THIS RELATES TO
6-12-06 Item No. 6
Supplemental Information No. 1

Review

of the

FY 2006-07 Recommended Budget

Prepared for the
Board of Supervisors
of the County of Santa Clara

Prepared by the:

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June 9, 2006

County of Santa Clara

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June 9, 2006

To: Board of Supervisors

From: Management Audit Manager RM

Subject: Analysis of the FY 2006-07 Santa Clara County Recommended Budget

The attached report is a limited review of the FY 2006–07 County of Santa Clara Recommended Budget. To prepare this report, we analyzed all County revenue and expenditure accounts which receive funds from or contribute funds to the County General Fund. We also reviewed the FY 2005–06 revenue and expenditure reports through Accounting Period 10, the FY 2006–07 Recommended Budget document and other documents and work papers prepared by the departments and staff of the County Executive's Office. Our staff also met with County Executive staff, various County financial officers, and department managers regarding the assumptions and projections upon which the FY 2006-07 Recommended Budget is based. This report has been discussed with the Budget Director who will provide a separate written response to the recommendations contained herein.

The County Executive's Recommended FY 2006-07 Budget includes \$3,853,802,561 in expenditures for all funds, which amounts to \$133,927,871 or 3.6 percent more than the \$3,719,874,689 budget adopted by the Board of Supervisors at the beginning of FY 2005-06. The General Fund portion of this budget shows an increase of \$143,009,533 from \$2,130,803,273 to 2,273,812,806. This represents an increase in County General Fund costs of 6.7 percent from the amount authorized at the beginning of FY 2005-06.

Report Conclusions and Recommendations

The attached table summarizes our recommended revenue and expenditure changes by Budget Unit. Detailed explanations of our recommendations are discussed in the body of the report. In total, this report includes total recommendations which amount to $11,648,919 in net increased revenues and $12,120,990 in reduced expenditures for a combined net benefit of $23,769,909.

SUMMARY OF MANAGEMENT AUDIT DIVISION RECOMMENDATIONS
FY 2006-07 BUDGET REVIEW

Budget Unit	Department Name	Revenue/Expenditure Account	Expenditure Decreases	Revenue Increases	Net Savings
	General Fund Balance		-	6,847,120	6,847,120
101-725	All Departments	PERS - Employer Contribution	8,946,615	-	8,946,615
101-725	All Departments	Interest - Deposits and Investments	-	(3,521,782)	(3,521,782)
101-725	All Departments	State/Fed/Other Reimbursements	-	(594,585)	(594,585)
101-725	All Departments	Salaries and Employee Benefits	777,403	-	777,403
	All Departments	Health Insurance Premiums-Discussion Only	-	-	-
	All Departments	Salary & Ben. Savings-New Positions-Disc. Only	-	-	-
	Various Departments	State Realignment	-	(720,532)	(720,532)
110	Controller-Treasurer	Sales Tax	-	256,246	256,246
110	Controller-Treasurer	In Lieu Local Sales and Use Tax	-	96,523	96,523
110	Controller-Treasurer	Interest - Deposits and Investments	-	2,535,519	2,535,519
110	Controller-Treasurer	State - Motor Vehicle	-	(2,744,290)	(2,744,290)
112	Tax Collector	SB 813 - Supplemental Property Tax	-	3,500,000	3,500,000
114	Clerk-Recorder	Real Property Transfer Tax	-	1,300,000	1,300,000
114	Clerk-Recorder	Overtime and Temporary Salaries	100,000	-	100,000
119	Special Programs	Operating/Equity Transfers-Transfers Out	631,000	-	631,000
148	Department of Revenue	Franchise Fees	-	333,692	333,692
230	Office of the Sheriff	Other Law Enforcement Services	-	1,901,242	1,901,242
235-240	Department of Correction	Prisoner Housing Federal	-	372,119	372,119
235-240	Department of Correction	Prisoner Housing State	-	152,844	152,844
235-240	Department of Correction	Prisoner Housing Other County	-	304,700	304,700
235-240	Department of Correction	Salaries and Employee Benefits	47,503	-	47,503
246	Department of Probation	Federal Title IV-E-Discussion Only	-	-	-
263	Facilities and Fleet	Utilities	625,969	-	625,969
263	Facilities and Fleet	Capital Projects Serv. & Suppl.-External	500,000	-	500,000
410	Public Health	EMS Fines and Penalties	-	559,680	559,680
410	Public Health	State Department of Health Services	-	492,500	492,500
410	Public Health	Pandemic Flu Preparedness	492,500	-	492,500
410	Public Health	Public Health Patient Fees	-	30,000	30,000
412	Mental Health Department	AB 3632 Funding - Discussion only	-	-	-
412	Mental Health Department	Contributions and Donations	-	80,743	80,743
414	Custody Health Services	Medical Svcs & Crisis Assess - Discussion only	-	-	-
418	Community Outreach Services	State Department of Health Services	-	467,180	467,180
		TOTAL	12,120,990	11,648,919	23,769,909

Available One-Time Resources

Included in the FY 2006-07 Recommended Budget are one-time resources that are allocated each year by Board policy to one of four categories of expense: (1) capital projects, (2) technology projects, (3) one-time reserve requirements, and (4) other one-time needs. In FY 2006-07, reserve requirements included funding requirements that in FY 2005-06 were funded from a safety-net reserve. In FY 2006-07, the County Executive has identified $170,000,000 in one-time resources, which is derived primarily from available reserves and the FY 2005-06 General Fund Balance. The projected FY 2005-06 General Fund Balance is comprised of: (1) salary and benefit savings, (2) Object 2 through Object 7 expenditure savings, and (3) unbudgeted revenue earnings.

The County Executive is recommending that the $170 million in one-time resources be allocated to the following general categories:

Capital Projects	$10,025,000
Technology Projects	3,524,530
Contingency Reserve	82,377,627
SSA Out-of-Home Placement Reserve	4,110,370
Drug & Alcohol Services Programs	1,805,861
Drug & Alcohol Services Residential & Transitional Housing	1,864,448
Department of Correction Academy	1,680,734
Sheriff's Homeland Security Positions	655,317
Fund 50 Percent of Retiree Health Normal Costs	11,357,217
One-time Funding to Support Ongoing Operations	46,800,000
Fund Pandemic Flu Preparation Costs	2,500,000
Drug & Alcohol SACPA Cost Funded by State in FY 2006	1,084,184
Probation Department SACPA Cost Funded by State in FY 2006	319,533
Other Miscellaneous	1,895,179
Total One-Time Allocations	**170,000,000**

The General Fund Balance estimate made by the County Executive was prepared in early 2005 based on Accounting Period 8 financial information. As part of our budget review, we analyzed salary and benefit savings and major revenue accounts based on Accounting Period 10 financial information in order to identify significant deviations. The estimates that we present below reflect differences from the amounts included in the FY 2005-06 Fund Balance that has been presented in the published budget.

Based on our analysis, we believe that available one-time resources will be approximately $183.3 million, rather than the $170 million originally included in the Recommended Budget. The sources of this $13.3 million increase include:

Realignment Sales Tax	$2,310,000
State Motor Vehicle Fees	(2,000,000)
SB 90 Mandated Cost Reimbursement	1,811,879
Interest Income	2,470,038
Local Sales and Use Tax and In-Lieu Sales and Use Tax	256,246
Supplemental Property Tax	576,762
Real Property Transfer Tax	722,195
Penalties and Costs on Delinquent Taxes	700,000
Total Net General Fund Balance Increases	**6,847,120**

Our analysis of each of these General Fund Balance sources follows.

Realignment Sales Tax

Santa Clara County receives a portion of a half-cent statewide sales tax that was provided to California counties starting in 1991, as funding for programs that were shifted from the State to counties. Gross realignment sales tax revenue received by the County is divided into three pieces: one helping to support public health Programs (Revenue Accounts 4412100), a second supporting mental health programs (Revenue Account 4410200) and a third supporting social services programs in the Public Health, Social Services Agency, District Attorney and Probation budgets (Revenue Account 4405095).

This revenue is also allocated to the County in two ways. First, annually the County is supposed to receive a base level of realignment sales tax funding that equals the amount it received in the previous fiscal year. In addition, to the extent the State collects sufficient sales tax revenues to pay more than the base amount owed to all counties, the excess collections revenue is distributed to counties as growth payments, usually in the form of "caseload growth" payments, which reflect the overall growth of counties' costs primarily for social services programs. These growth payments are distributed to the counties based on each county's growth in expenditures relative to that in the other counties. Once this growth payment is made, the amount paid becomes part of the base payment a county receives in the following fiscal year. However, no specific amount of realignment revenue is guaranteed, because it depends on the strength of sales tax collections by the State. To the extent that collections fall short of what is needed to pay the base amounts due each county, counties share proportionately in the shortfall.

For FY 2005-06, the County is currently due a base realignment amount of $103.4 million. Based on the Governor's May Budget Revision, ample sales tax revenue is projected to pay for base amounts due all counties, and to provide growth payments of nearly $207 million statewide, up from the estimate of $132.2 million in the January budget. We believe this estimate of additional sales tax collections is reasonable, given that it undoubtedly reflects recent sharp increases in the price of gasoline, which is included among the items on which the half-cent realignment sales tax is collected.

Because Santa Clara County and other counties are still awaiting realignment payments from the State for caseload growth that occurred in previous fiscal years, the amount of the statewide revenue the County will receive is predictable. Based on the caseload growth the County is owed, we expect the realignment growth payment to be at least $7.2 million. This payment is normally received in November, and would therefore be accrued to the FY 2005-06 budget by the Controller. Including this growth payment, we project that total realignment sales tax receipts for FY 2005-06 will be $110.64 million. This is $2.31 million more than the $108.33 million assumed by departments in Accounting Period 8 reports on which the calculation of fund balance is based.

State Motor Vehicle Fees

The County continues to receive a portion of vehicle license fee revenues to support public health, mental health and social services programs under the same 1991 realignment of State and County responsibilities that led to the sales tax allocations previously discussed.

As in the case of the realignment sales tax revenues, each year the County receives an allocation of these vehicle license fees in the form of a base payment, which equals the total amount of payments received in the prior fiscal year, and a separate "general growth" payment. This growth payment is made solely based on each county's share of the base State vehicle license fee funding for realignment. Also, the vehicle license fee growth payment for one fiscal year has historically been received after January 1 of the succeeding calendar year, so that the growth payment for Fiscal Year 2004-05 was received on February 7, 2006. Because this growth payment was received after the County's financial statements for FY 2004-05 were finalized, it is accounted for as part of 2005-06 revenues, the 2005-06 growth payment will be accounted for in FY 2006-07, and so on.

In reviewing the FY 2005-06 budget, we projected the County would receive $57.345 million from this source, based on the Governor's May 2005 Budget Revision forecast that $145.4 million would be available for a VLF growth payment, with Santa Clara County receiving about $4.8 million of that amount. In fact, the Statewide growth allocation issued in February 2006 turned out to be only $72.167 million, with Santa Clara County's share being $2.7 million. Accordingly, we now forecast that receipts from this source for the current fiscal year will total $55.3 million, versus the $57.3 million figure included in the FY 2005-06 budget and reflected in the Period 8 fund balance estimate for the Controller-Treasurer, which includes this revenue source. Therefore, the County Executive's General Fund Balance estimate should be decreased by $2 million.

SB 90 Mandated Cost Reimbursement

In FY 2005-06, the Controller has decided to set aside $1,811,879 in SB 90 payments as a reserve against potential audit disallowances from the State for SB 90 claims submitted during the current and past fiscal years. This equates to 15.0 percent of the $12.0 million in payments that were received by the County in FY 2005-06, through October 2005. To date, these reserved funds have not been recognized as income and are not included in the County Executive's Fund Balance estimate.

In addition to the reserve established by the Controller, the State routinely withholds up to 20 percent of the estimated claim amounts filed each year with the Commission on State Mandates (1) in anticipation that the actual claims may differ from the estimated claims; (2) to provide for potential changes in Statewide mandated cost program appropriations; and, (3) to safeguard the State against potential audit disallowances. Accordingly, the Controller's reserve provides an additional, locally-controlled withholding that supplements the amounts already being withheld by the State.

The Controller's decision deviates from previous County practice. In the past, the Controller expected that the State withholding would provide a sufficient margin for meeting any modifications to State appropriations, differences in estimated and actual claim amounts, or audit disallowances. The Controller suggests that this additional reserve is now necessary because of the significant unpaid prior year claim balance that exists, and a concern that State auditors may disallow certain claimed costs based on the method being used by the County to estimate productive hourly rates for County employees involved in mandated activities. In addition, the Controller is concerned about uncertain future State funding and the possible suspension of some mandates by the Legislature. The County's FY 2006-07 budget does not include any provisions to build on the FY 2005-06 reserve.

The $1.8 million reserve that has been established by the Controller is unnecessary, given information from the State and the character of outstanding claims. First, the State has been paying the full productive hourly cost of all claims filed since the FY 2000-01 claim year, except during the temporary general suspension of SB 90 program payments. In addition, on February 6, 2004, an email from the State Controller Audit Bureau, Chief of Compliance, stated that "the use of countywide productive hours would be acceptable to the State Controller's Office provided all employee classifications are included and productive hours are consistently used for all county programs . . ." The Chief continued by noting that "if a county chooses to deduct time for training and authorized breaks in calculating countywide productive hours, its accounting system must separately identify the actual time associated with these two components." The Controller indicates that the County is able to meet the State's requirement for reporting training hours, but is unable to technically comply with the requirement for reporting actual break time. Accordingly, while some amount of the claims may be in jeopardy, we believe that the major components of the productive hourly rate methodology will be accepted by the State. Therefore, the claimed amount should essentially be accepted for payment.

Second, the entire amount of the reserve was obtained from non-Mental Health claim payments and, therefore, represents non-Mental Health income for the County (Mental Health has recognized all payments that have been received on its claims). In FY 2004-05 and FY 2005-06, the County claimed approximately $10.6 million in non-Mental Health program mandates. Therefore, the $1.8 million reserve established by the Controller is approximately 17.1 percent of the non-Mental Health claim amount for those years. Added to the State withholding of up to 20 percent reported by the

Controller, the combined amount being withheld by the State and the County therefore equates to over 37.0 percent of total claims for the two years.

Third, not all claims include costs for personnel services. As an example, a substantial portion of costs incurred by the Mental Health Department are for services provided by contractors. Therefore, the productive hourly rate computation for County employees will not impact these claims even if it is disallowed by the State.

It is clear that the Governor and Legislature have avoided making full payment to local government for the cost of mandates during recent years. However, the economic circumstances that contributed to this behavior are reversing, and restored funding at the base level of mandated service is likely to occur, consistent with the State Constitution and law. Therefore, we believe the reserve established by the Controller is overly conservative, due to the already aggressive withholding policies practiced by the State. Accordingly, the Board of Supervisors should direct the County Executive to recognize the reserved funds as received income during FY 2005-06 and include the full reserve amount of $1,811,879 in the General Fund Balance for FY 2006-07.

(Note: At the time of this report, the Governor had proposed an increase in mandated cost reimbursement payments to local governments of $4.1 million, providing a total of $90.3 million for the payment of FY 2005-06 estimated mandate claims and $5.7 million for newly determined mandates. In addition, the Governor proposed that the FY 2006-07 State Budget include $71.8 million to repay local governments for prior year unpaid mandate claims, which is the first year of the 15-year repayment period for mandate debt that was incurred prior to FY 2004-05; and, an additional $86.9 million to pay the FY 2007-08 mandate debt in advance of the timeline required by law. While the Senate and Assembly have generally approved the first year repayment proposal, both have rejected the Governor's suggested prepayment of the second year debt. In addition, according to CSAC, all mandate items will be sent to conference before the budget is finalized, making the likelihood of further legislative adjustments likely. Accordingly, we have not estimated any additional income for the current year or for FY 2006-07, due to the volatility of negotiations and the current postures being taken by the two houses of the Legislature. Should the amount of the proposed State appropriation change appreciably during the coming weeks, the revenue account for reimbursement of State mandated costs may need to be adjusted).

Interest Income

Each year, the Controller estimates Interest Income by projecting the average daily cash balance and interest on investments to be earned by quarter by the County Commingled Fund. For the FY 2005-06 Fund Balance estimate, the Controller projected that approximately $15,488,603 in Interest Income would be realized by the General Fund. This projection is $5,295,714 more than the amount included in the FY 2005-06 Current Modified Budget.

Since the original General Fund Balance estimate was made, there has been a stronger than anticipated average daily cash balance in the Commingled Fund and interest rates have continued to rebound from historical lows during the past several years. More recent projections completed by the Controller suggest that interest income will now equal approximately $17,228,516 in FY 2005-06, or $1,739,913 more than what was estimated when developing the FY 2006-07 Recommended Budget. The primary reason for this projected increase is a stronger than anticipated average daily cash balance in the third quarter of the year.

Based on analysis conducted for this report, the Management Audit Division believes the Controller's most recent projection of the average daily cash balance in the fourth quarter continues to be conservative and that actual earnings for the year will likely be greater. Based on an analysis of historical changes in fund balance, we believe that the General Fund Balance estimate for FY 2005-06 should be increased by $2,470,038, rather than the $1,739,913 projected by the Controller, to reflect anticipated earnings from higher average daily cash balances in the fourth quarter of the year. At this level, total collections should be approximately $17,958,641.

Local Sales and Use Tax and In Lieu Local Sales and Use Tax

The County collects a Local Sales and Use Tax that is equivalent to 1.00 percent of taxable sales that occur within the unincorporated areas of the County. However, under State law enacted in 2004 to resolve the State's budget deficit, the State now receives 25 percent of this 1.00 percent Local Sales and Use Tax in exchange for an apportionment of an equal amount of Property Tax from the Educational Revenue Augmentation Fund (ERAF). Known as the "In Lieu Local Sales and Use Tax," this additional apportionment is based on "the combined total revenue loss of the county" due to the local sales and use tax allocation to the State, "annually estimated by the (State) Director of Finance, based upon the actual amount of sales and use tax revenues" collected "in the prior fiscal year and any projected growth on that amount for the current fiscal year as determined by the State Board of Equalization by August 15 of each fiscal year . . ."[1]

This change in the law is intended to provide the County with income that is equivalent to the full amount of the 1.0 percent local sales and use tax that it collects, although the methodology used for estimating the amount of In Lieu tax that is due, reconciling the estimate to actual collections, and releasing payment, defers receipt of a portion of the collection to the following fiscal year. Nonetheless, because of the strong linkage between these revenue accounts, the Management Audit Division has analyzed the two accounts together to determine the net impact to the County from sales and use tax collection activity that occurs within the unincorporated area.

Recent historical data on collections indicates that actual Local Sales and Use Tax collections through April of each year range between 62.4 percent and 66.8 percent of year-end totals, averaging 64.6 percent between fiscal years 2001-02 and 2004-05. Assuming that collections will continue at the historical average rate for the remainder of the fiscal year, the County will likely collect approximately $3,568,568 for its 0.75 percent local sales and use tax in FY 2005-06. This is $256,246 greater than the amount anticipated by the County Executive in the Fund Balance estimate included in the FY 2006-07 Recommended Budget.

[1] California Revenue and Taxation Code, Section 97.68

Due to the methodological approach used by the State for determining the amount of In Lieu Local Sales and Use Tax to be collected by the County, this account will realize approximately $1,061,113 in FY 2005-06. Although this amount is approximately $74,496 less than the budgeted amount of $1,135,609, the lower level of collections has already been recognized by the County Executive when estimating the General Fund Balance. Therefore, no adjustments need to be made in this account for the FY 2006-07 fund balance estimate. However, the net impact on the General Fund Balance from higher than anticipated Local Sales and Use Tax should be recognized, resulting in approximately $256,246 in additional fund balance.

Supplemental Property Tax

In FY 2005-06, the County Executive projects that approximately $30,900,000 will be collected in Supplemental Property Tax, based on collection activity through February 2006. More recent collections data through April 2006 shows that collections have been stronger than previously anticipated by the County Executive based on the February data. Combined with trending analysis from previous fiscal year collection patterns, the Management Audit Division now believes that total Supplemental Property Tax collections for the fiscal year will equal approximately $31,476,762, which is $576,762 more than the amount estimated by the County Executive for the Fund Balance.

Real Property Transfer Tax

In FY 2005-06, the County Executive projects that approximately $28,577,800 will be collected in Real Property Transfer taxes. More recent collections indicate that year-end receipts will be approximately $29,300,000, representing additional revenue of approximately $722,195.

Penalties and Costs on Delinquent Taxes

In FY 2005-06, the County Executive projects that approximately $17,700,000 will be received for penalties and costs on delinquent taxes. However, more recent receipts indicate that this account will end the year with approximately $18,400,000. We therefore recommend that this revenue estimate be increased by approximately $700,000.

FY 2006-07 Departmental Budgets

Various Departments

Account	County Executive Recommended	Management Audit Proposed	Increase/ (Decrease)
5110600-PERS Retirement	$240,231,917	$231,285,302	$8,946,615
4301100-Interest on Dep.	28,347,129	24,825,347	(3,521,782)
Various Reimbursements	3,666,137,405	3,665,542,820	(594,585)
Net Change			**4,830,248**

Background

The October 7, 2005 actuarial valuation reports on the County's CalPERS safety and miscellaneous employee pension plans estimate the County's required employer contributions for FY 2006-07 as follows:

Plan	Employer Rate	Required Contribution
Miscellaneous	11.923%	$119,967,097
Safety	25.831%	41,437,941
Total		**$161,405,038**

Last fiscal year, we suggested that the County consider prepaying the annual contribution on July 1 to take advantage of the 7.75 percent interest expense savings that CalPERS would provide, if the County prepaid its annual contribution. The savings of interest expense is available to CalPERS member agencies that prepay their annual employer contribution by avoiding a 7.75 percent interest charge built into the CalPERS computation of each member's total annual employer contribution requirement. Because most employers make their annual contributions on a bi-weekly basis throughout the fiscal year, which deprives CalPERS of the ability to fully invest the member agencies' contributions for the full fiscal year, CalPERS adds a 7.75 percent interest charge into its calculation of each agency's annual contribution requirement, based on its annual assumed rate of return on investments of 7.75 percent.

Although the Central Fire District was able to prepay its FY 2005-06 employer contribution and realized a savings of approximately $98,000, the County's cash position was not sufficiently strong at that time to comfortably permit prepayment. However, in the subsequent year, the County's cash position has improved significantly. The FY 2004-05 Comprehensive Annual Financial Report (CAFR) shows that the cash position in the General Fund increased by 68 percent from $229.4 million on June 30, 2004 to $386.1 million on June 30, 2005, while the cash position of all government funds grew from $507.2 million to $681.0 million during the same period.

Included in the Countywide (all governmental funds) cash position of $681.0 million was $171.9 million in the Valley Medical Center (VMC) Enterprise Fund. Consequently, the total combined General Fund-VMC Enterprise Fund June 30, 2005 unrestricted cash balance amounted to $557.9 million ($386.1 million plus $171.9 million), or an increase of $158.8 million during the past year. That strong cash position has continued into 2006, as confirmed by the Controller-Treasurer bond and investment staff that monitor the County's cash position for purposes of assessing the possibility of issuing Tax Revenue Anticipation Notes (TRANS). Due to the substantial cash position of the County, the County will not be able to issue TRANS in FY 2006-07. However, the County's cash position should permit the prepayment of the FY 2006-07 annual CalPERS employer contribution.

<u>FY 2006-07 PERS Employer Contribution of $164,438,757 versus $155,492,142 if Paid by July 14, 2006 for a Gross Savings of $8,946,615</u>

The County's CalPERS actuary calculated the FY 2006-07 fixed contribution the County would have to make if it chooses to prepay its employer contribution. The FY 2006-07 fixed amount employer contribution would be $155,492,142, versus the bi-weekly payment total CalPERS estimated to amount to $161,405,038, or a reduction of $5,912,896. However, the FY 2006-07 Recommended Budget includes estimated employer contributions totaling $163,541,879. Therefore, the gross reduction in CalPERS employer contributions would amount to $8,946,615, if the County chooses to prepay its annual employer contribution. It should be noted that the General Fund portion of the annual CalPERS employer contribution requirement is estimated to amount to more than 90 percent of the total, when the VMC Enterprise Fund is included. Consequently, although most of the benefit of a prepayment would accrue to the General Fund, all of the other funds, such as the Parks, Roads and Airports, Library, Environmental Health, Vector Control, and others, would also benefit from the prepayment.

<u>Revenue Losses if FY 2006-07 PERS Employer Contribution is Prepaid: $4,116,367</u>

To the extent that the County diverts available cash balances from its commingled fund to prepay its budgeted CalPERS employer retirement contribution expense, such monies would not be available for the Treasurer to invest. Based on discussions with the County's Investment Officer, the FY 2006-07 projected average return of the Commingled Fund amounts to an annual rate of 4.46 percent. Consequently, the County would lose approximately $3,647,832 of Commingled Fund interest revenue by prepaying its annual CalPERS employer costs. In addition, the County receives many revenues and reimbursements of costs that would be reduced if the County's retirement costs were reduced. Based on a survey of County departments, department fiscal officers estimated total reimbursement losses of approximately $594,585 if the County prepaid its retirement costs. Finally, if the County does not prepay its FY 2006-07 PERS employer contribution, it will have to make an additional $5,912,896 in cash payments to PERS during the fiscal year, resulting in a loss of approximately $126,050 of commingled fund interest earnings. Therefore, the net loss of interest revenue would amount to approximately $3,521,782 ($3,647,832 –minus $126,050) and the overall net savings to the County from prepaying its FY 2006-07 CalPERS employer retirement contribution would amount to approximately $4,830,248, of which $4,360,742 is projected to be a General Fund benefit.

<u>Arguments of the Controller' Office in Opposition to Prepayment of the County's FY 2006-07 Employer Contribution to PERS</u>

Prepayment of the County's FY 2006-07 PERS employer contribution would result in a net budget reduction of $4,830,248. However, the Controller's Office has advanced two arguments in opposition to the prepayment, including a suggestion that if the prepayment is made, the Board should reduce departmental salary savings correspondingly, and the County would be subject to a self-imposed penalty for withdrawal of funds from the Commingled Pool for investment purposes. The Controller suggests that the FY 2006-07 estimated salary savings should be reduced if the County prepays its PERS employer contribution, thereby offsetting some of the projected savings. The budgeted FY 2006-07 salary savings rate is 1.79 percent, or the equivalent of $160,144. If such salary savings were reduced from the FY 2006-07 departmental budgets, the projected net savings of prepaying the PERS employer contribution would be reduced from $4,830,248 to $4,670,104. However, reducing departmental salary savings below the current budgeted levels is certainly not required, since annual salary savings is budgeted at a very minimal level of only 1.79 percent. As evidence of this, actual FY 2005-06 salary savings are projected to exceed the budgeted amount by approximately $13.1 million. Furthermore, the number of funded vacant positions as of May 8, 2006 totaled 1,388 positions, and the FY 2006-07 Object One budget increased by approximately $105 million, without any corresponding increase in salary savings for nearly all departments.

A second argument of the Controller's Office in opposition to prepaying the FY 2006-07 employer contribution to PERS is based on a withdrawal of funds restriction in the Board of Supervisors investment policies governing monies on deposit in the Commingled Pool. This restriction pertains to withdrawal of funds by other government agencies that voluntarily participate in the County investment pool, and specifies that funds that are withdrawn are valued based on market value of the total fund at the time of withdrawal. Pursuant to this policy, a voluntary participant government agency would be charged a penalty or receive a bonus depending on the value of the commingled pool in relation to cost at the time of the withdrawal. The intent of this policy restriction is to prevent other government agencies from moving money into and out of the County's Commingled Pool and into alternative investments, in order to obtain the highest rate of return on investment. First, the Board policy does not apply to the County, but only to "voluntary participants." Second, the prepayment of the County's budgeted expense for employee retirement costs is not a withdrawal for investment purposes, but rather, it is equivalent to taking advantage of a cash discount on a commodity or equipment purchase, which the County does regularly throughout the year, but in smaller transactions. Third, none of the proposed withdrawal restrictions or conditions under which a penalty would be assessed or a bonus paid, or the criteria for determining and calculating a penalty or bonus, is in writing or have been approved by the Board of Supervisors.

Consequently, the assessment of a penalty by the Controller of approximately 0.50 percent on the $155.5 million, which would amount to about $777,500, would be inconsistent with current investment policies of the Board of Supervisors and would have the effect of taking County monies and reallocating them to the school districts, cities and other special districts that have monies on deposit in the County Commingled Fund at the time the County issues its warrant to CalPERS to pay its FY 2006-07 budgeted retirement costs.

Actual Year-end Estimated $4.8 Million Amount of FY 2006-07 Budget Savings

It should be noted that, as with all budget estimates of revenues and expenditures, the actual savings can only be calculated after the close of the FY 2006-07 fiscal year when actual expenditures and interest revenues are known.

If the Board of Supervisors chooses to implement this recommendation, the County's CalPERS actuary further advised that the electronic transfer of funds could occur anytime between July 1, 2006 and July 14, 2006. He also stated that CalPERS had not yet developed an option for its member agencies to prepay the employee share of annual contributions. In addition, once opting for an annual fixed contribution amount, contributions related to any plan modifications during the fiscal year could be deferred to the next fiscal year or paid bi-weekly at the County's option.

Object 1 Expenditures **Salary Calculation Adjustment**

Expenditure Account 5101000	**Permanent Salaries**
Expenditure Account 5110100	**Retiree Medical Expense**
Expenditure Account 5110300	**State Unemployment Insurance**
Expenditure Account 5110400	**County Contribution to FICA**
Expenditure Account 5110500	**Medicare Tax**
Expenditure Account 5110600	**County Contribution to PERS**
Expenditure Account 5110700	**Workers Compensation**

County Executive Recommended	**Management Audit Proposed**	**Expenditure Decrease**
$1,787,236,734	**$1,786,459,331**	**$777,403***

*** Estimated Net General Fund Expenditure Decrease is $477,800 and VMC Enterprise Fund Decrease is $199,907 for a total General Fund benefit of $677,707. The additional $100,000 benefits budgets funded by non-General Fund sources.**

The FY 2006-07 Recommended Budget includes negotiated salary increases for approximately 31 County employee bargaining units that are separately represented by labor organizations. Each collective bargaining agreement provides for a percentage salary increase effective as of various dates throughout the fiscal year. The collective bargaining agreements between the County and 21 labor organizations call for salary increases during Fiscal Year 2006-07, on a date other than July 1. However, the County's current BRASS budget software, which is used by the Office of Budget and Analysis (OBA), is limited in its capability to precisely calculate employee salary increases. Changes in rates of pay can only be calculated from the first day of a month. However, OBA reports that a software upgrade, which would enable precise calculation of salary and benefit costs, will be available for FY 2007-08.

Consequently, the FY 2006-07 increased salary and fringe benefit cost for 17 bargaining units was calculated from the first day of the month preceding the effective date of the negotiated increase, thereby overstating the FY 2006-07 budget. The increased salary and fringe benefit cost of the other four bargaining units was calculated from the first day of the month subsequent to the effective date of the negotiated increase, thereby understating the FY 2006-07 budget. Based on our analysis, the net cost of salaries and fringe benefits are overstated by approximately $777,000. Of this amount, approximately $100,000 is funded from non-General Fund or VMC Enterprise Fund sources.

In order to remove the excess monies from the FY 2006-07 budget, OBA should substitute salary increase factors for each bargaining unit as shown in the attached schedule. These factors reduce or increase flat annual percentages, based on the proportion of days during the fiscal year that the rate increase will be affective. When analyzed on a budget unit basis as an example, Budget Unit 921 - Valley Medical Center is overstated by approximately $200,000.

Expenditure Account 5110200 **Health Insurance Premiums**

County Executive Recommended	Management Audit Proposed	Expenditure Decrease
$167,036,931	**$167,036,931**	**$46,538 per day**

The FY 2006-07 Recommended Budget includes $167,036,931 for the County's cost of health insurance premiums for active employees. The average FY 2006-07 cost per employee is $11,139. Based on information provided by the Employee Services Agency, as of May 8, 2006 there were 1,388 currently vacant positions that are fully funded in the FY 2006-07 budget (Attachment 2). Just the health insurance premium costs budgeted for these positions amounts to approximately $15.4 million. Of the 1,388 vacant positions, 1,290 are in the General Fund or VMC Enterprise Fund and 98 are in other funds. Three hundred and twenty-two (322) of the 1,388 vacant funded positions have been vacant for more than one year. Total salary and benefit savings included in the FY 2006-07 budget amounts to $32.7 million, or 1.79 percent of the $1.83 billion salary and benefit budget, excluding the separate account of budgeted salary reduction which is used for specific circumstances and is not included in most department budgets. For the current fiscal year, FY 2005-06 actual salary and benefit savings in the General Fund and VMC Enterprise Fund are projected to exceed the approved budget estimate by more than $13 million.

The $15.4 million budgeted for health insurance premiums for vacant positions accounts for 39 percent of the entire salary and benefit savings in the FY 2006-07 budget, without accounting for any savings related to the salaries, retirement, Social Security, retiree health insurance, Medicare tax, worker's compensation insurance, and unemployment insurance on the 1,388 vacant positions. In addition, the FY 2006-07 budget includes an additional $1.7 million for health insurance premiums for 157 new positions, if these positions are approved by the Board of Supervisors. If the Board chooses to directly reduce the $167 million health insurance premium appropriation, by delaying the beginning date of funding on vacant positions only, General Fund savings including VMC Enterprise fund would amount to approximately $46,538 per day of delay. For example, funding all vacant positions effective July 15, 2007 would save approximately $465,380. Funding effective August 1, 2006 (a one month unfunding) would save approximately $973,518.

Expenditure Account 5107000 **Salary and Benefit Savings**

County Executive Recommended	Management Audit Proposed	Expenditure Decrease
$32,661,581	$32,661,581	$64,315 per day

The FY 2006-07 Recommended Budget includes $16.7 million to fund 157 new positions. These positions are funded effective July 1, 2006 at an average cost of $106,539. In some cases existing lists are available to appoint from, while in other cases the positions involve promotions that would then result in a vacancy in a lower classification. In other cases, ESA would have to recruit, conduct examinations and compile eligible lists. For each day funding is reduced to allow time for the administrative processing of requisitions, the County General Fund and VMC Enterprise Fund would save approximately $64,315.

Revenue Account 4405095-4410200-4412100 **State Realignment**

County Executive Recommended	Management Audit Proposed	Revenue (Decrease)
$113,188,006	$112,467,474	($720,532)

The revenue in these accounts represents the County's share of a half-cent statewide sales tax that was provided to California counties starting in 1991, as funding for programs that were shifted from State to County administrative responsibility. The gross amount of this revenue is actually divided into three pieces, one that supports public health programs, a second that supports mental health services, and a third that supports social service programs in the Social Services Agency, District Attorney and Probation Department budgets.

This reduction reflects a change in how the Office of Budget and Analysis, the Controller's Office and the Social Services Agency propose to account for these revenues, which are allocated to the County in two ways. First, annually the County is supposed to receive a base level of funding that equals the amount of realignment sales tax it received in the previous fiscal year. In addition, to the extent that statewide sales tax collections from this source exceed the amount required to fund the base level for all counties, additional growth payments to counties are provided. In recent years, these payments have been received by the County as "caseload growth" payments primarily for social services programs, and distributed among the counties based on each county's growth in social services expenditures relative to that of the other counties. These payments have historically been received in the fall of the year, and were accounted for on an accrual basis, so that the growth payment of $7.2 million expected to be received in September or October 2006 is accounted for as part of FY 2005-06 revenues, and is reflected in the discussion of fund balance earlier in this report.

For FY 2006-07 and subsequent years, the Social Services Agency believes that growth payments will be received as "general growth" payments rather than "caseload growth" payments. General growth payments are distributed among counties in the same proportion as the base level of funding, rather than reflecting differences among counties in caseloads. Furthermore, the Social Services Agency and the Controller believe that because a general growth payment is likely to be received after January 1, and therefore after the County's financial statements are finalized, general growth payments should be accounted for on a cash basis, in the fiscal year they are received, rather than in the fiscal year to which the State attributes them. Our review of historical documents on this point shows that in some years where the County received a general growth payment, it was received before Jan. 1, while in other years it was received after Jan. 1. The State Controller's staff in a telephone interview said they believed it is likely that general growth payments for realignment sales tax will occur after Jan. 1, as do general growth payments for realignment vehicle license fees.

Accepting the OBA, Controller and Social Services arguments as to how this revenue will be received and should be accounted for, the budgeted amount for FY 2006-07 must be reduced by $720,532, from $113.2 million to about $112.5 million. Our estimated budgeted figure reflects the following components:

Base payments for 2006-07 fiscal year	$110,637,392
General growth payment for 2005-06 fiscal year	1,830,082
Total realignment sales tax receipts for FY 2006-07	**$112,467,474**

While the Management Audit Division currently estimates that in addition to the above amounts, a general growth payment of $3.4 million is forecast by the State to be paid to the County for FY 2006-07, under the proposed accounting methodology, this revenue would not be recognized until the FY 2007-08 County Budget.

As an alternative to this reduction, the Board of Supervisors may want to adopt a policy to recognize all realignment revenues on a cash basis, reflecting the year in which the revenue is received. The effect of such a change would be to set the amount of revenue received in the current fiscal year, 2005-06, at $103.4 million. That would require a further reduction in the FY 2005-06 fund balance amount discussed earlier in this report, and instead shift additional revenue into next year's budget. The FY 2006-07 budgeted amount would then be $119.7 million, versus the budgeted amount of $113.2 million. The total amount of revenue recognized in Fiscal Years 2005-06 and 2006-07 would be the same, totaling $223.1 million, but the way the revenue is accounted for in the budgets would change.

Adopting this policy of recognizing all realignment revenues on a cash basis would make the revenues more predictable for budget forecasting purposes, and would also prevent wide variations in how these revenues are budgeted and recognized from occurring due solely to differences in the date at which the revenues are received.

Budget Unit 0110 – Controller - Treasurer **Page 220**

Revenue Account 4010100 **Sales Tax**

County Executive Recommended	Management Audit Proposed	Revenue Increase
$3,312,322	$3,568,568	$256,246

As discussed previously, the County collects a Local Sales and Use Tax that is equivalent to 1.00 percent of taxable sales that occur within the unincorporated areas of the County. However, under State law enacted in 2004 to resolve the State's budget deficit, the State now receives 25 percent of this 1.00 percent Local Sales and Use Tax in exchange for an apportionment of an equal amount of Property Tax from the Educational Revenue Augmentation Fund (ERAF). Therefore the basic Local Sales and Use Tax rate for the County now equates to 0.75 percent of taxable sales that occur within the unincorporated areas of the County.

The County's Local Sales and Use Tax collections are impacted by a number of variables, including the number of retail sales establishments in the unincorporated area and the volume of sales, as affected by the economy and competition from businesses outside of the unincorporated areas. Historically, this revenue has had a fairly stable growth curve that matches inflation, but has periodically grown or shrunk disproportionately when there have been major swings in the local economy. For example, FY 2003-04 actual collections were 18.2 percent over actual collections in the prior year, due in part to the beginnings of a local economic recovery.

Based on collections through April and prior year collection trends, we are projecting that FY 2005-06 Local Sales and Use Tax collections will be approximately 17.9 percent greater than the amount collected in FY 2004-05, as the economic recovery continues. Over the two years since FY 2003-04, collections will have grown by an equivalent of nearly 9.0 percent, which is significant but reasonable given current conditions.

It is difficult to predict future sales and use tax growth in FY 2006-07 due to a number of factors. On the one hand, retail sales in the unincorporated area will likely reach an historic high in FY 2005-06 and may be approaching the natural boundaries of growth given the number of retail sales outlets and volume of sales that occur. On the other hand, the real possibility of inflation due to increases in energy prices, and the corresponding inflationary impact on sales prices for taxable goods due to higher production and transportation costs, may result in a continuing rise in sales and use tax collections within the unincorporated areas. These and other conflicting factors suggest that inflationary growth could be significant. Because of these phenomena, we are therefore projecting no growth in FY 2006-07 Local Sales and Use Tax above the amounts we are projecting for FY 2005-06. Nonetheless, this no-growth assumption results in an increase in the budgeted amount from $3,312,322 to $3,568,568, or approximately $256,246.

It should be noted that the County and the City of San Jose are presently negotiating the terms of an agreement that will require the City to annex some existing unincorporated areas. However, discussions with representatives in the County Executive's Office indicate that the terms of the agreement are still being defined and the affected unincorporated areas have not yet been determined. While we agree with the Controller that the County's Local Sales and Use Tax revenue will be adversely affected by these annexations, we find it unlikely that the annexations will occur during FY 2006-07. Therefore, we are anticipating no impact on Local Sales and Use Tax collections during the forthcoming fiscal year.

Revenue Account 4010110 **In Lieu Local Sales and Use Tax**

County Executive Recommended	Management Audit Proposed	Revenue Increase
$1,093,000	**$1,189,523**	**$96,523**

As stated previously, under State law enacted in 2004 to resolve the State's budget deficit, the State now receives 25 percent of the County's 1.00 percent Local Sales and Use Tax in exchange for an apportionment of an equal amount of Property Tax from the Educational Revenue Augmentation Fund (ERAF). Due to the character of the methodology for apportionment that is prescribed by State law, the County receives an adjustment payment for the prior fiscal year in September and then two allocations based on estimated Sales Tax collections for the current fiscal year in January and May. All three of the payments are recognized as current year revenue.

Based on projected actual Local Sales and Use Tax collections in FY 2005-06, the Management Audit Division anticipates that the adjustment payment made in September will equal approximately $353,254 and the sum of the estimated payments for FY 2006-07 will be approximately $836,269, for total FY 2006-07 revenue of $1,189,523. This estimated amount is approximately $96,523 above the $1,093,000 included in the Recommended Budget.

Revenue Account 4301100 **Interest-Deposits and Investments**

County Executive Recommended	Management Audit Proposed	Revenue Increase
$19,777,061	**$22,312,580**	**$2,535,519**

As discussed in this report's section on fund balance, each year the Controller estimates interest income by projecting the average daily cash balance and interest on investments to be earned by quarter by the County Commingled Fund. Because of exceptionally strong average daily cash balances in the third quarter, and anticipated continued strong average daily cash balances in the fourth quarter of FY 2005-06, the General Fund will realize total interest earnings of $17,958,641. This is $2,470,038 greater than the amount budgeted for FY 2005-06, but only $730,125 more than the amount being estimated by the Controller in his most recent estimate.

Assuming that quarterly average daily cash balances will grow during FY 2006-07 by historical averages for the last five fiscal years, the amount available for the County to invest will increase by approximately 4.7 percent between fiscal years 2005-06 and 2006-07. This compares with an average growth estimated by the Controller of 4.0 percent from a slightly lower base in the fourth quarter of FY 2005-06. The differential between these two estimates equates to an average daily cash balance of approximately $20.0 million for the year.

The Controller is also estimating that the average earnings rate on investments during FY 2006-07 will decline from a first quarter rate of approximately 4.61 percent to a fourth quarter rate of approximately 4.36 percent, which represents a decline of 25 basis points. Based on discussions with the Controller and the County's investment officer, this decline is being forecast in anticipation that the Federal Reserve Board will stop adjusting interest rates after May, and that the investment market will rally in the last part of the year, driving down interest rates. The investment officer also believes that the inflationary effects of increased energy costs will be tempered by other compensating factors - such as lower labor costs from increased productivity - so that the cost of money will remain low. Lastly, the investment officer states that while short-term interest rates have increased substantially in recent months, longer-term rates have been more stable, indicating further support for her perspective that the economy will move strongly into FY 2006-07 and that interest on investments will correspondingly begin to decline.

This general economic assessment is consistent with the expectations of some economists who are external to the County and mirrors statements made by the Chairman of the Federal Reserve Board to Congress in February 2006. A report prepared by the Economic Information & Research Department for the Los Angeles County Economic Development Corporation (LAEDC) conforms to the investment officer's assessment of major economic indicators that affects interest rates. However, this non-profit group also forecasts increased interest rates during FY 2006-07. In a February 2006 report, the LAEDC stated that, "In any event, credit markets are expected to continue normalizing gradually, with the 10-year Treasury note rising to about 4.9% by the end of 2006 and 5.3% by the end of 2007 from 4.5% in December 2005. Mortgage rates will mirror the changes in Treasuries, pushing the 30-year fixed mortgage rate to about 6.6% by the end of 2006 and to 7.0% a year later." This latter assessment is supported by the UCLA Anderson School forecast prepared in April, which anticipates a continued weak economy through 2008 resulting, in part, from "higher short- and long-term interest rates."

Based on a review of these materials, we generally agree with the assessment made by the Controller and investment officer that interest rates will stabilize and could slightly decline toward the end of the fiscal year. However, our assessment of the various economic analyses and the County's most recent investment activity suggests that 1) the County's average interest rate will continue to increase through the second quarter as the market adjusts to one additional rate adjustment that will likely be made by the Federal Reserve Board in June, and 2) the market rally that results from declining interest rates and the impact on the County's average investment yield will be more tempered than previously anticipated by the County.

Accordingly, we project that the County will earn average interest of approximately 4.60 percent during FY 2006-07,[2] compared with the 4.46 percent earnings rate anticipated by the Controller. Applying this higher earnings rate to the adjusted average daily cash balance discussed previously, these assumptions result in expected interest earnings of $22,312,580 for FY 2006-07. This is approximately $2,535,519 more than the $19,777,061 budgeted by the County Executive and $1,524,723 more than the most recent revised estimate by the Controller based on FY 2005-06 third quarter average daily cash balance data.

Revenue Account 4403100 **State - Motor Vehicle**

County Executive Recommended	Audit Division Proposed	Revenue (Decrease)
$60,000,000	**$57,255,710**	**($2,744,290)**

This account represents the remaining portion of vehicle license fee revenues received by the County following the State's decision to permanently reduce the fee rates charged to vehicle owners, and replace fees formerly received by the County with additional property tax monies. The remaining share of vehicle license fee revenues supports public health, mental health and social services programs under the same 1991 realignment of State and County responsibilities that led to the sales tax allocations previously discussed.

As in the case of the realignment sales tax revenues, each year the County receives an allocation of these vehicle licenses fees in the form of a base payment which equals the total amount of payments received in the prior fiscal year, and a separate "general growth" payment. This growth payment is made solely based on each county's share of the base state vehicle license fee funding for realignment. This growth payment has

[2] Rising from a FY 2005-06 reported third quarter rate of 4.07 percent to approximately 4.65 percent in the second quarter of FY 2006-07, then declining to approximately 4.5 percent by year-end.

historically been received in January or February. Because it is received after the County's annual financial statements have been finalized, the Controller-Treasurer has been recognizing the growth payment for one fiscal year as revenue in the subsequent fiscal year, so that the growth payment for FY 2004-05, received on February 6, 2006, was included as revenue in the FY 2005-06 fiscal year.

Since May 2005, the Governor's Department of Finance has sharply reduced its statewide estimates of revenue growth from this source. Typically the strongest factor in these revenues is new car sales, which have slowed in recent months nationally as a result of increased gas prices, with particularly large declines among American auto makers, trucks and sport-utility vehicles, which generate higher VLF revenues based on their higher prices.

In FY 2005-06, we project that the County will receive approximately $55.26 million from this source, consisting of a base payment of $52.53 million, equaling last year's total receipts, and a general growth payment of $2.73 million that was received in February. The $55.26 million figure would then become the County's base payment amount for FY 2006-07.

Based on our discussions with the California Department of Finance and the State Controller, it appears probable that the State will in fact be able to pay the base amount budgeted for all counties in FY 2006-07, barring some significant unforeseen change. In addition, the May Revise for the Governor's Budget also projected about $60.72 million being available Statewide for a general growth allocation for FY 2005-06, which would be paid in January or February 2007, and become part of FY 2006-07 revenues. Assuming this allocation was distributed in a similar manner to the allocation received in February 2006, Santa Clara County would receive approximately $2 million. Added to the base amount of $55.26 million, the County would receive total revenue from this source of $57.26 million, approximately $2.7 million less than the budgeted amount.

Budget Unit 0112 – Tax Collector — Page 234

Revenue Account 4006100 — **SB 813 – Supplemental Property Tax**

County Executive Recommended	Audit Division Proposed	Revenue Increase
$28,000,000	$31,500,000	$3,500,000

Supplemental Property Tax is collected from property owners after the property value has been adjusted by the Assessor and a bill has been produced by the Tax Collector subsequent to a sale or some other ownership transfer that triggers a new assessment. The tax represents the amount due on the differential between the assessed valuation at the time of the transfer and the assessed value after the transfer. Depending on when the transfer occurs, one or more supplemental tax bills may be produced. When Supplemental Property Tax payments are received by the County, the payment is deposited into a trust fund and then apportioned by the Controller to the taxing jurisdictions on a monthly basis.

Analysis of data collected from the Tax Collector for previous budget reviews indicates that Supplemental Property Tax payments are typically collected and apportioned an average of nine months after the transfer has been recorded with the County. Accordingly, Real Property Transfer Tax activity for previous periods provides an early indication of the pattern of Supplemental Property Tax collections that will occur in the future. As discussed below for the Recorder, Real Property Transfer Tax collections for FY 2005-06 increased by approximately 12.0 percent above FY 2004-05 levels. However, for the six month period between October and March of the current and past fiscal years, the average monthly growth in Real Property Transfer Tax activity has been only 1.2 percent. This downward trend suggests that transfer activity is slowing and that Supplemental Property Tax collections will very likely level off in FY 2006-07, to approximately FY 2005-06 levels, when adjusted for the slowdown in transfer activity occurring nine months prior to collections.

For FY 2006-07, the County Executive has estimated that Supplemental Property Tax collections will decline from an estimated level of $31.5 million in FY 2005-06 to $28.0 million in FY 2006-07. This 12.5 percent decline is inconsistent with the pattern of Real Property Transfer Tax collection activity that has occurred in FY 2005-06, which suggests that there will be a flat or slight growth curve in Supplemental Property Tax collections when the payments are received an average of nine months after the property transfer date. Accordingly, the Management Audit Division recommends that the Supplemental Property Tax revenue account be increased to FY 2005-06 estimated levels, or $31,500,000. This adjustment results in an increase in budgeted revenues of $3.5 million in FY 2006-07.

Budget Unit 114 – Clerk-Recorder Page 243

Revenue Account 4020300 **Real Property Transfer Tax**

County Executive Recommended	Audit Division Proposed	Revenue Increase
$28,000,000	**$29,300,000**	**$1,300,000**

Real Property Transfer Tax revenue is received when real property transfers ownership and generally are computed on the sales price of the property. Economic indicators suggest that real property transfer activity is slowing as FY 2005-06 draws to a close.

The County Executive has recommended that $28 million be budgeted in Real Property Transfer Tax in FY 2006-07, which is 4.4 percent, or $1.3 million less than the amount the Management Audit Division is projecting will be collected in FY 2005-06. The County Executive's estimate is also below the annual revenue growth rate between Fiscal Year 2004-05 and FY 2005-06, which we have projected will be approximately 12 percent.

Despite the ongoing warnings of some economists and researchers about potential adjustments in the national housing market, and clear evidence of moderation in the local market, there is no indication that the local market is poised to rapidly decline over the next 13 months. For example, the Demographic Research Unit of the California Department of Finance indicates that as of January 2006, population is continuing to increase in Santa Clara County, and the County has the lowest percentage of vacant housing in the state, at 2.3 percent. With nearly all of the housing filled, the population growing, and indications of overall improvement in the local economy, it seems unlikely that demand for housing will significantly decline in the next 13 months. This can reasonably be expected to keep the real estate market strong.

Further, there have been some suggestions that the housing market has cooled in response to higher mortgage interest rates that have occurred during the past year. However, as indicated in other sections of this report, there are clear signs that interest rates will stabilize in the next year. If these predictions are correct, the recent declines in housing sales should begin to reverse along with real estate transfer activity.

While we do not believe that there will be an appreciable increase in real estate transfer activity during the coming fiscal year, we believe it is overly conservative to believe that the more recent decline in activity will be sustained. Therefore, we believe the Real Property Transfer Tax revenue account should be budgeted at current actual collection levels, or $29,300,000 for FY 2006-07. This adjustment would result in a $1.3 million increase in budgeted revenues for the fiscal year.

Expenditure Accounts
5101100 — **Temporary Salaries**
5103000 — **Overtime**

County Executive Recommended	Management Audit Proposed	Expenditure Decrease
$181,797	$81,797	$100,000

Historically, Department staff indicates that overtime and extra help usage is driven primarily by demand for document recording of mortgage refinances and real property transfers. As mortgage rates have increased significantly over the past several months, refinancing activity has declined sharply. In addition, somewhat fewer properties are changing hands. These factors result in fewer documents to record and declining need for staff augmentation to carry out recording activity. This drop in recording is reflected in the current-year revenue for the document recording fees, which are projected to come in 5.7 percent lower, yielding $383,800 less than anticipated by the current modified budget in the Recorder's cost center. Although it is theoretically possible that document activity will pick up next year, Department staff does not expect that this will occur. In addition, the Mortgage Bankers Association projects the national refinance market to decline from 53 percent of mortgage originations in early 2005 to about 36 percent throughout 2006-2007.

Based on the Department's assessment and external projections, it appears highly unlikely that the Department will need more overtime and extra help in FY 2006-2007 than it will use this year for document recording. If document recording activity did increase in FY 2006-2007, however, it appears that the Department's budget for regular salaries -- for which there is no budgeted salary savings -- would provide sufficient "cushion" to enable the Department to absorb any additional cost of overtime usage. For example, excluding the savings from the budgeted overtime and temporary salaries, the Department's savings in salary and benefit costs in FY 2004-2005 amounted to $130,000. The Department projects that its salary and benefits savings in the current year, excluding these items, will amount to almost $147,000. We project that the Department would continue to have net salary savings even if its overtime and temporary employee salaries were reduced by $100,000 next year. We therefore recommend that the combined budgets for temporary and overtime pay be reduced from $181,797 to $81,797 in FY 2006-2007. As shown in the table below, we expect that a $100,000 reduction would still leave about $15,000 in surplus in these combined accounts, not counting surplus that would be expected in other salary accounts as a result of salary savings.

Clerk-Recorder's Temporary and Overtime Salaries

Salaries	Projected Year End FY 2005-2006	Proposed for FY 2006-2007	Difference
Temporary Staff	$33,111	$91,797	$58,686
Overtime	$34,153	$90,000	$55,847
Total	**$67,264**	**$181,797**	**$114,533**

Subsequent to the production of a draft version of this report, Department staff reported that these funds will be used in FY 2006-07 for a previously unbudgeted purpose. The Department indicates that the funds will be used to employ three to four extra help staff for one year, plus significant overtime pay for existing staff, to validate and augment the work of outside vendors on three projects. These efforts are:

- The validation of the accuracy of two projects converting records to digital and computerized images; and,

- The indexing of the inventory of archival records.

The actual conversion work and inventorying will be carried out by vendors; the Department indicates that the $100,000 in extra help and overtime funds that previously had been established for recording documents will be used primarily for verifying the accuracy of the work of the vendors on these special projects.

There is no evidence that these newly identified expenses would exceed the Department's combined budget for regular salaries--which again contains no reduction for salary savings and has yielded significant surplus in the current and prior years—and the $81,797 that we propose leaving in the overtime and extra-help budgets for FY 2006-07.

Budget Unit 119 – Special Programs Page 46

Operating/Equity Transfers 5610100 **Transfers Out**

County Executive Recommended	Management Audit Proposed	Expenditure Decrease
($3,991,980)	($3,360,980)	$631,000

The FY 2006-07 Recommended Budget includes $3,991,980 in General Fund transfers to support various County special programs. Of this amount, $631,000 in General Fund support is included to reimburse the Department of Environmental Health's Consumer Protection Division for performing state mandated facility inspections that are exempt by State or local statutes from fees. During the last four fiscal years, the General Fund support transferred to the Department totaled $285,000, and did not fully reimburse the Division for its costs. The General Fund support included in the FY 2006-07 Recommended Budget is expected to fully cover the Consumer Protection Division's projected costs.

According to Department staff, in the mid-1990s, the Board took action during the County budget process to utilize General Fund resources to reimburse the Department for inspections performed on facilities that were exempt from fees. Although statute authorizes counties to utilize fee revenue collected to support *all* costs of the Consumer Protection Division Program, the Board has not revisited this issue since then and the County continues to provide some General Fund support for the Department.

According to Department staff, it maintains a fund balance in Environmental Health Fund 030 from revenue generated from fees collected for services performed by the Consumer Protection Division. Department staff indicate that the fund balance in FY 2004-05 was $3,945,668 and the fund balance for FY 05-06 is projected to total $4,790,982. According to Department staff, this fund balance was accrued as a result of a fee increase and the Department's proactive steps to develop a healthy reserve level through disciplined hiring practices and delayed implementation of automation projects. Although it has not yet finalized its spending plan for this reserve, the Department indicates that it was planning on using the resources to fill vacancies, fund numerous mandatory unbudgeted expenses such as retirement payoffs, increases in internal services costs, and salary increases due to the reclassification of positions; and make one-time capital and equipment purchases.

While the Department should be recognized for its success in re-establishing a fund balance in the Environmental Health Fund, we recommend that the County utilize a portion of this Fund's reserve to offset General Fund support for this program on a one-time basis in light of the County's budget situation. Under this approach, the transfer to the Department would be deleted to achieve $631,000 in General Fund savings in FY

2006-07. This action would still retain a sizeable fund balance in the Environmental Health Fund for the Consumer Protection Division Program.

Furthermore, given the County's legal authority to assess fees to fully recover the cost of the Consumer Protection Division's inspection activities, the Board should revisit its decision to utilize General Fund support for these services. In lieu of using General Fund monies on an ongoing basis, the County alternatively could increase the fees assessed by the Consumer Protection Division to generate sufficient revenue to offset its operating expenses. Given this potential opportunity for a long-term budget solution, we recommend that this issue be referred to the Housing, Land Use and Transportation Committee for further discussion, which we believe should occur concurrently with the Committee's review of the Department's expenditure plan for its reserve funding.

Budget Unit 148 – Department of Revenue Page 253

Revenue Account 4106100 **Franchise Fees**

County Executive Recommended	Management Audit Proposed	Revenue Increase
$1,050,000	$1,383,692	$333,692

The Department of Revenue (DOR) collects franchise fees from Pacific Gas & Electric and water and cable companies. There are no restrictions on the use of this revenue. In FY 2004-05, the DOR collected $819,601 from this source, and we project DOR will collect $1,383,692 in FY 2005-06. Department of Revenue staff project a similar, though slightly lower, amount of revenue in FY 05-06, totaling $1,355,560. The actual revenue achieved appears to increase significantly in 2005-06 largely due to a change in accounting policy. Starting in 2004-05, DOR could no longer accrue revenues that were not received within 180 days of the close of the fiscal year. Revenues that are received after this time period are budgeted in the following fiscal year.

The FY 2006-07 Recommended Budget includes $1,050,000 in franchise fee revenue. Based on our review of historical data on actual revenue achieved over the past several years, we believe the County could increase the budgeted revenue in this account to $1,383,692, an increase of $333,692. We arrived at this projection by analyzing actual revenue data from different points in time. First, we reviewed FY 2004-05 and FY 2005-06 YTD data for Period 10. In FY 2004-05, the Department had received 95 percent of its actual revenue by Period 10. Assuming the prior year's trend continues into FY 2005-06 and FY 2006-07, we estimate that the Department would receive a total of $1,393,692 each year. This calculation assumes no growth in revenue.

Second, we reviewed historical data on the actual Franchise Fee revenue received by DOR between FY 1995-96 and FY 2003-04. (Actual revenue received for FY 2004-05 was omitted from this analysis since it was distorted somewhat by the accounting policy change mentioned above). Using a linear trend model, we arrived at a similar level of projected revenue in FY 2006-07 (roughly $1.35 million) as we identified above.

Based on its review of collections in April/May, DOR has indicated that the continued trend in the collection of franchise fees in FY 2005-06 would allow it to increase the proposed budget by $200,000. The DOR staff has expressed concern that a more aggressive projection would put the County at risk of expecting more revenue than is necessarily reasonable. Furthermore, a conservative estimate provides the added benefit of increasing the likelihood of surplus revenue, which could be used, in turn, to cover other overaggressive revenue estimates that do not materialize.

During our review of the FY 2007 Recommended Budget for DOR, however, we did not identify any other revenues within the Department's budget that appeared to be overly aggressive. Furthermore, we believe that our recommended increase of $333,692 is reasonable in that it assumes no growth in FY 2006-07 and is in-line with historical data from a nine-year time period.

BU 230 Office of the Sheriff — Page 299

Revenue Account 4301100 Law Enforcement Services to Other Agencies

County Executive Recommended	Management Audit Proposed	Revenue Increase
$9,943,243	**$11,844,485**	**$1,901,242**

The FY 2006-07 budget for law enforcement services to contract cities reflects an increased cost of $1,160,352, or 8.50 percent over the FY 2005-06 budget. The budgeted cost increase pertains to annual salary and related fringe benefit increases, which account for about $481,000 of the increase. Most of the remainder of the increase pertains to greater fuel costs estimated to amount to an additional $570,000 in FY 2006-07. Although these cost increases were included in the Recommended Budget, the corresponding increase in reimbursement from the contract cities was not included. Because the law enforcement services provided by the Sheriff from the West Valley Patrol station include a small amount of services to unincorporated areas of the County, approximately 80 percent of the cost of the West Valley Patrol Cost Center is funded by contract city reimbursements, and the balance is a County General Fund cost.

The proposed $1,901,242 increase in reimbursement revenue would bring this budget into balance, ensuring that the cities and the County each pay their appropriate share of costs. It should be noted that the Recommended Budget is predicated on estimated salary increases that will not be precisely known until an annual salary survey is completed prior to the October 10, 2006 contract effective date. In the event that the survey results would require a reduction in the amount of salary and fringe benefits currently included in the budget, the Office of Budget and Analysis should make a corresponding reduction in the amount of contract city reimbursement revenue estimated in this account, if the Board of Supervisors approves this recommendation.

BU 235-240 Department of Correction **Page 312**

Revenue Account 4723110 **Prisoner Housing Federal**

Department Recommended	Audit Division Proposed	Revenue Increase
$7,271,895	$7,644,014	$372,119

This revenue source is received under agreements between the County and the U.S. Marshal's Office for the County to temporarily house federal prisoners and detainees. The FY 2006-07 budgeted level assumes that an average of 227 federal prisoners will be housed per day at a charge of $87 per day, which is the maximum amount the County is permitted to charge, based on housing these prisoners in the Main Jail.

The Management Audit Division has argued previously that the $87 per prisoner day maximum rate, which has been in place since 1998, should be renegotiated, as is permitted under federal regulations. In December 2004, the Controller-Treasurer Internal Audit Division joined us in that view, recommending as part of a report on Department of Correction rates and charges that a rate increase should be requested. On June 21, 2005, the Board approved a delegation of authority to the Chief of Correction to negotiate a rate increase with the U.S. Marshal's Office. At that time, the Department reported that actual costs to house federal prisoners in the Main Jail were $133.75 per day, while costs at the Correctional Center for Women at Elmwood were $77.34 per day. However, the Recommended Budget continues to budget this revenue at the 1998 rates.

Subsequent to receiving a draft version of this report discussion, the Department reported that it is in ongoing discussions with the U.S. Marshal's Office regarding a new contract, which the Department believes will be concluded in time for a new rate to go into effect beginning September 1. Although the U.S. Marshal has not committed to any specific rate, the Department believes it is reasonable to assume a rate of $97 per day for federal prisoners housed in the Main Jail, which is equivalent to the rate the Department says it was advised the U.S. Marshal is paying Alameda County. For prisoners housed at the Correctional Center for Women, the Department believes the rate will remain at the existing $75.35 per day, even though actual costs are higher, because that is the rate the U.S. Marshal is charged by Alameda County for women prisoners.

Based on these discussions with the Department, we recommend that the budget for this revenue be increased to $7,644,014, an increase of $372,119. This increase assumes three months of housing Main Jail prisoners at a rate of $87 per day, nine months housing such prisoners at a rate of $97 per day, and 12 months housing female prisoners at a rate of $75.35 per day. The Department agrees with this proposed revenue increase, which reflects the same volume of prisoners housed each day that was assumed in the Recommended Budget.

Revenue Account 4723120 **Prisoner Housing State**

Department Recommended	Audit Division Proposed	Revenue Increase
$3,112,538	$3,265,381	$152,844

This account represents revenue received for housing prisoners on behalf of the State, primarily at the Elmwood Correctional Facility. The prisoners are generally of two types, individuals arrested in Santa Clara County who have violated parole from the California Department of Corrections or the California Youth Authority, and participants in the In-Custody Drug Treatment Program, which is a program where parolees arrested on drug-related parole violations are housed at Elmwood and participate in an intensive 60-day substance abuse treatment program, and then receive additional monitoring outside incarceration.

The FY 2006-07 budgeted level for this program reflects housing an average of 125 State prisoners per day, which is approximately the level of State prisoner housing that has occurred during the past three months, in which the In-Custody Drug Treatment Program was fully operational.

The budget also reflects the current reimbursement rate of $68.22 per day received for housing each prisoner. However, the Governor's May Revision to the State budget states that, in accord with an agreement reached last year to review this rate annually based on agreed-upon methodology, the rate for FY 2006-07 will be increased from $68.22 per day to $71.57 per day. The County's legislative relations staff reports that the Legislature also concurs with last year's agreement, and therefore the additional revenue proposed should be included in the proposed State budget. Increasing the daily rate for housing state prisoners in County facilities, at the same volume of housing proposed in the budget, provides additional revenue of $152,844 to the budgeted amount. The Department agrees with this recommendation, assuming the information provided regarding the State's intention is correct.

Revenue Account 4723120 **Prisoner Housing Other County**

Department Recommended	Audit Division Proposed	Revenue Increase
$1,672,248	$1,976,948	$304,700

This account represents revenue received from Alameda, Marin and San Mateo counties for housing their prisoners requiring mental health care in the Unit 8A Mental Health unit in the main jail. Based on the latest information provided by the Department, the San Mateo contract requires that County to pay a flat amount, $2,500 per day, or $912,500 for the entire fiscal year, for guaranteed use of two beds per day in Unit 8A. The contracts with Alameda and Marin counties provide beds on an as-needed basis, with each county paying $1,386 per prisoner per day for 8A housing.

The budgeted amounts for these two contracts assumed providing about 46 bed days per month in Unit 8A to Alameda County prisoners, and about six bed days per month for Marin County prisoners. However, during the past 13 months, usage by Alameda County has averaged 52 bed days per month, while Marin County's usage has averaged 12 days per month since October 2005, when its current contract went into affect. Assuming this usage continues, at the new rates of $1,386 per day, the Department projects earning $199,584 from Marin County and $864,864 from Alameda County in Fiscal Year 2006-07. Combined with the guaranteed revenue from San Mateo County, the estimated revenue for Fiscal Year 2006-07 totals $1,976,248, $304,700 more than the budgeted amount. The Department agrees with this recommendation.

Budget Unit 235-Account 510 **Salaries and Employee Benefits**

Department Recommended	Management Audit Proposed	Expenditure Decrease
$30,690,204	**$30,642,702**	**$47,503**

A report on current vacant positions provided to the Management Audit Division by the Employee Services Agency included among the vacancies an Assistant Chief of Correction-U position that has been vacant since November 2, 2004. While other long-term vacant management positions in the Department have recently been filled, or are in the process of recruitment, ESA's executive recruitment staff, after discussions with the Department, reports recruitment for this position is not expected to begin until late August or early September at the earliest. ESA staff further reports that even filling the position through internal promotion would take at least six weeks, meaning the position will not be filled until early October at the earliest. Accordingly, we recommend that this position, which was budgeted for full-year funding in the recommended budget, be budgeted for only nine months of salary and benefits. At the position's reported cost of $190,010, this change provides savings of $47,503. Whereas other positions vacant in this Department may require backfilling with overtime, which offsets any potential savings, executive management positions are not eligible for overtime pay, and the functions of this vacancy are presumably being carried out by other managers as a temporary addition to their regular duties.

Budget Unit 246 – Probation **Page 331**

Revenue Account 4511200 **Federal Title IV-E**

County Executive Recommended	Management Audit Proposed	Revenue Change
$8,500,000	$8,500,000	$0

This revenue is federal reimbursement for a portion of probation services provided to delinquent minors who are considered "reasonable" candidates for possible placement in foster care. The funds are administered by the federal Department of Health and Human Services, Administration for Children and Families. In FY 2004-2005, the County recorded receipts of $9.2 million in this line item, although fiscal staff indicate that due to accrual errors, actual receipts were closer to $8.5 million. Reimbursements are made on the basis of quarterly work hour records completed by Probation Officers engaged in eligible activities, primarily court work and case management.

Historically, the Department has deemed juvenile wards as reasonable candidates for possible placement in foster care. As such, the Department has filed for and received reimbursement for work on behalf of approximately 2,600 juvenile probationers annually. However, new federal legislation, the Deficit Reduction Act of 2005 as signed by President Bush in February 2006, creates new restrictions that may greatly reduce the number of probationers for whom claims can be filed. The new law specifies that only probationers for whom foster care is "imminent" would be eligible for reimbursement.

The Probation Department estimates that, once federal guidelines are issued, only a fraction of its juvenile probationers will qualify as eligible, resulting in a reduction of several million dollars of revenue. On April 27, 2006, the California Department of Social Services issued a letter of alert to counties to be aware that changes in claims guidelines would be forthcoming, but provided insufficient information to determine the effect on Santa Clara County's Title IV-E receipts in either the current year or in FY 2006-07. For example, the State has indicated that it is seeking clarification as to whether the restrictions will be retroactive to the October 2005 date of the federal bill or whether the restrictions will go into effect at a future date. In May 2006, the association of the Chief Probation Officers of California (CPOC), noted that information regarding restrictions would be forthcoming, but was not yet available.

The proposed FY 2006-2007 Probation Department budget includes anticipated receipts of $8.5 million for this revenue. If federal restrictions were to be mandated by October 2006, and the restrictions that the Department anticipates will occur are in fact enacted, the revenue from this source could be reduced by as much as $5 million in FY 2006-07. In addition, if restrictions are implemented retroactively to October 2005, and supported by the State's inquiries to the federal government, revenue losses could be greater. Due to the uncertainty, we are not recommending reductions in this revenue at this time, but prudence demands that we alert the Board to potential future losses, the extent of which will depend on how the legislation is interpreted under federal guidelines and the timing of the implementation of restrictions.

BU 263 Facilities and Fleet — Page 166

Expenditure Account 5290100 — **Utilities**

County Executive Recommended	Management Audit Proposed	Expenditure Decrease
$14,597,661	$13,971,692	$625,969

Utility costs for most County facilities are included in this line item. At the time the budgeted amount was proposed by the Department in January, there was significant uncertainty about both natural gas and electricity prices as a result of reduced gas supplies from Hurricane Katrina and other factors. Since then, the outlook for utility rates has become more predictable, and the Department concurs that its original budget estimate, which included a 5 percent uncertainty factor, could be revised in light of new information. The revised figure includes the Department's latest estimate of utility costs, and represents an increase of 10.2 percent over the budgeted amount for the current fiscal year, and a 16.4 percent increase over the estimated actual utility expenditure of about $12 million for the current fiscal year

The Department reports a concern about the variability of utility costs due to weather, as very high summer temperatures or very low winter temperatures can increase utility use and therefore cost. For example, the Department acknowledges that the current year utilities expenditures are likely to be under budget, reflecting an unseasonably warm winter and late onset of hot weather. The Department is correct in its assessment of weather factors to date in calendar year 2006. We therefore also recommend that actual utilities expenditures be reexamined as part of the mid-year budget review, by which time the summer cooling season will be over. If expenditures at that point are higher than at a similar point in previous years, an addition to the utilities budget from contingency funds could be considered at that point.

Expenditure Account 5330200 — **Capital Projects Services and Supplies-External**

Department Recommended	Management Audit Proposed	Expenditure Decrease
$10,130,000	$9,630,000	$500,000

This line item represents the one-time appropriation recommended by the County Executive for the County's FY 2006-07 capital projects program. A transfer from the General Fund to the Capital Projects Fund typically funds this appropriation. Included in the F7 2006-07 appropriation is $1.6 million to implement security upgrades to the

County Government Center at 70 West Hedding Street. Included in the $1.6 million is $500,000 to reopen the entrance to the south side of the East Wing as an employee-only entrance, including a revolving door. This entrance is now closed in order to prevent temperature control problems reported by Clerk-Recorder staff at the time this entrance was open to the public. On May 2, 2006, the Board of Supervisors considered a security and protective services plan for the County Government Center and the County Center at Charcot. As part of its action to adopt that plan, the Board directed that an implementation plan for security in the Board of Supervisors chambers be prepared that eliminated the proposed door. Because the Board's May 2 action occurred after the preparation of the Recommended budget, money for the $500,000 revolving door was included. This funding should be eliminated, commensurate with the Board's May 2 action.

Budget Unit 410 – Public Health Page 423

Revenue Account 4203000 **EMS Fines and Penalties**

County Executive Recommended	Management Audit Proposed	Revenue Increase
$369,524	**$929,204**	**$559,680**

The County of Santa Clara receives fines and penalties from first responders and American Medical Response (AMR) when established timelines are not met. Prior to the AMR contract in October 2001, these fines and penalties were deposited into the General Fund and were available to offset the operating costs of the Emergency Medical Services (EMS) Agency of the Public Health Department. These resources are now deposited into a trust fund and allocated based on recommendations from the EMS Advisory Committee and the Executive Director of the Santa Clara Valley Health and Hospital System (SCVHHS).

In FY 2004-05 the Board of Supervisors approved a recommendation by the SCVHHS Director to allocate $115,942 in EMS Trust Fund monies towards offsetting costs in the EMS Agency, and the use of an additional $191,900 from this fund to support EMS staffing costs in FY 2005-06. The FY 2006-07 Recommended Budget includes an additional $61,682 to cover EMS staffing costs. In total, the Recommended Budget includes $369,524 in Trust Fund resources to support EMS staffing costs.

As described more fully in the December 2004 Management Audit of the Public Health Department, the Board of Supervisors and the SCVHHS Executive Director have the prerogative to dedicate these funds to ongoing operations when a financial hardship occurs in the County. We recommended, and the Board of Supervisors approved, the reporting of the Trust Fund balance during the budget process and the development of a definition of "financial hardship." On May 24, 2006, the SCVHHS reported to the Board that its unallocated fund balance of the Trust Fund equaled $1,379,120.

The SCVHHS staff has indicated that the County's prior use of these funds to support the operating costs of the EMS Agency has been acceptable to relevant stakeholders because they recognize the County's current fiscal crisis and its restraint in not utilizing all of the funds. Staff commented that were the Board to decide to utilize all of the available funds to support the operation of the EMS Agency, the cities, fire agencies, and EMS committee would express concern. Furthermore, according to Staff, actions to utilize all of the funds "would limit the EMS System's ability to meet urgent demands, should they arise."

The current General Fund support necessary to continue the operations of the EMS Agency in FY 2005-06 equals $837,680 according to the County Executive's Recommended Budget. As of this report, the Department was working with OBA to adjust this amount to reflect an additional reimbursement of homeland security funding, which would reduce the General Fund support budgeted for EMS to $559,680. We recommend that the $559,680 be transferred from the EMS Trust Fund in FY 2006-07, in addition to the $61,682 already added to the Recommended Budget from this source, due to the deficit of the FY 2006-07 Budget. This one-time transfer would not deplete the fund balance; it would still leave an adequate starting balance, to which additional fines and penalties from the end of FY 2005-06 and FY 2006-07 will be added.

On May 24, the Director of SCVHHS presented the FY 2006-07 Recommended Budget for the expenditure of the EMS Fines and Penalties Trust Funds. This budget included $421,969 in additional proposed expenditures in FY 2006-07 for various projects and activities intended to enhance the EMS system, which were in addition to the $369,524 included in the County Recommended Budget to offset the EMS Agency operating costs. Based on our review of the current fund balance, it appears that the projected level of new receipts in FY 2006-07 will exceed the total funding requests in the Recommended Budget and additional requests submitted by the EMS Agency. As a result, we believe the existing fund balance will be available to offset additional General Fund support for the EMS Agency as we have described above on a one-time basis.

Account	County Executive Recommended	Management Audit Proposed	Increase/ Decrease
4407200 State DHS Rev.	**$760,803**	**$1,253,303**	**$492,500**
Various Object 2 Exp.	**2,268,475**	**1,775,975**	**492,500**
Net Change			**$985,000**

The FY 2006-07 Recommended Budget includes 2,268,475 in one-time expenditures for the implementation of various Pandemic Influenza Preparedness activities, which include staff training, a public awareness and education campaign, medical supplies, and supplies and equipment. The 2006-07 Recommended Budget also includes $760,803 in revenue from the State Department of Health Services for various public health programs and services provided by the Public Health Department. None of this budgeted State revenue is intended to offset the Pandemic Influenza Preparedness activities; the Recommended Budget proposal would instead utilize General Fund resources.

The Governor's Budget includes $16 million (state and federal funding) for counties to strengthen and maintain local jurisdictions' ability to respond to an influenza pandemic. Under this proposal, each local jurisdiction would receive a base amount of funding of $100,000 for a total expenditure of $6.1 million. The remaining $10 million would be allocated based on county population. The Governor's Office has indicated its intent to provide this level of funding for two-years (for FY 2006-07 and 2007-08). Under this proposal, we estimate that Santa Clara County would receive approximately $595,000 each year. This amount reflects the sum of the base allocation and approximately 5 percent of the remaining funding that would be allocated based on population.

The Assembly approved the Governor's proposal, while the Senate approved a modified version, which increased the minimum amount allocated to counties to $150,000. Under the Senate's proposal, Santa Clara County would receive approximately $492,500. Due to the differences in the method of allocating the funding approved by the Assembly and Senate, this item has been referred to the Budget Conference Committee.

While the specific outcome of the 2006-07 proposal is uncertain, we believe it would be reasonable for the County to expect at least the lower allocation proposed by the Senate since both houses have approved the same overall level of funding and the proposal was initially presented by the State Administration. As such, the anticipated level of State revenue in FY 2006-07 for the Public Health Department should be increased by $492,500.

Furthermore, the Governor's Office has indicated its intent to provide the proposed level of funding for Pandemic Flu Preparedness for two years (FY 2006-07 and 2007-08). In anticipation of additional State funding in FY 2007-08, the County could suspend the implementation of roughly 22 percent of the expenditures outlined in the Recommended Budget for pandemic flu preparation until FY 2007-08 and, accordingly, reduce the proposed expenditures in FY 2006-07 by $492,500. Given the information available at this time, we believe State revenue would be available to support the deferred portion of the proposal in FY 2007-08.

The recommendations we have described above would enable the County to achieve a total of $985,000 in General Fund savings combined. This approach would still provide approximately $2.3 million in expenditures for pandemic flu preparation activities (over a two-year period). In the event that the State changes its plans to provide funding for pandemic preparedness activities in 2007-08, the Board could re-evaluate the one-time use of County General Fund monies for these activities during its budget discussions next year.

Revenue Account 4718100 **Public Health Patient Fees**

County Executive Recommended	Management Audit Proposed	Revenue Increase
$362,500	$392,500	$30,000

In FY 2005-06, the Public Health Department projects that it will receive approximately $30,000 in revenue for HIV testing, which is currently used to support the operation of the Crane Center. This source of revenue is expected to continue in FY 2006-07. However, the Department reports that the revenue was inadvertently omitted from the Recommended Budget, and believes that the revenue in this account may be increased for FY 2006-07 by $30,000. We recommend that this revenue be increased by $ 30,000 to reflect the additional patient fee revenue from HIV testing.

Budget Unit 412 – Mental Health Department Page 444

Revenue Account-4422400 **State Mandate Cost**

Discussion Only—AB 3632 Funding

The County is reimbursed for providing services to Seriously Emotionally Disturbed Children through the California SB 90 mandate claim process. For several years, due to the State's fiscal challenges, it has delayed the reimbursement of claims to counties for these services. Due to the recent passage of Proposition 1A in November 2004, however, the State no longer has the discretion of delaying these reimbursements if it wishes to continue the mandate. In 2005-06, the State appropriated $120 million General Fund on a one-time basis to continue the reimbursement of claims filed by counties for AB 3632 services. The County's FY 2005-06 Budget for the Department of Mental Health includes state revenue totaling $16,198,862 for AB 3632 services. This amount reflects revenue received for prior and current year claims. The FY 2006-07 Recommended Budget assumes a 3 percent increase in the claims submitted and accordingly includes $8,791,748 for AB 3632 services provided in the coming fiscal year.

Current State Budget discussions regarding the status of the AB 3632 program suggest that the County may be at risk of receiving a lower level of funding in FY 2006-07. The FY 2006-07 Governor's May Revise proposed a major redesign of the AB 3632 program. Among the major aspects of this redesign, the Governor has proposed: 1) the suspension of the SB 90 mandate for two years; 2) the creation of a new categorical program which would allocate funds based on the number of special education pupils in each county, and 3) an appropriation of $69 million in General Fund which would be used to supplement $69 million in Federal funding for special education services. The Administration has also proposed trailer bill language, which would require County Mental Health Departments and County Office of Educations to enter into contracts for the provision of special education services. According to the Legislative Analyst's Office, the estimated statewide cost of AB 3632 services is $180 million, roughly $42 million more than was proposed by the Governor. Bearing in mind the Governor's proposed reduction in funding for these services and the estimated percentage of special education students in Santa Clara County, we estimate that the County would receive approximately $5.4 million in funding under the Governor's approach, an amount which would translate into a $3.4 million reduction relative to the County's FY 2006-07 Recommended Budget.

The Senate approved an alternative approach to redesigning the AB 3632 program. Recognizing more time was needed to work out the details of the categorical program, the Senate assumed the mandate claim process would continue for half the year and provided additional funding for this purpose. In total, the Senate approved $189.5 million in revenue for AB 3632 services. The methodology used to distribute funding under this approach is uncertain; however, if the funds were distributed based on number of special education pupils, Santa Clara County would be adversely affected. We estimate that under the Senate's approach and a funding distribution based on pupils, the County would receive $7.4 million (a reduction of $1.4 million relative to the Recommended Budget).

As of June 6, the issue was still pending in the Conference Budget Committee. Although the outcome of this budget item is uncertain at this time, the pending statewide allocation and funding methodology pose a potential funding risk for the County.

Revenue Account 4813200 **Contributions and Donations**

County Executive Recommended	Management Audit Proposed	Revenue Increase
$108,124	**$188,867**	**$80,743**

The Recommended Budget for the Mental Health Department includes $108,124 in revenue drawn from the Morrison Trust Fund. According to SCVHHS staff, this fund was established in 1998 as a result of an $846,970 bequest to be used for suicide prevention and crisis services. The one-time donation and a modest amount of interest accrued in this Trust Fund currently support a position in the Mental Health Department and related services and supplies expenditures. Because the expenditures tied to this fund are greater than the new receipts (interest) deposited into the fund, the fund balance has decreased each year. According to the Department, in FY 2005-06, the beginning balance of the fund was $320,096, and we project the fund balance at year-end to total $217,073. The SCVHHS staff has indicated that once the Trust Fund resources are depleted, the Department will need to identify alternative sources of funding for the current expenditures or delete the position and related services and supplies from the budget.

In response to our inquiry regarding General Fund-supported suicide prevention and crisis services in the Mental Health Department, SCVHHS staff reports $80,743 in service agreements for staff that provide overnight coverage for a crisis hotline. Although these arrangements predate the Department's receipt of the Morrison donation, they are suitable expenditures for the Morrison Trust fund. The agreement which establishes this trust fund does not include any restrictions that would prevent the County from utilizing the fund to support existing activities.

Given the available fund balance and the County's FY 2006-07 budget situation, the County could, on a one-time basis, utilize Morrison Trust revenue to support these agreements and achieve General Fund savings in FY 2006-07 totaling $80,743. We estimate that, with the projected fund balance for the end of FY 2005-06, this recommendation would utilize almost all of the trust fund resources in FY 2006-07, leaving approximately $28,000 for suicide prevention and crisis services in FY 2007-08.

Budget Unit 414 – Custody Health Services
Discussion Item **Page 458**

The FY 2006-07 Recommended Budget includes $211,440 in new, ongoing expenditures for two positions at the Main Jail. These staff would perform mental health assessments on all inmates who are incarcerated with charges of sexual assault or sexually deviant behavior, after each court appearance, in order to prevent suicidal behavior. The positions would be supported with General Fund resources.

Our review of the Mental Health Services Act (Proposition 63) suggests that alternative funding may be available to support these positions in lieu of the General Fund. Proposition 63 was passed by the voters in November 2004 to establish a new source of tax revenue for the expansion of mental health services for children, adults, and seniors. The Proposition 63 statute specifies that funds can be used for services provided to adults who fit the criteria established in Welfare and Institutions Code Section 5600.3. Among other criteria, this section indicates that funds can be used for individuals that are arrested or convicted of crimes. The State Department of Mental Health has provided counties with a guidance document that further clarifies that Proposition 63-funded "services that are provided in jails or juvenile halls must be for the purpose of facilitating discharge."

In accordance with Proposition 63 requirements, the Department of Mental Health developed its set of proposed Proposition 63 expenditures "through a broad community stakeholder process." According to SCVHHS staff, this proposal for assessment staff working at the Main Jail was not brought forward during that process. In staff's opinion, the assessment of inmates returning from court appearances does not "facilitate discharge."

Because alternative funding was not formally pursued for this proposal, it is unclear whether assessment services for this population of inmates are eligible for Proposition 63 funding. For instance, it is unclear whether the State's use of the term "discharge" in its guidance document refers to the release of inmates from inpatient services within the institution, or the release from the institution altogether. Furthermore, we question whether one could reasonably argue that successful attempts to prevent suicide at some level is not facilitating an inmate's eventual release from the institution.

As of this report, we have not yet obtained an independent opinion on this issue or assessed the process and length of time that would be required to amend the County's current expenditure plan to reflect these assessment staff. However, in light of the pending policy and legal question as to whether Prop 63 should or can be used for staff in the Main Jail and the potential opportunity to reduce the demand for limited General Fund resources, we recommend that the Board suspend the funding of these positions and refer the matter to the Health and Hospital Committee and County Counsel for further review.

Budget Unit 418 – Community Outreach Services Page 491

Revenue Account 4407200 **State Department of Health Services**

County Executive Recommended	Management Audit Proposed	Revenue Increase
$0	$467,180	$467,180

The Valley Children's Health Initiative provides eligibility screening for public health insurance programs; assists in the completion of the application process for Healthy Families, Medi-Cal, or Healthy Kids; and educates families regarding the enrollment and membership process in public insurance programs. The FY 2006-07 Recommended Budget includes $1.1 million in General Fund support for this program.

The Governor's Budget proposes $19.7 million in local assistance funding for county-based outreach and enrollment activities in the Medi-Cal and Healthy Families programs. Approximately $17.2 million would be allocated to larger counties using a methodology that takes into consideration the number of children enrolled in either Medi-Cal or Healthy Families and the number of eligible children who are uninsured. This funding is to be used by counties to partner with public and private community organizations for outreach, streamlined enrollment and retention efforts. The remaining funding ($2.5 million) would be allocated to DHS for the remaining counties who have applied for funding and can demonstrate they have a coalition for outreach and enrollment. According to a Senate Health Subcommittee report on this item, under this proposed allocation, Santa Clara County would expect to receive 2.8 percent of the funding for larger counties, or approximately $479,000.

Both the Senate and Assembly have approved a modified version of the Administration's proposal, which includes a slightly higher amount of funding for the smaller counties, and leaves approximately $16.7 million for the larger counties, 3.0percent less than the Governor's proposed amount of $17.2 million. Under the Legislature's approach, we believe Santa Clara County would be expected to receive $467,180. The Senate also proposed that trailer bill language be adopted which specifies $3 million be set aside for small counties; requires that counties submit outreach and enrollment plans and proposed budgets to the State Department of Health Services; restricts the use of the funds for outreach and enrollment purposes, and requires counties to collaborate with a wide-range of organizations such as community-based organizations, schools, clinics, and safety-net providers. At this time, there has been no indication that this trailer bill language would include a provision to restrict the State funding to new outreach activities.

While the specific outcome of the trailer bill language is uncertain, we believe it would be reasonable for the County to budget its anticipated share of the Legislature's allocation for outreach services, since both houses have approved the same overall level of funding and the proposal was initially presented by the Administration. This funding could be used to offset General Fund support in the Recommended Budget for outreach activities performed by Community Outreach Services to achieve as much as $467,180 in General Fund savings.

Analysis of Prepaying the FY 2006-07 PERS Employer Contribution

	FY 2006-07 Budgeted PERS Employer Contribution
FY 2006-07 PERS Budget for Employer Contributions	
General Fund	106,502,756
VMC	47,626,060
Other Funds	7,067,284
PERS employer contribution not based on salaries*	3,242,657
Total	**164,438,757**
PERS 06-07 Cash Contribution Option	
Misc	115,572,234
Safety	39,919,908
Total	**155,492,142**
Projected Gross Savings:	**8,946,615**
Less Interest Rev Loss @4.61%-4.36%	-3,647,832
Less Controller-Treasurer Proposed Penalty 6/9/06	-594,585 ***
Add Interest Rev Loss From Higher PERS Payments if Not Prepaid	126,050
Net Benefit All Funds	**4,830,248**
Net Benefit by Fund:	
General Fund	3,698,967
VMC Enterprise Fund	661,775
Other Funds	469,506
Combined Benefit to General Fund and VMC	**4,360,742**

* Estimate based on 69.12% County-wide average employer cost of total PERS in BRASS budget system.

** Estimate calculated by each department.

*** Proposed penalty pertains to agencies that withdraw funds for alternative investments. The prepayment of a budgeted expense is not withdrawal of monies for reinvestment purposes. This transaction is the equivalent of taking a cash discount on a commodity purchase. In addition, none of the proposed withdrawal restrictions or penalty conditions and criteria for determination and assessment are in writing or have been approved by the Board of Supervisors. Current investment policy only specifies that funds are withdrawn based on "market value," but do not define the calculation of market value or its application.

Computation of Commingled Fund Interest Loss

Amount of PERS Cash Prepayment	Bi-weekly Payment	PERS Prepayment Not Avail for Investment	Lost Com Fund Interest	Date
155,492,142	5,980,467	0	0	7/1/2006
	5,980,467	155,492,142	275,700	7/15/2006
	5,980,467	149,511,675	265,096	7/29/2006
	5,980,467	143,531,208	254,492	8/12/2006
	5,980,467	137,550,741	243,888	8/26/2006
	5,980,467	131,570,274	233,284	9/9/2006
	5,980,467	125,589,807	222,680	9/23/2006
	5,980,467	119,609,340	208,396	10/7/2006
	5,980,467	113,628,873	197,976	10/21/2006
	5,980,467	107,648,406	187,557	11/4/2006
	5,980,467	101,667,939	177,137	11/18/2006
	5,980,467	95,687,472	166,717	12/2/2006
	5,980,467	89,707,005	156,297	12/16/2006
	5,980,467	83,726,538	145,877	12/30/2006
	5,980,467	77,746,071	132,467	1/13/2007
	5,980,467	71,765,604	122,278	1/27/2007
	5,980,467	65,785,137	112,088	2/10/2007
	5,980,467	59,804,670	101,898	2/24/2007
	5,980,467	53,824,203	91,708	3/10/2007
	5,980,467	47,843,736	81,518	3/24/2007
	5,980,467	41,863,269	70,201	4/7/2007
	5,980,467	35,882,802	60,173	4/21/2007
	5,980,467	29,902,335	50,144	5/5/2007
	5,980,467	23,921,868	40,115	5/19/2007
	5,980,467	17,941,401	30,086	6/2/2007
	5,980,467	11,960,934	20,058	6/16/2007
	155,492,142		**3,647,832**	

Controller-Treasurer Projected Interest Rates:

interest	percent
q1	4.610
q2	4.530
q3	4.430
q4	4.360

Summary of Vacant Positions By Fund
(as of May 8, 2006)

	All Funds	VMC Ent Fd	General Fund	Other Funds
Positions Vacant 30 Days or Less	221	41	173	7
Positions Vacant 1 to 2 Months	137	48	82	7
Positions Vacant 2 to 3 Months	95	36	54	5
Positions Vacant 3 to 6 Months	316	67	225	24
Positions Vacant 6 Months to 1 Year	328	142	161	25
Positions Vacant 1 to 2 Years	188	90	71	27
Positions Vacant 2 to 3 Years	61	51	9	1
Positions Vacant 3 to 5 Years	36	31	4	1
Positions Vacant 5 to 10 Years	36	31	4	1
Positions Vacant 10 Years or More	1	1	0	0
Total Vacant Positions as of 5/8/06	**1,419**	**538**	**783**	98

Note 1: Other funds includes.
200 Child Support Services
261 Environmental Health
411 Vector Control
603 Roads
608 Airports
610 Library
710 Parks and Recreation
725 Valley Health Plan

Note 2: Totals include 30 General Fund and 1 VMC Enterprise Fund positions that are unfunded. Twenty-Four unfunded Deputy Sheriff Cadet positions have been excluded.

Summary of Vacant Positions By Budget Unit
(as of May 8, 2006)

Budget Unit	Description	Vacant Postions
101-105	Board of Supervisors	9
106	Clerk of the Board	2
107	County Executive	6
110	Controller-Treasurer	4
112	Tax Collector	10
114	County Recorder	3
115	Assessor	36
118	Purchasing Department	4
120	County Counsel	9
130	Personnel	8
132	Risk Management Department	1
135	Intergovernmental Services	2
140	Registrar of Voters	4
145	Data Processing	13
148	Department of Revenue	8
168	Office of Affordable Housing	1
190	Communications	5
200	Child Support Services	19
202	District Attorney	10
203	DA-Lab of Criminalistics	7
204	Public Defender	9
210	Office of Pretrial Services	5
230	Sheriff Services	110
235	DOC Contract	99
240	Department of Corrections	16
246	Probation	84
260	Envir Res Adm/Planning Dept	8
261	Environmental Health	4
262	Dept of Agr/Wts-Ms/Anml Cont	10
263	Facilities Department	17
293	Medical Examiner/Coroner	2
410	Public Health	73
411	Vector Control	8
412	Mental Health	19
414	Children's Shelter/Custody Hlth Svcs	14
417	Bureau of Alcohol and Drug Programs	7
418	Community Outreach Services	4
502-505	Social Services Admin.	164
603	Roads	18
608	Airports	1
610	Library	37
710	Parks and Recreation	6
725	Valley Health Plan	5
921	Valley Medical Center	538
Total		**1,419**

Note: Budget Unit 230 excludes 24 vacant unfunded Deputy Sheriff cadet positions