THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

Date Issued: September 9, 2010 **IBA Report Number:** 10-69

Budget and Finance Committee Meeting Date: September 15, 2010

Item Number: 4a

Proposed Changes to Budget Policy Regarding Budget Monitoring Process

OVERVIEW

At the City Council meeting of June 14, 2010, the City Council adopted the Fiscal Year 2011 Budget, and directed that the City's Budget Policy be amended to incorporate changes to the Budget Monitoring process, as recommended by the IBA. These changes were prompted by the delayed recommendations provided to the City Council to address the FY 2010 General Fund budgetary shortfall, which negatively impacted the City Council's ability to make final decisions necessary to adopt the FY 2011 budget in time to meet Charter-required deadlines.

This report presents proposed changes to the Budget Policy to incorporate timing improvements to the Budget Monitoring process to prevent these complications from being repeated.

FISCAL/POLICY DISCUSSION

IBA Previous Suggestions

The IBA previously suggested improvements to the Budget Monitoring process, which were adopted by the Council in June 2010, as follows:

1. When a year-end deficit is projected in the Mid-Year Monitoring Report, action should be taken immediately to correct the budget through mid-year budget adjustments;

2. When a year-end deficit is still projected in the Year-End Report, solutions eliminating it should be proposed immediately, and Council should be given sufficient opportunity to provide input on proposed solutions;
3. The Year-End Report (including recommendations for eliminating any projected current year deficit) should be provided to the Council in advance of or on the same day as the

Council's first scheduled meeting on budget deliberations/decisions on the upcoming fiscal year budget.

Since that time, the IBA discussed the proposed changes to the Budget Policy with the Chief Operating Officer and the Chief Financial Officer. Of the three changes, the requirement to immediately correct projected deficits at the time of the Mid-Year Monitoring Report appeared to cause the greatest concern.

It was discussed that, at the time of the Mid-Year Report, revenue and expenditure projections are still subject to significant change prior to the end of the fiscal year, and premature efforts to mitigate a projected shortfall at that time could cause more harm than good, potentially hampering or causing the discontinuation of certain city services or programs unnecessarily.

Because of this, the IBA has revised the suggestions, eliminating the first proposed change, while continuing to recommend changes 2 and 3, which require that solutions to a year-end deficit be provided in the Year-End Report, and ensuring that the solutions are provided in a timely manner, prior to final Council decisions on the upcoming fiscal year budget. These changes specifically address the timing problems that were recently encountered, which complicated balancing the current budget, while adopting a new budget for the next year.

IBA Recommended Language Changes to Budget Policy

The specific language changes to the relevant Budget Policy sections to incorporate these recommendations are provided below. Additions are shown in bold, with double-underline. These changes have been reviewed and agreed to by the COO, the CFO and Financial Management staff. A complete version of the Budget Policy is provided as an attachment to this report, and also reflects strikeout/underline changes.

> BUDGET DEFICITS: (page 6)
> Unanticipated decreases in revenue and/or increases in expenditures may result in budget shortfalls. As such, revenue and expenditure projections shall be conducted throughout the fiscal year in order to identify any potential deficits that may require mitigation efforts authorized by City Council. Should revenues decline and/or expenditures increase, alternative funding sources, budget reductions, or reallocations of funds among departments shall be identified to support the ongoing activities of the City. **The Financial Management Department's quarterly budget monitoring process is the process by which potential deficits and surpluses will be identified. Mitigation steps will be recommended to City Council as determined necessary to offset unanticipated expenditures or revenue shortfalls. When a deficit is projected in the Year-End Budget Monitoring Report, the report will include recommendations for addressing the projected shortfall for Council consideration. The Year-End Budget Monitoring Report will be released to the Council in late May in order to incorporate nine months of actual results in the analysis. The Year-End Budget Monitoring Report will be released in advance and presented to the Council in advance of or on the same day as the Council's first public hearing on**

final budget decisions for the upcoming fiscal year. This will allow the Council to have a complete picture of the City's budget for the current fiscal year prior to making final decisions on the budget for the upcoming fiscal year.

Financial Reporting and Monitoring (page 9)
The Chief Financial Officer (CFO) is responsible for oversight of the City's comptroller, financial management, treasury, risk management, and debt management functions. On a monthly basis, the City Comptroller shall submit to the Mayor and to the City Council a summary statement of revenues and expenses for the preceding accounting period and the status of appropriations in comparison to actuals, in order to detail the financial condition of the City as mandated by the City Charter Sections 39 and 89.

The Financial Management Department oversees the City's budget and executes its budget monitoring responsibilities through the analysis of expenditures and revenues for operating funds included in the annual AO. This analysis may identify significant variances between budgeted and projected amounts and provide relevant information to maintain budgetary control and balance. Departmental expenditure activity shall be monitored at least quarterly and presented to the Budget and Finance Committee at least three times a year. The Independent Budget Analyst shall review these quarterly reports and may provide recommendations for City Council consideration.

The Financial Management Department shall prepare quarterly reports that include forecasts of annual revenues and expenditures based on actual results and knowledge of spending trends and operations. These reports shall explain significant revenue and expenditure variances and indicate trends that may require remediation, such as budget reductions, a reallocation of funds between departments, or the appropriation of new revenues. If departments are projected to overspend, Financial Management, in conjunction with the departments, shall develop remediation plans to reduce expenditures, including the deferral of hiring and major expenses for goods and services prior to recommending the use of reserves. **When the Year-End Budget Monitoring Report projects a deficit in the current year, the report will include recommendations for remedying the shortfall for Council consideration. The Year-End Budget Monitoring Report will be released in advance and presented to the City Council in advance of or on the same day as the Council's first public hearing on final budget decisions for the upcoming fiscal year.**

CONCLUSION

At the meeting of June 14, 2010, the City Council adopted the Fiscal Year 2011 Budget, and directed that the City's Budget Policy be amended to incorporate changes to the Budget Monitoring process. These changes were prompted by the delayed recommendations provided to the City Council to address the FY 2010 General Fund budgetary shortfall, which negatively impacted the City Council's ability to make final decisions necessary to adopt the FY 2011 budget in time to meet Charter-required deadlines.

This report presents proposed language changes to the Budget Policy to incorporate timing improvements to the Budget Monitoring process to prevent these complications from being repeated.

The IBA recommends that the Budget and Finance Committee recommend approval of the proposed language changes to the Budget Policy to the City Council, in order to improve the Budget Monitoring Process so that budget balancing solutions to year-end deficits are provided in the Year-End Report and in a timely manner, prior to final Council decisions on the upcoming fiscal year budget.

Elaine DuVal
Fiscal & Policy Analyst

APPROVED: Andrea Tevlin
Independent Budget Analyst

Attachment:

1. Council Policy 000-02: Budget Policy (strikeout/underline) with Proposed Changes Regarding Budget Monitoring Process

CITY OF SAN DIEGO, CALIFORNIA

COUNCIL POLICY

IBA DRAFT 9/9/2010

SUBJECT: BUDGET POLICY
POLICY NO.: 000-02
EFFECTIVE DATE: October 26, 2009

INTRODUCTION:

The following policies outline the City of San Diego's (City) guidelines for budgetary decision making and set standards for sound budgetary practices and fiscal performance.

An adopted set of Budget Policies that are consistently followed will assist the City in achieving its current and future goals in a fiscally responsible and sustainable manner. These policies serve to guide the creation of the City's budget and outline standards for revenue generation and the execution of operating and capital budget expenditures as recommended by the Government Finance Officers Association (GFOA) and the National Advisory Council on State and Local Budgeting (NACSLB). This document shall be reviewed on a regular basis to reflect the highest standards of fiscal management and the City's budgetary goals.

OBJECTIVES:

According to the GFOA and the NACSLB, a budget policy should address and establish the guidelines for the following elements:

- Operating and Capital Budget Policies
- Budgetary Controls
- Revenue/Expenditure Policies

This document addresses each of these elements, and provides the City with a comprehensive foundation upon which the prudent establishment, execution, and monitoring of annual budgets can occur.

BACKGROUND:

The City of San Diego's budget is developed annually for each fiscal year, July 1 through June 30. Under the strong mayor form of government, the budget is proposed by the Mayor with input from City Council and the public. The budget may be revised by City Council and is adopted by Council subject to mayoral line-item veto. The City Council may subsequently override the Mayor's veto by a majority vote and establish the annual budget.

The City uses strategic planning to map its goals and manage the tools and resources necessary for achieving them. The City Strategic Plan defines the direction for the City and provides a framework for the strategies and activities of the departments. The budget process is structured each year to achieve the fiscal and policy goals for the upcoming fiscal year while adhering to the timeline defined by the City Charter. The budget process is composed of the following phases: budget development, budget review, budget adoption, and budget monitoring.

Budget Development- Five-Year Financial Outlook
The City Strategic Plan is the framework for the City of San Diego's Five-Year Financial Outlook (Outlook). The development of the Outlook is the first step in the annual budget process. The Outlook outlines the Mayor's fiscal priorities for the next five years and presents a forecast for anticipated revenues and expenditures. It also provides a comprehensive, long-range analysis of the City's General Fund by incorporating economic assumptions and newly-prioritized or mandated expenditures. The information presented in the Outlook serves as the basis for determining the coming year's operating budget allocations. The Capital Improvements Program (CIP) budget development process also uses the Outlook, but initially begins with the identification and prioritization of capital improvement projects by the Capital Improvements Program Review and Advisory Committee (CIPRAC) and participating City departments.

Policy decisions and strategies are made using the information contained in the Outlook and results from the CIPRAC review. General Fund revenues and expenditures are then established and balanced through the budgeting process and any remaining changes to the non-general funds and capital improvement projects are made, resulting in the Mayor's Proposed Budget. The budget document is created, presented by the Mayor to the City Council, and made public by April 15 in compliance with the City of San Diego Charter [Article XV, Section 265, Item (b)(15)]. The proposed budget is published in hard copy and is also posted on the City's website. Subsequent to the release of the proposed budget, the Independent Budget Analyst issues a report that analyzes the proposed budget.

A key component of the operating budget process that does not coincide with the proposed budget development timeline is the establishment of the Salary Ordinance which fixes the salaries of all officers and employees of the City. In accordance with the City's Charter Section 70, the Salary Ordinance must be introduced no later than April 15 and adopted no later than May 30 of each year as mandated by the City's Charter Section 11.1. Any changes to the proposed budget are incorporated into the Mayor's May Revision, which is described in the following section.

Budget Review
The Mayor's release and presentation of the proposed budget in April is followed by the public review and discussion of the budget. This phase includes the City Council noticing a minimum of two public budget hearings where additional Council District priorities and recommended changes to the proposed budget are identified. The Mayor also presents the budget to the public

in a series of Town Hall meetings held in each Council District to provide the public an opportunity to ask questions and provide feedback.

Based on the most up-to-date information that may not have been available during the development of the proposed budget, the Mayor issues the May Revision to the proposed budget. This document contains the Mayor's recommended changes to the budget based on revised current year expenditure and revenue projections, changes to salaries adopted in the Salary Ordinance, and adjustments to capital improvement projects. Based on the proposed budget and the May Revision, the Independent Budget Analyst issues a report of recommended budget changes to the City Council.

Budget Adoption
During the month of June, the Budget and Finance Committee reviews the changes recommended in the Mayor's May Revision and by the Independent Budget Analyst and approves modifications to the proposed City budget. This modified budget is then docketed for review and adoption by the City Council. The City Council approves, by resolution, the budget prior to June 15, as mandated by the City's Charter Section 290. Within five business days of Council's approval, the Mayor has the discretion to line-item veto any budget modifications approved by Council. In turn, the City Council, also within five business days, has the authority to override the Mayor's veto by five votes, which is the same number of votes required to adopt the budget, and establish the annual budget.

In July, the Financial Management Department documents the final changes made to the proposed budget throughout the process in a budget Change Letter. The Appropriation Ordinance (AO), which enacts the budget into law, is then presented to the Budget and Finance Committee and the City Council for review and adoption in July, as required by the City of San Diego Charter [Article VII, Section 71]. The Statement of Budgetary Principles is an accompanying resolution to the Appropriation Ordinance for the ~~primary~~ purpose of outlining a process for the Mayor to notify the Council of programmatic changes to the adopted budget and enhancing communication between the Executive and Legislative branches regarding budgetary information. The adopted budget is published in September and made available to the public in hard copy and on the City's website.

Budget Monitoring
The Financial Management Department monitors the City's annual operating budget throughout the fiscal year. Quarterly reports are produced and presented to City Council to forecast year-end results and aid in adjusting the budget throughout the year to address ~~due to unforeseen~~ changes in revenues and expenditures. The Independent Budget Analyst reviews these quarterly reports and provides recommendations for City Council consideration. Monthly budgets are developed and monitored for each City department as a tool for benchmarking actual expenditures and revenues and to support departments' adherence to their annual budget.

BUDGET POLICIES

BUDGET PROCESS:

Balanced Budget
A balanced budget is a fundamental requirement of a government agency. **The City shall adopt and maintain a balanced annual operating budget and an integrated capital budget by the end of each fiscal year in accordance with the City Charter Section 69**. For each fund, annual expenditures shall not exceed annual revenues plus available fund balances. In other words, the City of San Diego shall adopt and maintain a balanced General Fund operating budget where budgeted revenues are equal to budgeted expenditures. Non-general funds shall be considered balanced when budgeted expenditures are equal to or less than the amount of budgeted revenues plus available fund balance. It shall be a goal of the City to achieve a long-term structurally balanced budget through efficiencies, permanent reductions to the expenditure base, and/or revenue enhancements. A structurally balanced budget is defined as a budget that does not rely on reserves or the use of one-time revenues for ongoing expenditures.

Public Involvement
Public involvement shall be encouraged in the annual budget decision-making process through public hearings, public outreach, and information. Public participation efforts will allow the City to achieve the following objectives: improve performance by identifying public needs and service delivery expectations and understand the public's priorities in budgeting. Increased public involvement will allow the City to be more responsive to community needs, thereby increasing the value that the public receives from City government.

City Council
The City Council members shall communicate their budget priorities to the Mayor in advance of the adoption of the annual budget. City Council shall also adopt an annual legislative budget calendar that establishes the time frame for each phase of the budget process and in accordance with the City Charter's requirements.

Operating Budget
The operating budget development process shall begin with the preparation of the Five-Year Financial Outlook, which shall be developed prior to the proposed budget. The operating budget shall contain the expected revenue and expenditure appropriations, staffing levels, and tactical plans for each department. Tactical plans shall include the departments' mission, strategic goals and objectives, performance measures, and targets. The performance results shall be reported at fiscal year-end. The Tactical Plans shall be updated annually to ensure departments' priorities are in line with the City Strategic Plan and performance measures and targets are meaningful and realistic with regard to budgeted dollars.

Capital Improvements Program Budget
The CIP budget shall be a multi-year capital improvement plan for the City and shall be developed in conjunction with the operating budget to ensure effective utilization of the City's overall resources to operate and maintain facilities. The annual CIP budget shall include projects that span multiple fiscal years and result in capitalized assets. The CIP budget may include other projects of a capital nature that span multiple fiscal years and have significant cost estimates. Annual allocation projects shall provide for smaller, sub-projects that are expected to be completed in a short timeframe. The annual CIP budget shall reflect total estimated project costs by including all prior- and current-year expenditures and appropriations, and future-year project costs, including any future funding needs through project completion. CIP projects shall only be established with partial funding if there is a reasonably high expectation that the remaining funding will be identified and the project will be completed within a reasonable timeframe for the type of project. Project budgets may be based upon revenues anticipated to be received during the fiscal year; however, the project shall not be released nor shall expenditures be incurred until cash is available to support the budget. In accordance with the City of San Diego Charter [Article VII, Section 84], appropriations for CIP projects that are not completed within the fiscal year shall continue until the project is completed or abandoned. CIP projects; however, shall be reviewed periodically to identify projects that are not progressing and funds that may be available to be reprogrammed for another purpose.

In order to ensure the integration of long-range planning, the development of the multi-year CIP budget shall be primarily based upon the adopted General Plan, community plans, and growth strategies. Further, Sections 65103 (c) and 65401 of the State's Planning and Zoning law require that the CIP be submitted by the Planning Commission to the City Council with assurance of General Plan conformance prior to the adoption of the annual budget. In accordance with Council Policy 800-14, project ranking shall be used to make funding recommendations and shall be reported in the annual CIP budget. Finally, estimated future impacts on operating budgets shall be provided for all capital improvement projects seeking approval by City Council and shall be included in the City's Five-Year Financial Outlook.

BASIS OF BUDGETING:

The City's budgets for Governmental Funds, such as the General Fund, Debt Service Funds, Special Revenue Funds, and Capital Project Funds shall be prepared based on the modified accrual basis of accounting (revenues are recognized in the accounting period in which they become available and measurable, and expenditures are recognized in the accounting period in which the fund liability is incurred) except that (1) encumbrances outstanding at year-end shall be considered expenditures and (2) the increase/decrease in reserve for advances and deposits to other funds and agencies shall be considered as additions/deductions of expenditures. The budget for the City's Proprietary Funds, which are comprised of Enterprise Funds and Internal Service Funds, shall also be prepared on the modified accrual basis of accounting with the exception that revenues are recognized when they are earned.

The City's operating budget shall exclude unrealized gains or losses resulting from the change in fair value of investments, and proceeds from capital leases. These calculations are performed solely for financial statement reporting purposes, to be in compliance with Generally Accepted Accounting Principles (GAAP).

INCLUSION AND DISCLOSURE OF BUDGETED FUNDS:

The City's budget shall be detailed in a comprehensive document that includes all General Fund activities and projects. The budget document shall include the General Fund, as well as Enterprise, Debt, Internal Service, Capital Improvements, and Special Revenue Funds so that the entire resources of the City can be viewed comprehensively for decision making.

Any departments or funds with positions shall be budgeted. Departments or funds shall budget at the cost or fund center, the lowest level of the organizational structure, and shall also assign budgets to programs as further described in the "Programmatic Budgeting" section of this policy document.

PROGRAMMATIC BUDGETING:

The City shall categorize budgets into programs and services that are provided both internally to other City Departments and externally to its residents. Budgets shall be developed by classifying expenditures and revenues of both operating and Capital Improvements Program projects into City programs. These programs shall be identified to provide budgetary, revenue, and expenditure information for priority City programs. Throughout the year, actual expenditures and revenues will be tracked by these program categories to provide more meaningful management information for decision-makers and the public. Examples of these programs are: Brush Management, Youth Services, and Americans with Disabilities Act (ADA) projects.

BUDGET DEFICITS:

Unanticipated decreases in revenue and/or increases in expenditures may result in budget shortfalls. As such, revenue and expenditure projections shall be conducted throughout the fiscal year in order to identify any potential deficits that may require mitigation efforts authorized by City Council. Should revenues decline and/or expenditures increase, alternative funding sources, budget reductions, or reallocations of funds among departments shall be identified to support the ongoing activities of the City. The Financial Management Department's quarterly budget monitoring process is the process by which potential deficits and surpluses will be identified. Mitigation steps will be recommended to City Council as determined necessary to offset unanticipated expenditures or revenue shortfalls. When a deficit is projected in the Year-End Budget Monitoring Report, the report will include recommendations for addressing the projected shortfall for Council consideration. The Year-End Budget Monitoring Report will be released to the Council in late May in order to incorporate nine months of actual results in the analysis. The Year-End Budget Monitoring Report will be released in advance and presented to the Council ~~at~~

~~the same time that the Mayor presents the May Revision to the Proposed Budget to the Council~~ in advance of or on the same day as the Council's first public hearing on final budget decisions for the upcoming fiscal year. This will allow the Council to have a complete picture of the City's budget for the current fiscal year prior to making final decisions on the budget for the upcoming fiscal year.

If mitigations cannot be identified to offset the deficit, contingency plans that use the City's reserves shall be implemented as a means of maintaining the funding levels necessary for department operations in accordance with the City's Reserve Policy. Reserve policies are disclosed under the "Reserves, Encumbrances, and Carryovers" section of this policy document.

RESERVES, ENCUMBRANCES, AND CARRYOVERS:

Establishing strong fiscal reserves can help insulate the City from dramatic economic downturns or unforeseen emergencies. It is the City's policy to have fund reserves that may be executed in times of disaster, emergency, or a severe economic downturn. The City's General Fund reserves are comprised of the Emergency Reserve, the Appropriated Reserve, and the Unappropriated Reserve (unallocated fund balance).

The Emergency Reserve is meant to be used only in the event of a natural disaster or unforeseen catastrophic events. Emergency Reserve funds shall not be accessed to meet operating shortfalls or to fund new programs or personnel. The Emergency Reserve funds may be appropriated by the City Council in the event of a public emergency, as determined by a two-thirds vote of the City Council.

The funds dedicated to the Appropriated Reserve are appropriated to a single discretionary account within the General Fund budget and shall conform to no maximum or minimum amount in any given fiscal year. Funds which are not expended in a given fiscal year shall revert back to the General Fund's Unappropriated Reserve balance and may be re-appropriated in the subsequent fiscal year. The authority and process for use of the Appropriated Reserve shall be established in the AO.

The Unappropriated Reserve is intended to support General Fund operations in the event that additional funding is required but the use of the Emergency Funds would not be appropriate. Should the funds in the Appropriated Reserve be exhausted during the fiscal year, the Unappropriated Reserve may be used to fund unexpected City priorities. Recommendations for appropriation of these funds shall be made by the Mayor or the City Council and approved by the Council.

Additional reserves include the following: Development Services Fund Reserves, Risk Management Reserves, Water Enterprise Fund Reserves, Wastewater Enterprise Fund Reserves,

Public Liability Fund Reserves, Workers' Compensation Fund Reserves, and Long Term Disability Fund Reserves. These additional reserves are described in more detailed in the *City Reserve Policy*.

Encumbrances
Operating departmental encumbrances, other than those used administratively by the City Comptroller's Office, shall be cleared at the conclusion of each fiscal year. Operating funds encumbered via a Comptroller Certificate or Purchase Order shall be automatically released by the City Comptroller by the end of the following fiscal year that the encumbrance was established. However, balances remaining in capital improvement projects at year-end shall be carried forward into subsequent fiscal years until project completion or cancellation.

All encumbrances at the end of the current fiscal year that are carried forward shall be automatically applied to the new fiscal year budget for all regular operating funds (a fund type that does not carry over unexpended, unencumbered appropriations to the following fiscal year, such as the General Fund). All departments shall review and close all but the most critical encumbrances prior to the end of the fiscal year. Exceptions to this policy shall be considered at year-end for encumbrances related to major, non-recurring projects or contractual obligations such as consultant services or studies, for which work has begun and the project or deliverable remains a priority but will not be completed until a subsequent fiscal year. Requests for such exceptions shall be submitted to Financial Management (FM) as part of the year-end budget monitoring process. Any FM-approved requests shall require subsequent City Council approval in the Year-End Budget Monitoring Report presented to City Council in June.

BUDGET EXECUTION:

Budgetary Control
Budgetary control is first established by the City Charter. The City Council may authorize the transfer of all or part of an unencumbered balance of an appropriation, interdepartmentally or intradepartmentally, in those cases where the funding for a current year's programmatic activity has proved to be insufficient. The City Council may not, however, exercise authority to transfer salary account funding to any other purpose, except in the event of a public emergency where such a transfer would ensure the safety of the lives and property of the residents of the City of San Diego, as mandated in the City Charter Section 73. City Charter Section 84 requires that any unencumbered balance of an appropriation at the close of the fiscal year, except retirement and certain trust funds, revert to the fund from which appropriated; however, appropriations for expenditures for improvements or other work which will not be completed within the year, such as capital improvement projects, shall be continued until the purpose for which the appropriation was made has been accomplished or abandoned.

Budgetary control is further defined by the City Council in the AO. The AO shall include the necessary budget delegation to the Mayor in order to carry out the business of the City. No

department, fund, or project, regardless of funding source, shall expend an amount in excess of its appropriations unless revised as authorized in the AO or through a City Council approved amendment to the AO. The City Council approves amendments to the AO throughout the fiscal year through actions brought to the City Council at the request or recommendation of the Mayor or independent department heads, as required by City Charter Sections 73 and 275. Revenues collected/received in excess of the original amount estimated as part of the adopted budget shall not be expended without prior approval granted through the AO or an amendment to the AO. In accordance with the requirements of the City Charter, the AO details the operating appropriations in two categories: 1) salaries and wages and 2) fringe benefits and non-personnel expenses (NPE). It also details the CIP appropriations at the project level. The level of detail is presented in the following ways depending on funding type:

- General Fund appropriations are summarized by department.
- Non-general fund appropriations are displayed by fund and grouped by fund type.
- Capital Improvements Program (CIP) appropriations are displayed by project.

Financial Reporting and Monitoring
The Chief Financial Officer (CFO) is responsible for oversight of the City's comptroller, financial management, treasury, risk management, and debt management functions. On a monthly basis, the City Comptroller shall submit to the Mayor and to the City Council a summary statement of revenues and expenses for the preceding accounting period and the status of appropriations in comparison to actuals, in order to detail the financial condition of the City as mandated by the City Charter Sections 39 and 89.

The Financial Management Department oversees the City's budget and executes its budget monitoring responsibilities through the analysis of expenditures and revenues for operating funds included in the annual AO. This analysis may identify significant variances between budgeted and projected amounts and provide relevant information to maintain budgetary control and balance. Departmental expenditure activity shall be monitored at least quarterly and presented to the Budget and Finance Committee at least three times a year. The Independent Budget Analyst shall review these quarterly reports and may provide recommendations for City Council consideration.

The Financial Management Department shall prepare quarterly reports that include forecasts of annual revenues and expenditures based on actual results and knowledge of spending trends and operations. These reports shall explain significant revenue and expenditure variances and indicate trends that may require remediation, such as budget reductions, a reallocation of funds between departments, or the appropriation of new revenues. If departments are projected to overspend, Financial Management, in conjunction with the departments, shall develop remediation plans to reduce expenditures, including the deferral of hiring and major expenses for goods and services prior to recommending the use of reserves. When the Year-End Budget Monitoring Report projects a deficit in the current year, the report will include recommendations

for remedying the shortfall for Council consideration. The Year-End Budget Monitoring Report will be released in advance and presented to the City Council in advance of or on the same day as the Council's first public hearing on final budget decisions for the upcoming fiscal year.

~~The Independent Budget Analyst shall review these quarterly reports and shall provide recommendations for City Council consideration.~~

Performance Reporting and Monitoring
The Business Office manages the activities related to performance monitoring and reporting. Performance information is provided using reporting templates that include the departments' objectives and associated measures organized in the Balanced Scorecard (BSC) framework. Baseline and target information shall also be included to provide context for the current data and allow departments to identify trends. Explanations shall be given for performance measures not meeting or trending toward performance targets. Once data reporting templates are completed, they shall be sent to the Business Office for review, analysis, and inclusion into the City-wide Performance Measure Database. Performance deficiencies shall be identified and solutions to improve performance shall be determined by the respective departments.

Budget Actions
In addition to the quarterly monitoring reports, the Financial Management Department shall monitor the budget throughout the fiscal year through the review of requests for City Council and Mayoral Actions that affect either the operating or CIP budgets. The Independent Budget Analyst may review any Council actions and provide an independent recommendation to City Council. Additionally, during the course of the fiscal year, it may be necessary to execute budgetary reprogramming in order to balance expenditures against the appropriate revenues. All budgetary adjustments shall be consistent with the authority provided in the AO. This shall be achieved through Council-approved Ordinances or Resolutions and may result from recommendations made in the quarterly monitoring reports and/or other departmental requests for City Council action.

FIVE-YEAR FINANCIAL OUTLOOK:

The City shall prepare a multi-year financial outlook (Outlook) for the General Fund that projects revenues and expenditures over a five-year period to include all committed expenditures. Committed expenditures are defined as the operational costs for new facilities, the annualization of operating costs for facilities that were opened the previous fiscal year and were only partially funded, contractual obligations, and/or any federal/State or City Council mandated activities. Revenue and expenditure assumptions shall include baseline growth projections. The Outlook shall be presented to the City Council annually and updated as needed to accommodate changing national, regional, and local economic conditions (e.g. inflation rate, tourism trends, consumer spending, the housing market), as well as the State budgetary policies and actions that affect the City's major revenues.

Components of the Outlook include:

- A statement for General Fund revenue and expenditures shall be produced for each year.
- The Outlook shall be built upon a baseline of the current year balanced operating budget trended forward using conservative economic growth assumptions.
- The revenue and expenditure projections shall be based on a series of assumptions, including: projected inflation rates, salary and fringe cost increases and assumptions based on labor agreements, pension funding obligations, retiree health funding, major revenues, operating commitments stemming from capital projects, leases, and legally mandated or City Council mandated projects, and currently adopted City Council policies.
- Various scenarios shall be built into the Outlook using alternative economic and policy assumptions. The Outlook shall provide additional assumptions for low- and high-growth scenarios for major revenues and include possible contingent expenditure impacts and risks to the General Fund.
- Projections shall include estimated future maintenance and operating costs of current capital improvements for projects that are budgeted in the capital budget. This outlook data shall be presented in a form that will facilitate annual budget decisions within a multi-year strategic planning perspective.
- Potential solutions shall be identified in the Outlook to the extent possible to balance the General Fund over the five-year period forecasted.
- 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.
- The components shall also include the following amounts for each of the forecast's five years for retiree health care: the Annual Required Contribution (ARC); pay-as-you-go costs; and the unfunded liability, based on the following two scenarios:

    1. Based on current funding strategy of pay-as-you-go amount plus some additional amount for pre-funding future liability for retiree health (lower than the ARC).

    2. Based on payment of the full ARC each year.

<u>REVENUE POLICIES</u>:

General Revenue Policies

General Fund revenues shall not be earmarked for any particular purpose, unless required by law or generally accepted accounting principles (GAAP). Revenues shall be deposited in the General Fund and appropriated during the budget process or a separate City Council action. All revenue forecasts shall be objective and reasonable. All of the City's Enterprise Funds such as Water, Metropolitan Wastewater, Development Services, Airports, Golf Course, Refuse Disposal, and Recycling shall be fully self-supporting from revenues generated by rates, fees, and charges.

One-Time Revenues
The City of San Diego shall limit, whenever possible, the use of one-time revenues such as grants, tax windfall, or fund balances to fund one-time expenditures. Furthermore, ongoing expenditures shall be funded by ongoing revenues. When new and ongoing program expenditures are added to the budget, an ongoing revenue source such as an increase in existing revenues or a new revenue source shall be identified to fully support the cost of the program.

User Fees
Revenues derived from user fees shall be updated annually as part of the budget process. The fee increases are to be based on the Consumer Price Index (CPI), inflation estimates, or other annually adjusted inflators until the next comprehensive user fee study is conducted.

The *User Fee Policy* requires that the full cost of services be determined in order to adequately establish fees to cover such costs. Fees shall be categorized based upon the level of cost recovery: Category I (full recovery), Category II (partial recovery), and Category III (fines and penalties). Cost recovery provides revenue enhancement to the City through full cost accounting, which improves government efficiency, as well as maintains equity in the provision of public services. User fees that do not meet the criteria for Categories II and III shall be developed to achieve full cost recovery.

Economic Indicators
The City of San Diego has four major sources of General Fund revenue—property tax, sales tax, Transient Occupancy Tax, and franchise fees—all of which are affected by changes in the local, State, or national economies. Economic data shall be evaluated from multiple sources to analyze short- and long-term revenue trends. The following indicators shall be considered: housing market, interest rates, tourism industry, retail sales, unemployment rates, consumer confidence measures, the CPI, and others. Based on these economic indicators, the City shall project revenue growth rates, analyze projections against actual receipts, and modify projections quarterly, if warranted. Sources shall include independent studies compiled by SANDAG (San Diego Association of Governments), the UCLA Anderson Forecast, San Diego Regional Chamber of Commerce, the University of San Diego Real Estate Institute, San Diego Convention and Visitors Bureau, and other State and regional econometric analyses.

Long-Term Revenue Projections

The City's long-term revenue forecasting used for the Outlook shall be based on the analysis of the historical revenue trends for each individual revenue source. The historical trend analysis shall include, at minimum, a ten-year performance history for each major revenue. In addition to the historical trend analysis and review of current economic conditions, the City shall consider potential legislative changes when forecasting the major revenue growth rates.

Short-Term Revenue Projections
The short-term revenue projections shall be based on the current economic conditions, legislation, and fiscal policy changes. The current economic indicators will assist in developing the growth rate for each major revenue category. Short-term revenue projections will assist in making budgetary and policy decisions for the current and upcoming fiscal year.

Legislative and Policy Analysis
The Financial Management Department, in conjunction with the Community & Legislative Services Department, shall monitor all relevant State legislation and policies that may affect City revenues and adjust revenue projections as indicated to ensure that conservative revenue projections are maintained.

EXPENDITURE POLICIES:

General Expenditure Policies
The annual budget process shall weigh all competing requests for City resources within expected fiscal constraints. Requests for new operating expenditures made outside the annual budget process shall be discouraged. New initiatives shall be financed by reallocating existing City resources to programs and services with the highest priorities or through new revenue sources.

Pension Obligations
The City's budget shall fully fund the Annual Required Contribution (ARC) as determined by the San Diego City Employees' Retirement System (SDCERS) actuarial valuation report. The Governmental Accounting Standards Board (GASB) requires the disclosure of the actuarial information to determine if assets are sufficient to pay benefits when they become due. Budgeting the full ARC for the City's Retirement System is critical for the long-term fiscal health and stability of the City.

Retiree Healthcare Obligations
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.

Budgeted Positions
All City positions shall be budgeted. Grant funded positions shall be budgeted as limited positions. Positions that are funded through grant resources are authorized to exist as long as grant funding is available. Upon the termination of grant funding, the positions funded under the respective grant shall be eliminated from the budget.

Labor Agreements
The City's budget shall include compensation and benefit increases in accordance with the Memorandums of Understanding (MOUs) between the City and its respective collective bargaining units.

CONCLUSION:

These Budget Policies outline the City of San Diego's guidelines for budgetary decision making and set a standard for sound budgetary practice and fiscal performance.

Adhering to an adopted set of Budget Policies provides a framework for consistent and transparent budgeting that is fiscally responsible. These policies were drafted to include recommended budget practices asserted by the Government Finance Officers Association (GFOA) and the National Advisory Council on State and Local Budgeting (NACSLB). These policies shall be reviewed on a regular basis in order to ensure that the policies reflect the highest standards of fiscal management and the City's budgetary goals.

The City of San Diego's Budget Policies set forth protocols and best practices regarding operating and capital budgets, budgetary controls, and revenue and expenditure policies that result in the legal establishment, timely execution, and effective monitoring of the City's budget.