budget cycle as well as new non-GPF assessment districts proposed to start in the second year. If these new revenue measures are permanent changes to the revenue structure, then when the economy recovers, the result will again be increasing expenditures. Thus, while Council has little choice but to adopt whatever revenue enhancements it can in this short-run, as the economy hopefully moves into recovery, attention needs to be focused on how to build in a business cycle contingency fund to handle temporary business cycle slow downs. Though it seems hard now to treat this as a priority, there is no better time to commit to this course, since the need will easily be forgotten as the economy recovers, and will not become apparent until the next downturn when it will again be too late.

Recommendations

- 1) Departments need effective and timely tools with which to monitor their spending. Equally important, they need trained staff and regular attention to the reports at all levels of management. In the past, budget surpluses made close and timely scrutiny of spending rates less crucial.
- 2) Increased emphasis needs to be placed on the quarterly reconciliation of authorizations, revenues and expenses. This will encourage ongoing timely reconciliation and corrective action. In a way similar to how private sector quarterly earnings reports create pervasive incentives for managers throughout the organization to find ways to contribute to the bottom line, this *could* even be used to encourage an organizational culture of ongoing departmentally initiated productivity enhancements, rather than top down cuts later on.

- 3) The costs of benefit and salary negotiations must be provided for more adequately in future budgets and the impact of MOUs must be clear and explicit. These increases in personnel costs affect both discretionary and non-discretionary spending.
- 4) The departments must request realistic funding, with the assumptions clearly stated, so their budgets are realistic. Additionally, budgets should be structured to build in contingency for a certain number of emergencies or exceptional events during the budget cycle such as the riots after the Superbowl, or protests, making clear the extent to which authorized overtime is to be spent for ongoing operations or held in contingency for exceptional events. Underestimating expected costs will only create problems in the future when a particular department overspends its budget. Again, proper use of accounting tools can help.
- 5) The budget proposal should cite specific authorized and funded staffing levels for uniformed Police and Fire personnel, balancing the cost of negotiated benefits increases with the staffing levels needed to maintain public safety. To the extent overtime is being used to support ongoing functions, it needs to be evaluated along with funded staffing levels. The proposal should also make clear the extent to which authorized overtime is to be spent for ongoing operations or held in contingency for exceptional events.
- 6) Attention needs to be focused on how to build in a business cycle contingency fund to handle temporary business cycle slow downs.
- 7) The proposals to initiate new assessment districts to create new revenues—whether GPF or non-GPF--should include clear and transparent accounting to ensure accountability as to the sources and uses of funds.

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FINANCE & MANAGEMENT CMTE.

JUN 8 2004