

**Review of the County of Santa Clara
FY 2014-15 Recommended Budget**

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

**Prepared by the
Board of Supervisors Management Audit Division
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June 11, 2014

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County of Santa Clara

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June 11, 2014

To: Board of Supervisors

From: Management Audit Manager *RAM*

Subject: Analysis of the County of Santa Clara FY 2014-15 Recommended Budget

The attached report presents the independent review and analysis of the County of Santa Clara FY 2014-15 Recommended Budget by the Management Audit Division of the Board of Supervisors. To prepare this report, the Management Audit Division analyzed all County departmental budgets that are wholly or partially financed, directly or indirectly, by the General Fund. Other funds, including the Valley Medical Center Enterprise Fund and various special and internal service funds were also analyzed. In addition, we reviewed the most recent FY 2013-14 SAP accounting system revenue and expenditure reports through Accounting Period 11, the FY 2014-15 Recommended Budget document, and other materials and work papers prepared by staff of the County Executive's Office and individual departments.

Our staff met with County Executive staff, various County financial officers, and department managers regarding the assumptions and projections upon which the FY 2014-15 Recommended Budget is based. A draft of this report was provided to and discussed with the Office of Budget and Analysis Budget Director. We subsequently made edits and revisions to the draft report, which are included in this final report; as such, any discrepancies between our final June 11 report and the Budget Director's June 10 response to our report are due to the effects of timing differences.

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District 4

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County Executive: Jeffrey V. Smith

Board of Supervisors
June 11, 2014

The following is a high-level summary of the County Executive's FY 2014-15 Recommended Budget as compared with the County budget adopted by the Board of Supervisors for FY 2013-14:

- Expenditures – All Funds:
The FY 2014-15 Recommended Budget includes \$4,905,816,020 in expenditures for all funds, which is \$313,908,833 (6.8 percent) more than the \$4,591,907,187 budget adopted in FY 2013-14.
- Positions – All Funds:
The Recommended Budget for FY 2014-15 also includes 16,156.4 positions, or 390.6 positions (2.5 percent) more than the 15,765.8 positions approved by the Board as of July 1, 2013.
- Expenditures – General Fund:
The General Fund portion of the FY 2014-15 Recommended Budget includes \$2,572,873,030 in expenditures, which is \$89,232,898 (3.6 percent) more than the \$2,483,640,132 budget adopted in FY 2013-14.
- Positions – General Fund:
The Recommended General Fund Budget for FY 2014-15 includes 9,285.5 positions, or 303.1 positions (3.4 percent) more than the 8,982.4 positions approved by the Board as of July 1, 2013.
- Revenues:
FY 2014-15 County-wide revenues increased from \$4,342,931,224 to \$4,693,393,262, which is an increase of \$350,462,038, or 8.1 percent. General Fund revenues increased from \$2,278,290,131 to \$2,391,965,330, which is an increase of \$113,675,199, or 5.0 percent.
- Valley Medical Center:
The FY 2014-15 Recommended Valley Medical Center budget amounts to \$1,333,647,600, or 28.4 percent of the entire County budget, and includes 5,315.9 authorized positions, which represents 33.9 percent of the total County workforce.

Board of Supervisors
June 11, 2014

The attached table summarizes our revenue and expenditure recommendations within Budget Units. Detailed explanations of our recommendations are provided in the body of the report. In total, this report includes General Fund and other recommendations that amount to \$10,334,055 in revenue increases and \$8,278,404 in expenditure decreases, for a combined net savings to the County of \$18,612,459.

This report also contains recommendations relating to the County-wide Unemployment Insurance ISF Fund and the Liability Insurance ISF Fund managed by the Employee Services Agency. The Management Audit Division would like to thank the Office of Budget and Analysis and various departmental staff for their cooperation, responsiveness and assistance during our review of the FY 2014-15 Recommended Budget.

**SUMMARY OF MANAGEMENT AUDIT DIVISION RECOMMENDATIONS
FY 2014-15 BUDGET REVIEW**

Item No.	Budget Unit	Department Name	Revenue/Expenditure Account	Revenue Increases	Expenditure Decreases	Net Savings	Page No.
1	110	Controller-Treasurer	SB90 Reimbursement	\$ 5,771,578	\$ -	\$ 5,771,578	1
2	130	Employee Services Agency	Unemployment Insurance-Fund 0076	\$ -	\$ 1,002,784	\$ 1,002,784	4
3	130	Employee Services Agency	Unemployment Insurance-All Funds	\$ -	\$ 1,075,276	\$ 1,075,276	4
4	130	Employee Services Agency	Liability Insurance	\$ -	\$ 3,300,000	\$ 3,300,000	9
5	148	Revenue	Miscellaneous Reimbursements	\$ 44,540	\$ -	\$ 44,540	20
6	202	District Attorney	Office Expenses	\$ -	\$ 518,741	\$ 518,741	22
7	202	District Attorney	Premium Pay	\$ -	\$ 187,577	\$ 187,577	24
8	204	Public Defender	Premium Pay	\$ -	\$ 86,669	\$ 86,669	27
9	230	Sheriff	Federal-Other Grants and Aids	\$ 350,000	\$ -	\$ 350,000	30
10	246	Probation	Services and Supplies Expenditures (Multiple Accounts)	\$ -	\$ 635,000	\$ 635,000	33
11	263	Facilities and Fleet	Civic Center Parking	\$ 103,614	\$ -	\$ 103,614	40
12	410	Public Health	Services and Supplies Expenditures (Multiple Accounts)	\$ -	\$ 500,000	\$ 500,000	41
13	904	Central Fire	Retirement-Special District (PERS)	\$ -	\$ 173,044	\$ 173,044	44
14	921	Valley Medical Center	Fund 0060-Interest Expense	\$ -	\$ 574,203	\$ 574,203	46
15	921	Valley Medical Center	Fund 0060-Interest on Deposits	\$ 225,000	\$ -	\$ 225,000	47
16	921	Valley Medical Center	Bond Fund-Interest Expense	\$ -	\$ 225,110	\$ 225,110	49
17	921	Valley Medical Center	Surplus Bond Fund Balances	\$ 3,839,323	\$ -	\$ 3,839,323	51
18	921	Valley Medical Center	Realign Temp. Employee, Overtime & Call Duty Budget	\$ -	\$ -	\$ -	52
19	Multiple	Salary Savings	Salaries and Benefits			*	56
			TOTAL	\$ 10,334,055	\$ 8,278,404	\$ 18,612,459	

Notes:

*Policy decision.

Revenue Account 4422400	State-Mandate Cost	
County Executive <u>Recommended</u>	Management Audit <u>Proposed</u>	Revenue <u>Increase</u>
\$835,000	\$6,606,578	\$5,771,578

This account receives State funding from the State’s program to reimburse local governments for the costs of programs they are mandated by State law to carry out, known generically as SB 90 programs, after the law creating the requirement. Although the mandates are imposed on various County departments, the revenue received is budgeted in the Controller-Treasurer Department, because that department, working with the affected departments, prepares the annual claims the County submits reporting its costs to carry out the mandated programs. This reimbursement is mandated by Title XIII B, Section 6 of the Constitution of the State of California.

The Governor’s Budget May Revision 2014-15 states:

“The state owes counties, cities, and special districts \$900 million in mandate reimbursements for costs incurred prior to 2004 that must be repaid under current law by 2020-21. Annual payments on this debt have been postponed in recent years.”

The May Revision proposes to accelerate the required payment, by providing \$100 million for this pre-2004 mandate debt. A letter to the Legislature from the Department of Finance provides additional detail, stating that 73.1 percent of the money, or \$73,100,000, would be provided to counties. The letter further states:

“These monies are general purpose revenues for local governments and are available for core local government services such as public safety.”

Accompanying the letter is proposed legislative language implementing the proposal, which states that, within the respective shares allocated to counties, cities and special districts, “payment instructions shall limit the payment to each city, county and special district to that city’s, county’s and special district’s proportional amount of the total outstanding pre-2004 claims, that have been approved for payment.”

Accordingly, the Management Audit Division sought to determine the County's probable share of the proposed additional payment. The source of the Governor's estimate of \$900 million owed is not clear. Management Audit staff used the State Mandated Program Cost Report of Unpaid Claims and Deficiency, dated April 30, 2014 and submitted by the State Controller to the Legislature, to calculate the total amount owed. Our review calculated that the State owes \$796,909,683 to "local agencies," which includes counties, cities and special districts, as opposed to K-12 school districts and community college districts. That report does not disaggregate the "local agency" amount among the three types of local jurisdictions. However, based on the Department of Finance letter, which stated that counties are owed 73.1 percent of the Statewide total, counties are owed \$582,540,978 of the \$796.9 million shown in the Controller's report. Using the Governor's \$900 million figure, the share owed to counties across the State is \$657.9 million.

We then requested the Controller-Treasurer Department to help us determine the amount owed to the County of Santa Clara by the State for all claims from Fiscal Year 2003-04 and previous years. The Department did so, from the County's SAP accounting system, and reported that amount to be \$51,944,201. This sum amounts to 8.92 percent of the total owed to counties Statewide, based on the Controller's report, or 7.89 percent of the total, using the figure derived from the May revise.

Assuming the County of Santa Clara gets its proportionate share of the \$73,100,000 allocated to counties in the Governor's new proposal, it would therefore receive, depending on the figure used for the total Statewide debt owed, from \$5,771,578 to \$6,518,204 in additional SB 90 reimbursements during Fiscal Year 2014-15, if the Governor's proposal is approved by the Legislature.

We believe it is highly likely that some version of this proposal will in fact be approved, given the Democratic majority in both houses of the State Legislature, and the fact that State law only requires a majority vote to approve the budget. However, to be conservative the Board may choose to budget only a portion of the additional revenue we calculate will be received. For example, budgeting \$1 million additional revenue from this source would amount to only 15.3 to 17.3 percent of our estimated revenue receipt.

The Controller-Treasurer Department disagrees with this recommendation, pointing out that the proposal is not before an Assembly-Senate conference committee that is expected to begin working on a final budget bill next week. As *The CSAC Bulletin* noted

on Friday, May 30, that item is not before the committee because the committee's starting point is the legislation heard by the budget subcommittees and approved in each house. The SB 90 proposal was not heard, because it was not proposed by the Governor as part of his January budget, but only in the May Revise. CSAC is urging the legislature to consider the proposal as part of the conference committee's work or other discussions leading to approval of a final budget bill by June 15. We still believe chances are good for some form of the proposal to be approved, and have included the item to keep the Board and Administration aware of the potential revenue, and the need to plan for it, as opposed to having the revenue just fall into FY 2014-15 fund balance.

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BU 130 – Employee Services Agency

Unemployment Insurance

Expenditure Account 5430500 (Fund 0076)	County Executive <u>Recommended</u>	Management Audit <u>Proposed</u>	Expenditure <u>Decrease</u>
Unemployment Insurance Claims	\$3,000,000	\$1,997,216	\$1,002,784
Expenditure Account 5110300 (All Funds)	County Executive <u>Recommended</u>	Management Audit <u>Proposed</u>	Expenditure <u>Decrease</u>
Unemployment Insurance Claims	\$1,075,276	\$0	\$1,075,276 ¹
Total Net Available for Reappropriation			\$2,078,060

The Unemployment Insurance Division of the Employee Services Agency administers the Unemployment Insurance Fund, the County’s self-insurance fund to guard against liability from former employees who have filed claims for unemployment benefits due to involuntary unemployment.

There are two primary aspects of this fund’s financial operations: First, the County reimburses the California Employment Development Department for actual claims filed by unemployed individuals from the Unemployment Insurance Claims account, which is budgeted at \$3,000,000 in the Recommended Budget. Second, the Unemployment Insurance Fund then charges a premium to all County departments for the cost of providing this insurance coverage. The total premium for this insurance is \$1,075,276 in the Recommended Budget. We propose reductions to both of these accounts.

Over the last 10 years unemployment liabilities in the Unemployment Insurance Fund (0076) have significantly fluctuated, causing deficit year-end fund balances 50 percent of the time, particularly during the recession. However, as the economy began to recover, FY 2011-12 initiated a trend of accumulating year-end fund balance surpluses. After careful review of historical expenses, the Management Audit Division recommends that the Unemployment Insurance Fund claim expenditures budget decrease by \$1,002,784.

¹ Department payments are reflected as revenue in the Unemployment Insurance Fund (0076) under account 4727100 Other Charges for Services. The Recommended Budget for this revenue is \$1.2 million, even though the paying departments are budgeted to pay the lesser amount of \$1,075,276. The difference appears to be related to differences in the timing of the development of the estimates and the availability of updated rate information. To implement our recommendation, both the expenditures and the equivalent revenue would need to be removed from the budget.

In addition, we recommend eliminating the entire premium charge to County departments of \$1,075,276.

Principles and standards for governmental cost allocation plans are established by the federal Office of Management and Budget. Standards to provide a uniform approach for determining cost allocation plans are outlined in Circular A-87, a document known as "Cost Principles for State, Local and Indian Tribal Governments." In the State of California, the State Controller's Office currently presides as the statewide authority overseeing compliance of governmental cost allocation plans with Circular A-87. According to the State Controller's guidelines, when counties establish internal service funds, these funds should only charge other departments the cost of providing services (inclusive of indirect costs) with no objective to achieve profit. Any revenue exceeding operating costs should only accumulate to the equivalent of 60 days of average cash expenses as a reasonable working capital reserve. Since the Unemployment Insurance Fund is a self-insurance fund, federal and State guidelines also permit a board of supervisors to establish by resolution specified reserve fund policies based upon an actuarial analysis.²

The funding policy for the Unemployment Insurance Fund was last updated and adopted in 1995 and does not stipulate a minimum reserve threshold. The Employee Services Agency reported that the Unemployment Insurance Fund has not had a recent actuarial analysis. Since the Unemployment Insurance Fund has no specific reserve threshold or recent actuarial analysis, the Management Audit Division applied Circular A-87's general standards for internal service funds, pending County adoption of a reserve policy based upon actuarial evaluation.³

The FY 2014-15, recommends budget for unemployment insurance claim expenditures amounts to \$3,000,000, or approximately \$500,000 less than the prior year's adopted budget. However, a review of the insurance claim expenses over the last 10 years indicates that claim expenditures will decrease more than the Recommended Budget suggests. The table below provides an overview of average expenditures by quarter based off a 10 year analysis.

² Handbook of Cost Plan Procedures for California Counties, California State Controller, October 2012

³ It should be noted that the Board of Supervisors has adopted a funding policy for the Workers' Compensation and Liability Insurance Funds to fund these internal service funds based on expected costs, known as the 50 percent confidence level.

10-Year Overview of Unemployment Insurance Claim Expenses

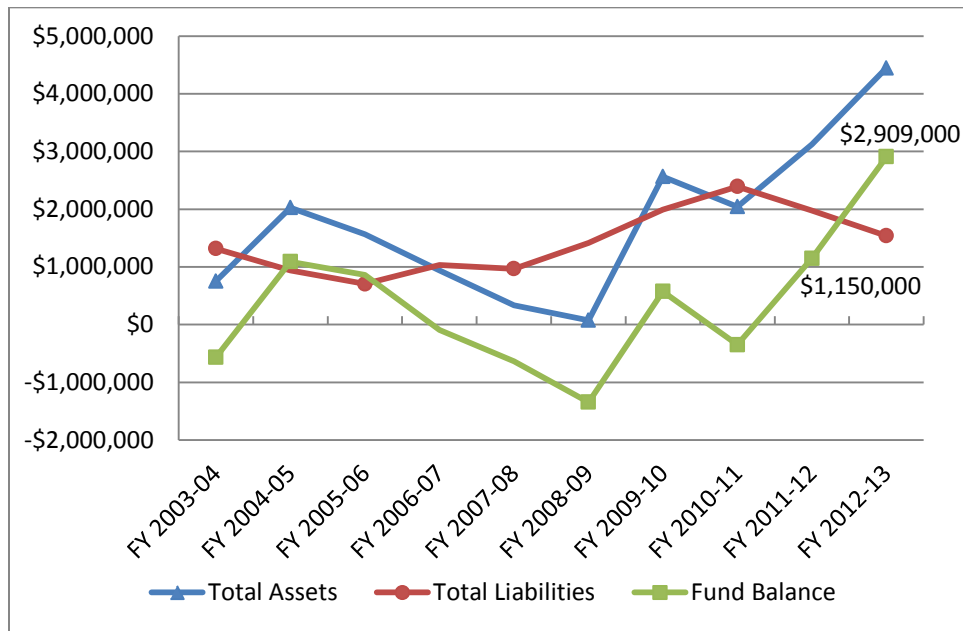
<u>Fiscal Year</u>	<u>Average Claim</u>	<u>Average Percentage</u>	<u>Fiscal Year 2013-14</u>
<u>Quarter</u>	<u>Expense</u>	<u>of Annual Expense</u>	<u>Claim Expense</u>
Quarter 1	\$554,626	25%	\$562,061
Quarter 2	\$428,834	19%	\$391,568
Quarter 3	\$600,482	27%	\$479,842
Quarter 4	<u>\$622,921</u>	<u>28%</u>	<u>\$563,745⁴</u>
Total	<u>\$2,206,864</u>	<u>100%</u>	<u>\$1,997,216</u>

As depicted in the table above, we project close to \$2 million in year-end expenditures for unemployment claims, or \$1,002,784 less than the recommended budget. Responding to our draft review, the Office of Budget and Analysis recommended an alternative deduction of \$805,000 from the original recommended budget, based upon the Employee Services Agency’s method of calculating claim expenditures through a weighted average of the last four fiscal quarters. After speaking with the Employee Services Agency, however, the Management Audit Division believes that our revised \$1,002,784 is the appropriate amount to deduct from the original recommended budget for claim expenditures. With the preponderance of evidence pointing toward lower demand for unemployment insurance benefits, and assuming similar expenditures will occur in FY 2014-15, we recommend a budget of \$1,997,216.

In order to provide a more comprehensive evaluation, the Management Audit Division also evaluated 10 years of financial data from the Comprehensive Annual Financial Reports. During the course of this analysis we identified the Unemployment Insurance Fund as maintaining an inappropriate surplus balance. The graph on the following page provides an overview of the insurance fund’s assets, liabilities and subsequent fund balances.

⁴ FY 2013-14 Quarter 4 is estimated based off the analysis indicating that Quarter 4 claim expenses over 10 years on average incur approximately 28 percent of the annual cost. Data was extracted from the Employee Services Agency’s Unemployment Insurance Rates detailed accounting spreadsheet.

Unemployment Insurance Fund Balance over the Last 10 Years



Source: Comprehensive Annual Financial Reports, Fiscal Years 2003-04 through 2012-13.

A 10-year review of the Unemployment Insurance Fund’s assets and liabilities reveals a fluctuating fund balance that rested in deficits five out of the last 10 years, mostly through recessionary years. Due to improved economic conditions, operating expenses decreased, but department charges continued to accrue revenues, which eventually surpassed costs. At the end of FY 2011-12, the Unemployment Insurance Fund had a fund balance of \$1,150,000; the highest balance observed dating back at least to FY 2003-04. Despite this surplus, the Unemployment Insurance Fund continued to accrue more assets over liabilities, resulting in a surplus of \$2.9 million at the end of FY 2012-13.

In our draft budget review, the Management Audit Division recommended maintaining the permitted 60-day working capital and reimbursing County departments for excess service charges accumulated over three years, totaling \$2.9 million in surplus carried over from FY 2012-13, and \$1.5 million as of the end of May 2014. After speaking with the Employee Services Agency, however, we agree with the response provided by the Office of Budget and Analysis that the Unemployment Insurance Fund should credit the County departments in FY 2014-15. By crediting the departments, the Unemployment Insurance Fund would not charge County departments for the next fiscal year, thereby reducing the fund balance to an immaterial profit at the close of FY 2014-15. Subsequently, the Management Audit Division recommends budgeting \$0 for the Countywide Expenditure Account 5110300, resulting in a \$1,075,276 FY 2014-15

reduction in service charges to County departments.⁵ Using our estimate of unemployment insurance claim costs and the Employee Services Agency's estimate of outstanding liabilities for FY 2014-15, we estimate that the Unemployment Insurance Fund will have a surplus of \$697,523. Since this is almost twice as large as the average 60-day working capital of \$382,225, we recommend that the Employee Services Agency adjust the rates in FY 2015-16 to ensure that this balance draws down to an immaterial profit at year-end.

In addition to reducing the FY 2014-15 budget and crediting County departments, the Management Audit Division also recommends that the Board of Supervisors establish a funding policy for the Unemployment Insurance Fund, consistent with that of the Workers' Compensation Insurance Fund and the Liability Insurance Fund, based on the expected (50 percent confidence level) liabilities. Further, the Employee Services Agency staff reported that no actuarial analysis has been performed on the Unemployment Insurance Fund in recent history. To comply with the State Controller's cost plan procedures, we recommend the County hire an actuary to evaluate the County's Unemployment Insurance Fund.⁶

⁵ As previously noted, the Recommended Budget for Revenue Account 4727100 in the Unemployment Insurance Fund is \$1.2 million, while the countywide rate charges were estimated to accumulate \$1,075,276 in Expenditure Account 5110300. With the implementation of this recommendation, both accounts should be brought down to zero.

⁶ Handbook of Cost Plan Procedures for California Counties, California State Controller, October 2012.

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Budget Unit 130 – Human Resources & Employee Relations **Page 219**

Expenditure Account 5220200		IC-Insurance
County Executive	Management Audit	Expenditure
<u>Recommended</u>	<u>Proposed</u>	<u>Decrease</u>
\$23,835,051	\$20,535,051*	\$3,300,000*

*Subject to a policy decision of the Board of Supervisors

The Human Resources and Employee Relations Department manages various internal service funds (ISF) pertaining to employee benefits and County liabilities. Included among these is the County-wide Liability Insurance ISF, which provides funding for liability claims against the County related to general liability, automobile liability and medical malpractice liability. The most recent County Comprehensive Annual Financial Report (CAFR) shows that as of June 30, 2013, the Liability Insurance ISF had total assets of \$39,921,000 and total liabilities of only \$25,195,000, for a net fund balance of \$14,726,000 (Attachment 1). The September 2013 actuary report compares the level of funding of each of the three liability categories with the Board-adopted policy to fund costs at the “Expected” level as shown in the attached graphs, which illustrate the magnitude of the surplus balance (Graphs 1-3) as of June 30, 2013.

Board of Supervisors’ Liability Insurance ISF Funding Policy

Development of surplus fund balances in internal service funds is governed by State and federal cost accounting standards, and by policy of the Board of Supervisors within the federal OMB A-87 requirements as administered by the State Controller as the cognizant agency for the federal government in California. State and federal limitations specified in OMB A-87 and the State Controller’s Handbook of Cost Plan Procedures (HCPP) for California Counties mandate that internal service funds operate on a break-even basis, except for the permitted accumulation of 60 days working capital, and actuarially based reserves for insurance ISF funds. The County’s established funding policy was adopted by the Board of Supervisors on March 3, 2003, and requires the County’s internal service funds to fund such costs at the expected level (assets equal liabilities) with the exception of the medical malpractice liability related to claims made within two years, which are funded in excess of the expected cost (at the 75 percent

confidence interval) to provide additional reserves for these claims. Currently, the amount of the additional reserves is about \$748,000.

OMB A-87 Annual Procedures to Minimize Surplus/Deficit ISF Balances

When surplus balances occur in ISF funds, OMB A-87 requires that the surplus, with the exception of the 60-day working capital amount, be promptly refunded either in the same or subsequent fiscal year. If a fund deficit occurs, subsequent year rate increases are permitted to restore full funding including a working capital reserve (HCPP Section 2240-2245). The County ISF funding policy adopted by the Board of Supervisors in 2003¹ specifies spreading of surpluses and losses over a three-year period (the budget year and the two subsequent fiscal years). Although the Department reported that it administratively revised this policy in 2012 and now spreads gains and losses from a prior year over the subsequent two years, the County policy is not consistent with the requirements of OMB A-87, but the County could request the State Controller's Office to review and approve the policy as an exception. Despite the uncertainty of the appropriateness of the current policy, it has not been effective in maintaining a break-even fund balance in the Liability Insurance Fund ISF, as the balance has ranged from a low of \$9.0 million to a high of \$14.7 million in excess of actuarially determined liabilities during the 11 year period since 2003. Prior to 2003, and as long ago as FY 1994-95, the ISF fund balance ranged from \$11.4 million to \$27.3 million. Since a basic tenet of internal service fund operations specified by OMB A-87 is that "ISFs should not produce any significant profit or loss in the long run (HCPP Section 2240)," the County's current ISF funding policy does not achieve the goal of minimizing fund balances pursuant to OMB A-87.

Further, since the Board adopted the Liability Insurance ISF funding policy in March 2003, the County's financial position has changed significantly. While pension and related costs have increased significantly, the County's contingency reserve has grown from \$37 million to \$112.7 million and the cash reserve, which currently amounts to \$15 million, did not exist in 2003. Consequently, it would be appropriate for the Board to review and update this policy in order to achieve compliance with OMB A-87 and more closely reflect the County's current financial condition.

¹ And reconfirmed in 2005.

Liability Insurance ISF Fund Balance History:

To determine how and when the Liability Insurance ISF accumulated a fund balance of \$14.7 million, we examined the County's audited financial statements for the past 23 fiscal years, since FY 1990-91. As of June 30, 1991, the Liability Insurance ISF had a fund balance of only \$1.9 million, or about 33 days of working capital (clearly in compliance with OMB A-87). Due to operating losses over the next three fiscal years, the Liability Insurance ISF fund balance diminished to only \$617,000. However, in FY 1994-95 the Liability Insurance ISF made and retained a profit of \$10,829,000 (Attachment 2). Following FY 1994-95, the ISF made substantial annual profits over the subsequent five fiscal years, which were followed by seven years of losses and six years of profits. During the 19-year period from FY 1994-95 to FY 2013-14, the ISF fund balance never dropped below \$9.0 million and was as high as \$27.3 million (Attachment 3). Although the Department attempted to limit annual profits and the growth of fund balance by incurring operating losses in 15 of the 23 fiscal years, due to the significant fund balance in the ISF and high interest rates in the earlier years, investment income totaled \$52.7 million, which more than offset the operating losses.

FY 2013-14 Projected and FY 2014-15 Budget

Although the most recent audited financial statements report total Liability Insurance ISF assets of \$39.9 million and liabilities of only \$25.2 million for a surplus fund balance of \$14.7 million, the current fiscal year operations (FY 2013-14) are projected by the Department to generate a loss of about \$4.8 million, resulting in a year-end ISF fund balance estimated to amount to \$9.9 million as of June 30, 2014. Based on discussions with staff from the State Controller's Office, the development and retention of large fund balances in internal service funds is not permitted by OMB A-87, and it is important that such surpluses be refunded promptly as specified in the regulations². Since the Liability Insurance ISF has maintained surplus fund balances for the past 20 years ranging from \$9.0 million to \$27.3 million, the County's ISF funding policy should be amended and the excess June 30, 2014 retained earnings should be refunded in the FY 2014-15 budget.

The Department reported that the FY 2014-15 budget for GL Account 5210200 IC-Insurance amounts to \$23,835,051 and does reflect a reduction of \$3,300,000 from the

² State staff reported that the State was recently audited by federal auditors who determined that the State Information Services Department ISF Fund had developed and maintained ongoing surpluses for several years. As a result, the State was required to immediately refund the entire amount to its customers, including the federal government, and the State was assessed a fine since the ISF surplus balances were an ongoing business practice.

actuary's estimated funding requirement, which would reduce the \$9.9 million retained earnings described above to \$6.6 million. The Department also reported that an additional \$300,000 reduction of the retained earnings will occur when its final adjustments to the Recommended Budget are provided to OBA, further reducing the retained earnings balance to about \$6.3 million. Lastly, the Department reported that an amount of \$3.0 million is maintained in the Liability Insurance ISF fund as an earthquake, flood and miscellaneous liability reserve leaving a balance of \$3.3 million retained earnings as shown below:

June 30, 2013 Liability Insurance ISF Fund Surplus Balance	\$ 14.7 million
Est. FY 2013-14 Liability Insurance ISF Fund Loss	<u>- 4.8 million</u>
Est. June 30, 2014 Liability Insurance ISF Fund Surplus Balance	\$ <u>9.9 million</u>
FY 2014-15 Liability Insurance ISF Budgeted Rate Reduction	\$ - 3.3 million
Additional FY 2014-15 Liability Insurance ISF Rate Reductions	- 0.3 million
Earthquake, flood, miscellaneous reserve	<u>-3.0 million</u>
Est. June 30, 2014 Liability Insurance ISF Surplus Fund Balance	\$ <u>3.3 million</u>

Earthquake, Flood and Miscellaneous Reserve

OMB A-87 regulations pertaining to insurance internal service funds limit fund reserves to amounts no greater than the amounts recommended by the County's actuaries (HCPP Section 2255). Based on discussions with the Department, it is unknown when \$3 million of the Liability Insurance ISF surplus fund balance was first identified as a reserve for earthquake, flood and miscellaneous liabilities, or what was the source of the monies for that reserve. The County does maintain an excess liability policy covering such natural disasters, so this reserve would be available to fund losses pertaining to deductible amounts in the policy. Further, the Department does have actuarial reports for medical, general and auto liability, but there are no actuarial reports pertaining to earthquakes, floods and miscellaneous liabilities. Consequently, either the Department should obtain an actuarial evaluation to support the retention of the \$3 million reserve in the internal service fund, or it should be removed from the Liability Insurance ISF fund and transferred to a reserve in the General Fund.

60-Day Working Capital Reserve

As previously described, the Liability Insurance ISF Fund balance as of June 30, 2014 is estimated to amount to \$9.9 million. The Department plans to refund about \$3.6 million

in the FY 2014-15 budget, reserve \$3.0 million for an Earthquake, Flood and Miscellaneous Reserve, and retain about \$3.3 million to be refunded in the FY 2015-16 budget. However, since a multi-year retention of surplus internal service funds is not permitted by OMB A-87, either the Department should refund the additional \$3.3 million in FY 2014-15, or maintain these monies as a 60-day working capital reserve as permitted by HCPP Section 2245.

Consequently, the Board should make a policy decision as to whether the County should implement a 60-day working capital reserve in the Liability Insurance ISF Fund or refund the \$3.3 million surplus retained earnings in the FY 2014-15 budget. Our review of accounting entries for this fund found that its primary revenue source, insurance premiums paid by operating departments, is received at the start of the fiscal year, with expenses paid during the subsequent 12 months. In addition, the Liability Insurance ISF Fund has an existing cash balance of about \$40 million. Consequently, a 60-day working capital reserve is not needed and may be difficult to justify to the State Controller's Office. Therefore, we believe the remaining \$3.3 million surplus fund balance should be refunded to the operating departments in FY 2014-15, permitting the reprogramming of the funds to other Board priorities and underfunded programs.

Summary of Recommendations

It is recommended that the Board of Supervisors:

- 1) Review and update the Internal Service Fund (ISF) funding policy in Section 4.15 of the Board Policy Manual adopted March 3, 2003; and,
- 2) Determine whether the County should refund the projected June 30, 2014 \$3.3 million surplus balance in the Liability Insurance ISF fund through a rate reduction in the FY 2014-15 budget, or establish a 60-day working capital reserve in the Liability Insurance ISF Fund.

It is recommended that the Employee Services Agency:

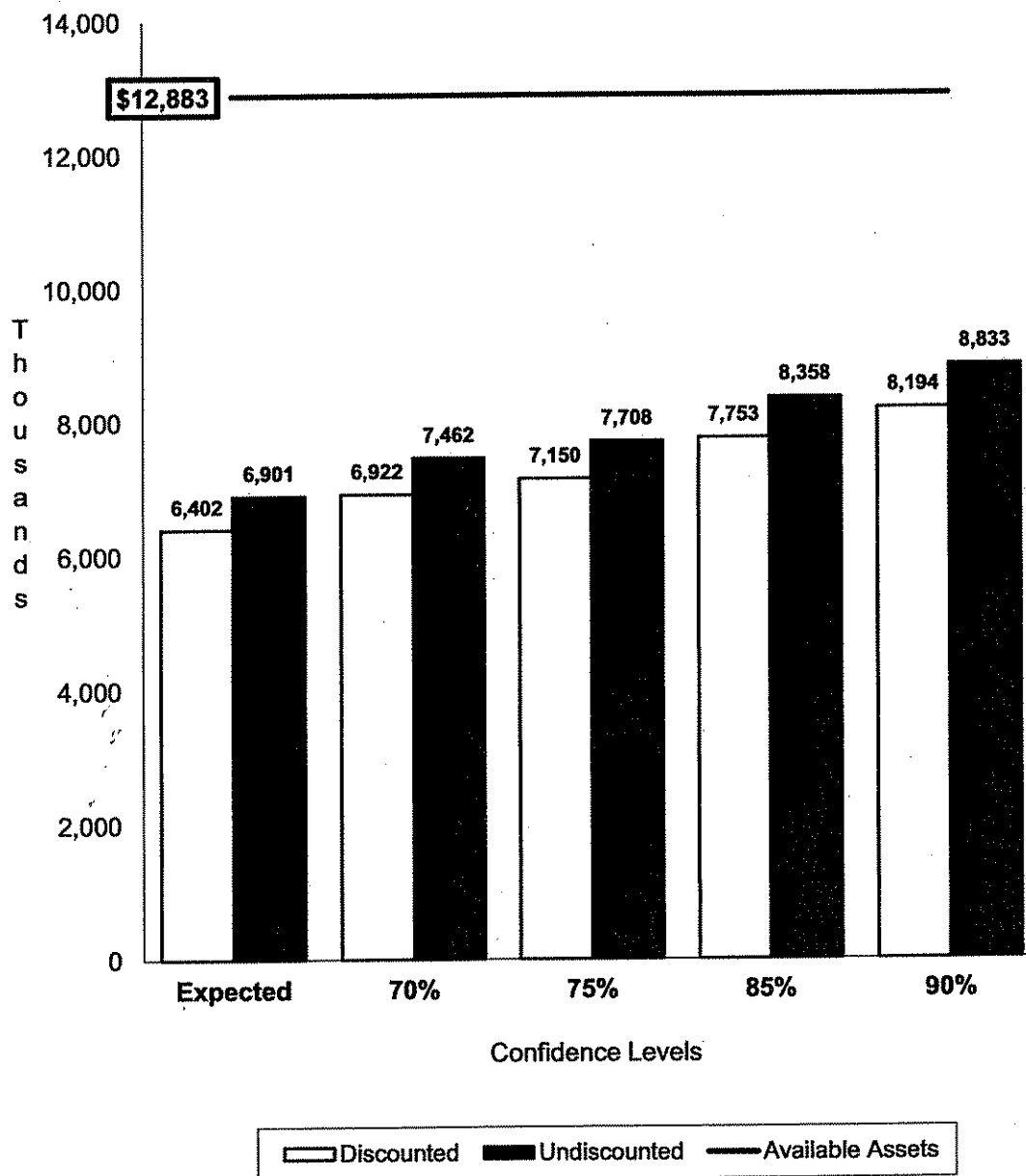
- 1) Obtain an actuarial valuation report to support the retention of a reserve for earthquakes, floods and miscellaneous liabilities, or transfer this reserve to a General Fund reserve.

COUNTY OF SANTA CLARA
Combining Statement of Fund Net Position
Internal Service Funds

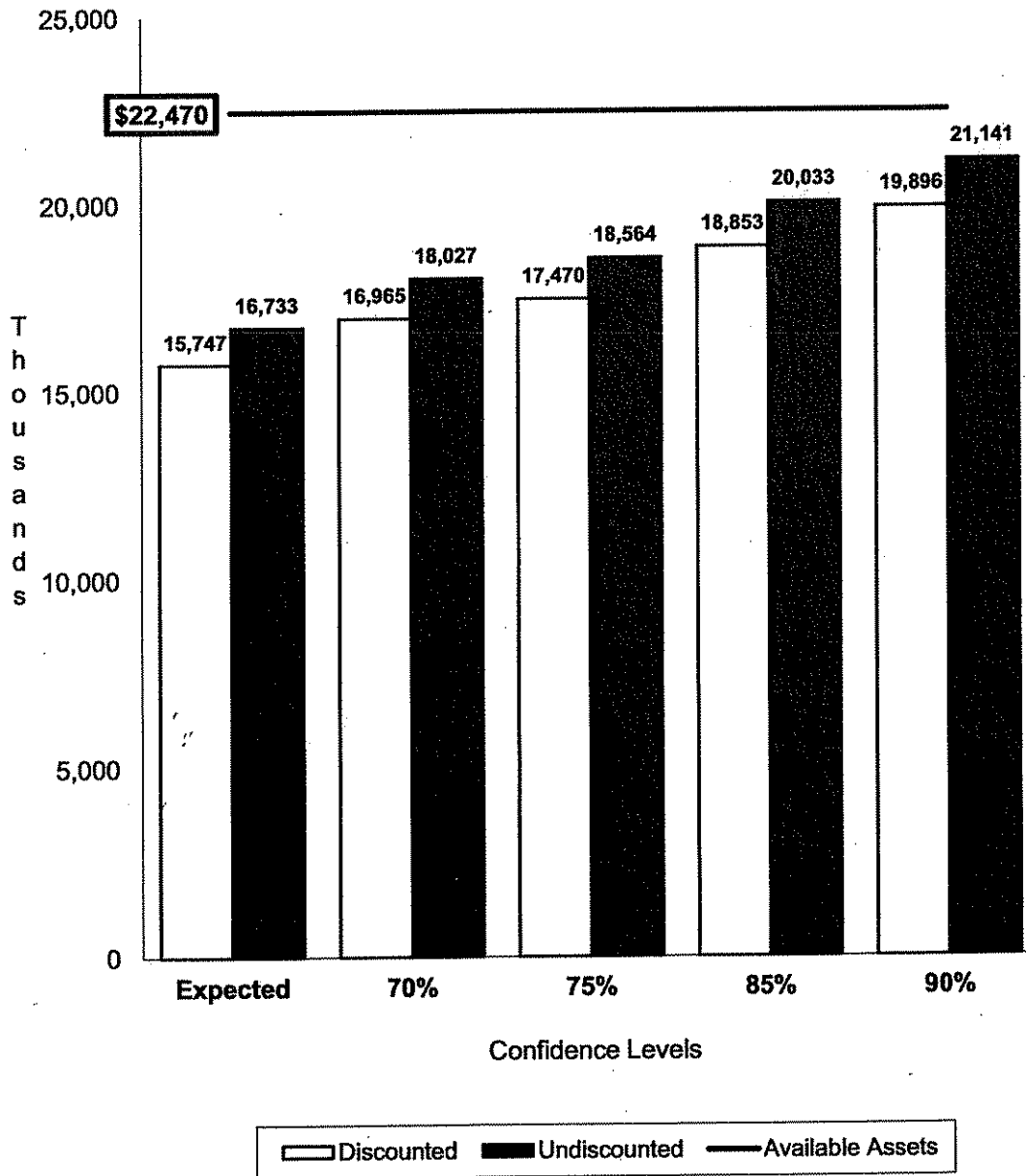
June 30, 2013
(In thousands)

	Information Services	Fleet Management	Insurance	Printing	Unemployment Insurance
Assets:					
Current assets:					
Cash and investments:					
Unrestricted	\$ 8,818	\$ 11,318	\$ 24,410	\$ 1,142	\$ 4,382
Restricted with fiscal agent	-	-	14,007	-	-
Other restricted	-	-	-	-	-
Accounts receivable, net	19	421	178	1	66
Due from other funds	2,453	-	-	-	-
Due from other governmental agencies	25	-	-	2	-
Inventories	219	828	-	157	-
Prepaid rent/insurance	527	-	1,326	-	-
Total current assets	12,061	12,567	39,921	1,302	4,448
Noncurrent assets:					
Net pension asset	-	-	-	-	-
Other assets	-	-	-	-	-
Capital assets:					
Nondepreciable	-	1,295	-	-	-
Depreciable	1,229	3,019	-	20	-
Total noncurrent assets	1,229	4,314	-	20	-
Total assets	13,290	16,881	39,921	1,322	4,448
Liabilities:					
Current liabilities:					
Accounts payable	1,843	559	1,399	36	3
Accrued salaries and benefits	391	103	20	18	-
Accrued liabilities	-	-	-	-	-
Due to other funds	-	-	-	-	-
Due to other governmental agencies	-	1	-	-	-
Current portion of insurance claims	-	-	8,502	-	1,536
Current portion of accrued vacation and sick leave	160	33	5	1	-
Current portion of bonds payable	-	-	-	-	-
Total current liabilities	2,394	696	9,926	55	1,539
Noncurrent liabilities:					
Noncurrent portion of insurance claims	-	-	15,103	-	-
Noncurrent portion of accrued vacation and sick leave	2,710	536	166	194	-
Noncurrent portion of bonds payable	-	-	-	-	-
Net OPEB obligation	-	-	-	-	-
Total noncurrent liabilities	2,710	536	15,269	194	-
Total liabilities	5,104	1,232	25,195	249	1,539
Net Position:					
Net investment in capital assets	1,229	4,314	-	20	-
Unrestricted (deficit)	6,957	11,335	14,726	1,053	2,909
Total net position (deficit)	\$ 8,186	\$ 15,649	\$ 14,726	\$ 1,073	\$ 2,909

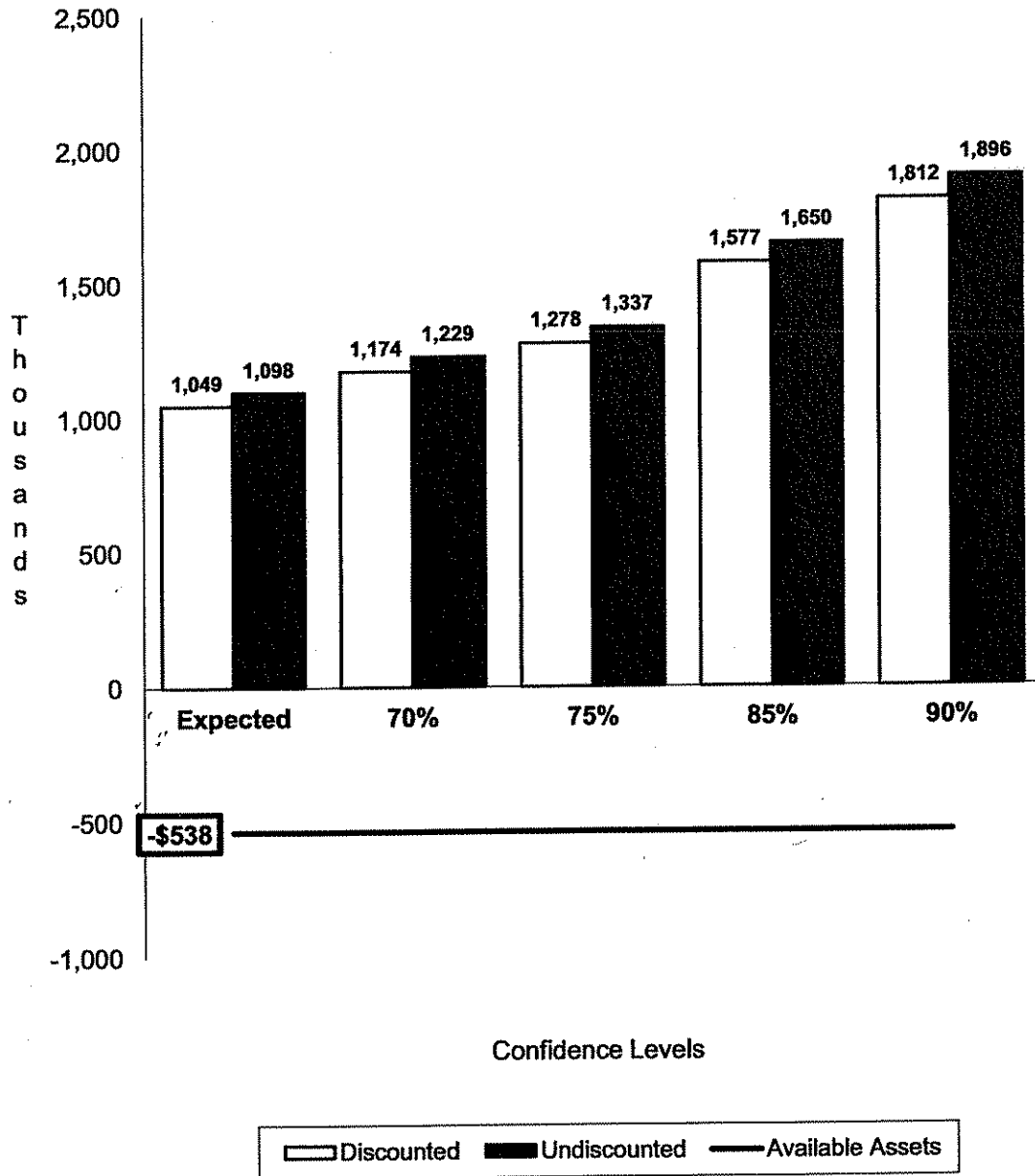
Santa Clara County -
 Medical Malpractice
 Available Assets vs Outstanding Liability (\$000's)
 at June 30, 2013



Santa Clara County -
 General Liability
 Available Assets vs Outstanding Liability (\$000's)
 at June 30, 2013



Santa Clara County -
Auto Liability
Available Assets vs Outstanding Liability (\$000's)
at June 30, 2013



COUNTY OF SANTA CLARA

INTERNAL SERVICE FUNDS
COMBINING STATEMENT OF REVENUES, EXPENSES AND CHANGES IN RETAINED EARNINGS (DEFICIT)
YEAR ENDED JUNE 30, 1995 (In Thousands)

	Data Processing	Fleet Management	Insurance	Printing	Community- cations	Motor Pool	Unemploy- ment Insurance	Workers' Compen- sation	Total
OPERATING REVENUES -									
Charges for services	\$14,964	\$6,887	\$19,781	\$2,092	\$4,999	\$ 736	\$993	\$25,569	\$76,021
OPERATING EXPENSES:									
Salaries and benefits	9,506	1,600	761	665	1,894	-	178	1,932	16,536
Services and supplies	4,699	2,178	405	643	2,858	597	19	1,288	12,687
Depreciation and amortization	632	2,284	20	76	24	519	-	57	3,612
Leases and rentals	32	2	-	-	-	-	-	6	40
Other	562	249	405	313	124	-	116	625	2,394
Claims and premiums	-	-	10,914	-	-	-	678	14,081	25,673
Total operating expenses	15,431	6,313	12,505	1,697	4,900	1,116	991	17,989	60,942
OPERATING INCOME (LOSS)	(467)	574	7,276	395	99	(380)	2	7,580	15,079
NONOPERATING REVENUES (EXPENSES):									
Interest income	159	66	3,553	-	-	23	66	3,209	7,076
Interest expense	(23)	(306)	-	(30)	(16)	-	-	-	(375)
Other - net	13	32	-	1	2	41	(27)	(1,572)	(1,510)
Total nonoperating revenues (expenses)	149	(208)	3,553	(29)	(14)	64	39	1,637	5,191
NET INCOME (LOSS)	(318)	366	10,829	366	85	(316)	41	9,217	20,270
RETAINED EARNINGS (DEFICIT):									
Beginning of year	3,425	4,469	562	(547)	383	(228)	729	(12,021)	(3,228)
End of year	\$ 3,107	\$4,835	\$11,391	\$ (181)	\$ 468	\$ (544)	\$770	\$ (2,804)	\$17,042

ANALYSIS OF INSURANCE ISF FUND BASED ON AUDITED FINANCIAL STATEMENTS

Fiscal Year	Beginning Fund Balance	Operating Revenue	Operating Expenses	Profit (Loss)	Interest/Other Revenue	Transfers	Ending Fund Balance	Profit (Loss) Including Invest Income	Cash Balance	Total Assets	Total Liabilities	Fund Balance	% Funded
2012-13	14,046,000	23,469,000	22,916,000	553,000	118,000	9,000	14,726,000	671,000	38,417,000	39,921,000	25,195,000	14,726,000	158%
2011-12	11,428,000	21,787,000	19,724,000	2,063,000	555,000	0	14,046,000	2,618,000	39,661,000	40,948,000	26,902,000	14,046,000	152%
2010-11	14,028,000	20,544,000	23,801,000	(3,257,000)	657,000	0	11,428,000	(2,600,000)	39,200,000	41,178,000	29,750,000	11,428,000	152%
2009-10	11,141,000	24,286,000	22,338,000	1,948,000	994,000	(55,000)	14,028,000	2,942,000	39,144,000	40,900,000	26,872,000	14,028,000	152%
2008-09	9,038,000	25,062,000	24,303,000	759,000	1,744,000	(400,000)	11,141,000	2,503,000	37,992,000	40,019,000	28,878,000	11,141,000	139%
2007-08	9,350,000	23,645,000	26,445,000	(2,800,000)	2,488,000	0	9,038,000	(312,000)	36,893,000	38,488,000	29,450,000	9,038,000	131%
2006-07	11,601,000	17,909,000	23,249,000	(5,340,000)	2,239,000	850,000	9,350,000	(3,101,000)	35,691,000	37,142,000	27,792,000	9,350,000	144%
2005-06	12,277,000	14,003,000	15,901,000	(1,898,000)	1,222,000	0	11,601,000	(676,000)	36,412,000	41,404,000	26,320,000	11,601,000	142%
2004-05	24,160,000	7,777,000	20,801,000	(3,024,000)	1,141,000	0	12,277,000	(1,883,000)	39,658,000	41,404,000	29,127,000	12,277,000	142%
2003-04	23,233,000	8,811,000	8,280,000	531,000	396,000	0	24,160,000	927,000	50,665,000	51,610,000	27,450,000	24,160,000	188%
2002-03	24,767,000	15,276,000	18,850,000	(3,574,000)	2,040,000	0	23,233,000	(1,534,000)	55,324,000	56,245,000	33,012,000	23,233,000	170%
2001-02	27,260,000	11,869,000	14,974,000	(3,105,000)	3,305,000	0	24,767,000	200,000	55,739,000	57,314,000	32,547,000	24,767,000	176%
1999-01	24,407,000	8,699,000	15,105,000	(6,406,000)	3,713,000	0	24,567,000	(2,693,000)	55,178,000	56,258,000	31,691,000	24,567,000	178%
1998-99	24,407,000	9,570,000	9,717,000	(147,000)	3,000,000	0	27,260,000	2,853,000	52,934,000	54,269,000	27,009,000	27,260,000	201%
1997-98	17,873,000	8,770,000	5,041,000	3,729,000	2,805,000	0	24,407,000	6,534,000	52,409,000	54,052,000	29,645,000	24,407,000	182%
1996-97	14,236,000	8,034,000	8,478,000	(444,000)	4,081,000	0	17,873,000	3,637,000	51,126,000	53,082,000	35,209,000	17,873,000	151%
1995-96	11,730,000	10,900,000	11,794,000	(894,000)	3,400,000	0	14,236,000	2,506,000	53,066,000	55,237,000	41,001,000	14,236,000	135%
1994-95	11,446,000	12,135,000	11,058,000	1,077,000	3,294,000	(4,087,000)	11,730,000	4,371,000	46,363,000	48,829,000	37,099,000	11,730,000	132%
1993-94	617,000	19,781,000	12,505,000	7,276,000	3,553,000	0	11,446,000	10,829,000	59,230,000	64,532,000	53,086,000	11,446,000	122%
1992-93	(1,434,000)	15,382,000	16,167,000	(785,000)	2,836,000	0	617,000	2,051,000	48,309,000	54,748,000	54,131,000	617,000	101%
1991-92	(4,247,000)	15,600,000	15,613,000	(13,000)	2,826,000	0	(1,434,000)	2,813,000	51,938,000	59,910,000	61,344,000	(1,434,000)	98%
1990-91*	1,934,000	11,596,000	20,798,000	(9,202,000)	3,021,000	0	(4,247,000)	(6,181,000)	41,928,000	57,880,000	62,127,000	(4,247,000)	93%
	8,514,000	11,329,000	21,133,000	(9,804,000)	3,224,000	0	1,934,000	(6,580,000)	36,407,000	55,449,000	53,515,000	1,934,000	109%

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Revenue Account 4813900	Miscellaneous Reimbursements	
County Executive <u>Recommended</u>	Management Audit <u>Proposed</u>	Revenue <u>Increase</u>
\$0	\$44,540	\$44,540

The Department of Revenue (DOR) charges the Employee Services Agency (ESA) to handle the billing of County retirees for any medical insurance premium they are required to pay based upon the Memorandum of Understanding that covered their employment with the County. DOR charges ESA an administrative fee of \$20.00 per account per year for this service.

As illustrated in the following table, over the past five fiscal years, actual annual billing revenues, including our FY 2013-14 projection, range from \$46,400 to \$59,260, and average \$54,975.

**DEPARTMENT OF REVENUE
DOR CHARGES PAID BY ESA FOR RETIREE PREMIUM COLLECTIONS
FY 2009-10 TO FY 2013-14**

<u>Fiscal Year</u>	<u>GLA 4813900</u>
2009-10	\$55,840
2010-11	59,260
2011-12	62,540
2012-13	46,400
Projected 2013-14	50,835
<i>5-Yr Average</i>	<i>\$54,975</i>

Source: County SAP, ZFMP011 accounting report

Note: ESA pays for this service out of its Fund 0309, an unbudgeted fiduciary retirees' benefits trust.

DOR fiscal staff advised us that DOR has never budgeted for this revenue since it has always been ESA's intention to move to another retiree billing option through CalPERS. Indeed, the FY 2014-15 Recommended Budget does not contain any amount for this service. ESA staff advised us that they are currently analyzing this issue but have not yet made a decision to transition to CalPERS. Nor do they have a timeline to conclude their analysis. In addition, for FY 2014-15 they have already established 2,227 retiree

billing accounts with DOR, and will add more accounts as active employees retire throughout the year. Based on this information alone, DOR should expect to collect, and therefore budget, at least \$44,540 (which is 2,227 accounts times \$20.00 administrative fee).

Expense Account 5250100		Office Expense
County Executive	Management Audit	Expenditure
<u>Recommended</u>	<u>Proposed</u>	<u>Decrease</u>
\$1,138,741	\$620,000	\$518,741

Under the Office of the District Attorney, Object 2 line item budgets for office expenses have been systematically high for the past five years, compared to actual expenses. While it is normal for miscellaneous line items such as office expenses to fluctuate from year to year, a historical review of the District Attorney’s office expenditures reveals a reasonably consistent and predictable annual expense. Based on the Management Audit Division’s review of historical trends and year-to-date expenses, we recommend that the District Attorney’s budget for Office Expense be reduced by \$518,741.

For FY 2013-14, the Office of the District Attorney adopted a budget of \$1,256,166 for office expenses; however, year-to-date actual expenses extracted from SAP for accounting period 11 (through the end of May) show that expenses have only accumulated to \$518,024. As displayed in the following table, since FY 2009-10, the average percent increase from the end of May through the end of the fiscal year has been 16 percent. Assuming FY 2013-14’s expenditures in accounting period 11 will increase by 16 percent, the Management Audit Division estimates year-end expenses to reach approximately \$599,000 – an amount 52 percent less than the adopted budget.

Office Expense Actual Expenditures by Fiscal Year and Accounting Period

<u>Fiscal Year</u>	<u>Expense as of May 31</u>	<u>Final Actual Expense</u>	<u>Percent Change between Periods</u>	<u>Adopted Budget</u>	<u>Unexpended Appropriations</u>
FY 2009-10	\$412,229	\$469,846	14%	\$1,486,927	\$1,017,081
FY 2010-11	\$399,509	\$459,967	15%	\$897,898	\$437,931
FY 2011-12	\$504,637	\$582,528	15%	\$836,256	\$253,729
FY 2012-13	\$453,534	\$535,298	18%	\$2,000,178	\$1,464,880
Average	\$442,477	\$511,910	16%	\$1,305,315	\$793,405
FY 2013-14	\$518,024	\$599,059 ¹	16%	\$1,256,166	\$657,107

¹ FY 2013-2014’s expense is the estimated year-end assuming Period 11 expenses increase by 16%.

A review of the past five years also displays a systematic adoption of large budgets when actual expenses are comparably low. A review of FY 2012-13 stands out with the largest discrepancy where year-end actual expenses (\$535,298) were 73 percent less than the adopted budget (\$2 million). Seeing that office expenses have become relatively stable from year to year, it would be financially prudent of the District Attorney’s Office and the County to adopt a budget reflective of the actual costs of this service need. An additional analysis of the District Attorney’s Object 2 budget show year-end unexpended appropriations dating back to FY 2009-10. This observation, displayed in the table below, further supports the notion that the Office Expense general ledger account has an inflated budget that contributes to the overall Object 2 year-end unexpended appropriations.

Object 2 Adopted Budget & Actual Expenditure Comparison

<u>Fiscal Year</u>	<u>Actual Expense</u>	<u>Adopted Budget</u>	<u>Unexpended Appropriations</u>
FY 2009-10	\$20,523,519	\$22,199,716	\$1,676,197
FY 2010-11	\$19,726,592	\$21,065,320	\$1,338,728
FY 2011-12	\$16,262,052	\$16,994,408	\$732,357
FY 2012-13	\$15,653,814	\$16,636,527	\$982,713
FY 2013-14	\$19,350,882 ²	\$19,597,833	\$246,951

Although we estimate approximately \$250,000 in unexpended Object 2 appropriations this year, our historical review shows total expenditures usually much lower than the adopted budget. The County Executive’s FY 2014-15 recommended budget for Object 2 also supports the suggestion that expenditures will be less next year as the budget is decreased by approximately \$20,000 from \$19,598,833 to \$ \$19,580,000.

Furthermore, the Office of Budget and Analysis reported that the Office Expense general ledger account is over budgeted to accommodate for other grant related expenses which are credited against other expenditure line items. In order to properly control Object level expenses, subobject accounts must also be more appropriately controlled particularly when budgeted monies are systemically used for other purposes than originally appropriated. When counties utilize subobject accounts for budgeting and accounting, the State Controller’s accounting standards require specific accounts where appropriate, including Office Expense. Under an Office Expense subobject account, specific types of expenses are listed which may be included, grant

² FY 2013-2014’s expense is estimated assuming Period 11’s balance increases by 24%, the average increase from the end of May to the end of the fiscal year.

expenditures not falling within a categorization of office expenditures. Grant expenses, whether to governmental or nongovernmental organizations, must be accounted for in different subobject accounts. In order to better control expenses and maintain transparency as to how the District Attorney’s Office is utilizing the public’s money, the Office of Budget and Analysis and the District Attorney’s Office should adjust the general ledger accounts to reflect the proper non-office related expenditures in their appropriate expenditure accounts.

Based on historical data of year-end expenses and the year-to-date accounting for FY 2013-14, the Management Audit Division recommends that the Office of the District Attorney decrease its office expense budget from \$1,138,741 to \$620,000. Recognizing that annual expenditures usually fall below \$600,000, but that FY 2012-13’s expenses increased by 18 percent from the end of May through the close of the fiscal year, an adopted budget of \$620,000 should provide the District Attorney with a reasonable budget for office needs. Lowering the adopted budget for office expenses will allow the reappropriation of \$518,741 for other needs in the County.

Expense Account 5104000		Premium Pay
County Executive	Management Audit	Expenditure
<u>Recommended</u>	<u>Proposed</u>	<u>Decrease</u>
\$297,577	\$110,000	\$187,577

The Office of the District Attorney is budgeted to have 527.5 full-time equivalent employees during FY 2014-15. Contingent upon the varying bargaining units representing these employees, the County is obliged to provide premium pay when employees are eligible for such compensation, according to each employee’s respective labor agreement. Since FY 2009-2010, the District Attorney’s expenses on premium pay have not exceeded \$90,000 despite annual appropriations between \$200,000 and \$300,000. Based on the Management Audit Division’s projection of premium pay expenditures, actual costs are estimated to be approximately \$188,000 less than the County Executive’s recommended budget.

From FY 2009-10 through FY 2012-13, actual expenses accounted for during accounting period 11 (the end of May) never exceeded \$76,000. During the course of this review, the Management Audit Division found that current year-to-date expenses for premium pay have amounted to nearly \$85,000, a 12 percent increase from FY 2012-13’s expenses as of the end of May. Based on the four-year average of 14 percent increases in accumulated premium pay expenditures from the end of May to the close of the fiscal

Review of the County of Santa Clara FY 2014-15 Recommended Budget

year, the Management Audit Division estimates that FY 2013-14's year-end expenses will amount to approximately \$97,000. Our year-end estimated cost falls about \$200,000 below the adopted budget. The table below provides an overview of this analysis depicting a similar systematic trend of adopting relatively large budgets in comparison to true annual costs.

Premium Pay Actual Expenditures by Fiscal Year and Accounting Period

<u>Fiscal Year</u>	<u>Expense as of May 31</u>	<u>Final Actual Expense</u>	<u>Percent Change between Periods</u>	<u>Adopted Budget</u>	<u>Unexpended Appropriations</u>
FY 2009-2010	\$75,287	\$85,869	14%	\$281,071	\$195,202
FY 2010-2011	\$71,960	\$82,120	14%	\$281,071	\$198,951
FY 2011-2012	\$66,187	\$76,703	16%	\$207,299	\$130,596
FY 2012-2013	\$75,704	\$85,484	13%	\$232,508	\$147,024
Average	\$72,284	\$82,544	14%	\$256,480	\$167,943
FY 2013-2014	\$84,857	\$96,945 ³	14%	\$297,577	\$200,632
FY 2014-2015	\$95,116 ⁴	\$108,666 ⁴	14%	-	-

Furthermore, Object 1 actual expenses over the last four years had increased by 9% from the end of May until the close of the fiscal year. Using FY 2013-14's Object 1 expenditure balance at the end of May, we project that year-end actuals will amount to \$83.2 million – approximately \$6.5 million less than the adopted budget of \$89.7 million. With the unexpended appropriation of \$6.5 million, our analysis indicating an inflated budget for premium pay is supported by the overall availability of Object 1 appropriations. The table below provides an overview of historical expenditures.

Object 1 Adopted Budget & Actual Expenditure Comparison

<u>Fiscal Year</u>	<u>Expense as of May 31</u>	<u>Final Actual Expense</u>	<u>Percentage Change between Periods</u>	<u>Adopted Budget</u>	<u>Unexpended Appropriations</u>
FY 2009-10	\$73,767,360	\$80,634,691	9.3%	\$80,636,157	\$1,466
FY 2010-11	\$74,011,598	\$80,744,438	9.1%	\$80,782,906	\$38,468
FY 2011-12	\$71,847,275	\$78,267,884	8.9%	\$78,281,326	\$13,442
FY 2012-13	\$75,035,679	\$81,756,902	9.0%	\$82,029,210	\$272,308
FY 2013-14	\$76,270,918	\$83,192,559 ⁵	9.1%	\$89,747,357	\$6,542,718

³ FY 2013-2014's year-end expense assume expenses as of May increase by 14% by year's end.

⁴ FY 2014-2015's May expense is based on a 12% increase as experienced from FY 2012-2013 to FY 2013-2014. Year-end expense assumes a 14% increase from May to end of the year based on the four-year average.

After reviewing historical year-end expenses and the year-to-date accounting for FY 2013-14, the Management Audit Division recommends that the Office of the District Attorney decrease its premium pay budget for FY 2014-15 from \$297,577 to \$110,000. Seeing that historical accounting portrays premium pay expenses as relatively stable and predictable, it would be financially prudent of the District Attorney's Office and the County to adopt a budget reflective of the true cost of service. Lowering the adopted budget for premium pay will allow the reappropriation of \$187,557 for other needs.

⁵ From FY 2009-10 through 2012-13, year-end final expenses increased on average by 9.1% from accounting period 11 (end of May). FY 2013-2014's final expense assumes May's balance will increase by the average 9.1% by year's end.

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Expense Account 5104000		Premium Pay
County Executive	Management Audit	Expenditure
<u>Recommended</u>	<u>Proposed</u>	<u>Decrease</u>
\$191,669	\$105,000	\$86,669

The Office of the Public Defender anticipates budgeting for 247 positions consisting of lawyers, paralegals, analysts and administrative support staff. Under the County’s labor agreements with various bargaining units representing these employees, certain provisions allow for premium or differential pay as a part of the salaries and benefits paid out for work. After reviewing the historical trends and year-to-date accounting of expenditures, the Management Audit Division recommends a reduction of \$86,669 in FY 2014-15’s recommended budget for premium pay.

From FY 2009-10 through FY 2012-13, year-end actual expenditures for premium pay only exceeded \$100,000 once. The highest annual expense was in FY 2012-13 when actual expenses accumulated to \$100,562. In FY 2013-14, the County adopted a budget of \$191,669 for premium pay, more than double the prior year’s actual expense due to a change in the Government Attorneys Association’s (GAA) labor agreement for differential pay. Year-to-date expenses, however, show expenditure levels comparable to historical trends. A summary is provided in the table below which shows expenditures as of both the end of May and the end of the fiscal year to more accurately compare costs accrued during the annual budget review and actual year-end expenses.

Premium Pay Actual Expenses by Fiscal Year and through the End of May

<u>Fiscal Year</u>	<u>Expense as</u>	<u>Actual</u>	<u>Percent Change</u>	<u>Adopted</u>
	<u>of May 31</u>	<u>Expense</u>	<u>between Periods</u>	<u>Budget</u>
FY 2009-10	\$76,861	\$87,749	14%	\$90,735
FY 2010-11	\$79,825	\$90,782	14%	\$90,735
FY 2011-12	\$77,986	\$89,956	15%	\$27,625
FY 2012-13	\$91,163	\$100,562	10%	\$82,709
FY 2013-14	\$87,861	\$99,623 ¹	13%	\$191,669

¹ FY 2013-14’s estimated year-end assumes the balance as of the end of May increases by 13 percent.

On average, expenses for premium pay increased by 13 percent from the end of May to the close of the fiscal year. Assuming that FY 2013-14's year-to-date expenses accounted for at the end of May increase by 13 percent by the end of the year, premium pay costs are anticipated to meet \$99,623, approximately \$92,000, less than the adopted budget. Despite the comparably low year-to-date actual and estimated expenses for FY 2013-14, the County Executive once again recommends a premium pay budget of \$191,669 for FY 2014-15.

To further support this argument, an analysis of Object 1 expenditures shows the Office of the Public Defender consistently with year-end unexpended appropriations. The table below provides an overview of actual expenses for salaries and benefits compared to adopted budgets.

Object 1 Adopted Budget & Actual Expenditure Comparison

<u>Fiscal Year</u>	<u>Expense as of May 31</u>	<u>Actual Expense</u>	<u>Percentage Increase</u>	<u>Adopted Budget</u>	<u>Unexpended Appropriations</u>
FY 2009-10	\$35,846,521	\$39,268,846	10%	\$39,536,751	\$267,905
FY 2010-11	\$36,942,761	\$40,309,025	9%	\$41,075,121	\$766,096
FY 2011-12	\$36,698,900	\$40,110,045	9%	\$40,370,663	\$260,618
FY 2012-13	\$39,215,296	\$42,713,582	9%	\$42,916,995	\$203,414
FY 2013-14	\$41,519,416	\$45,346,980 ²	9%	\$46,985,732	\$1,638,752

As the table above displays, expenditures for salaries and benefits under Object 1 turn out to be relatively stable and consistent in their growth from accounting period 11 to the close of the fiscal year. Based on our estimates, we anticipate that the Public Defender's Office will have a \$1.6 million in unexpended appropriations this year. Seeing that the Public Defender also anticipates an increase of approximately \$2 million under Object 1 for FY 2014-15, the preponderance of evidence suggests that the Public Defender has over budgeted its premium pay budget, even if a variety of pay differentials are charged under other general ledger accounts.

Based off historical data of year-end expenses and the year-to-date accounting for FY 2013-14, the Management Audit Division recommends that the Office of the Public Defender's budget for premium pay be decreased from \$191,669 to \$105,000. Recognizing that annual expenditures usually rest below \$100,000, this threshold

² From FY 2009-10 through 2012-13, year-end final expenses increased on average by 9% from accounting period 11 (end of May). FY 2013-2014's final expense assumes May's balance will increase by the average 9% by year's end.

should provide the Office with reasonable accommodation for premium pay demands. Lowering the adopted budget for premium pay will allow the Board of Supervisors to reappropriate an additional \$86,669 for other needs in the County.

During the course of this budget review, staff from the Office of Budget and Analysis informed the Management Audit Division that the Office of the Public Defender provided an updated projection of premium pay costs for FY 2014-2015 at about \$233,021. After reviewing the evidence of historical actual costs, and observing the low year-to-date expenditures for FY 2013-2014 after the GAA labor contract changes, the Management Audit Division finds no compelling evidence to support this increase in the premium pay budget.

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Revenue Account 4580100	FED-Other Grants and Aids	
<u>County Executive Recommended</u>	<u>Management Audit Proposed</u>	<u>Revenue Increase</u>
\$0	\$350,000	\$350,000

This revenue account receives funds from several different grant programs. While one grant, for crime prevention related to child sexual predators, is ending in Fiscal Year, 2013-14, three others appear likely to continue, and a description of each and our funding expectation follows.

Avoid the 13

A grant from the California Office of Traffic Safety funds the Avoid the 13 Holiday DUI program, which the Sheriff administers to provide supplemental funding for the Office of the Sheriff and other local law enforcement agencies to provide enhanced enforcement driving-under-the-influence enforcement during holiday periods. The Office of the Sheriff has received funding for this program regularly from the State since at least Fiscal Year 2003-04. Last year we recommended to budget \$100,000 from this source. In fact, the Board on September 10, 2013 accepted a grant award totaling \$179,470 for the period through September 30, 2014. In reviewing Governor Brown’s proposed FY 2014-15 budget, we note that proposed funding for such grants has been reduced, but even the Office of the Sheriff indicates they believe the program will continue, noting that “Santa Clara County is a leader in Avoid the 13 enforcement and the State has always been supportive of our activities.” Accordingly, we recommend that \$100,000 again be budgeted for this program in this account.

Statewide Terrorism Training

In December 2012, the Board accepted a one-time grant to pay for 14 months of salary, benefits and related expenses for a Sheriff’s Captain who, through a contract with the San Diego Urban Area Security Initiative, manages Statewide terrorism training and exercises for local law enforcement agencies. Although accepted in December 2012, most of the grant funding has been received in the current fiscal year, and was included in the Current Modified Budget. No funding is being included in the base budget for FY

2014-15, and the department stated it is waiting to hear back from San Diego officials on the status of the next contract and funding.

The most recent information obtained by the Management Audit Division is a March 18, 2014 Grant Programs Directorate Information Bulletin from the Federal Emergency Management Agency, which administers Urban Area Security Initiative (UASI) Funding. That bulletin includes federal Fiscal Year 2014 (October 1, 2013-September 30, 2014) allocations by urban area, and identifies the San Diego area's allocation as \$16,874,000, about the same funding level as in FY 2013. Furthermore, President Obama's proposed FY 2014-15 budget for FEMA would expand funding for its state and local programs from \$1.5 billion to more than \$2.2 billion. Based on this information, we believe there is ample evidence that the San Diego UASI program will continue, and that funding for the staffing the County of Santa Clara is providing will continue.

We further note that at the time the existing grant agreement was presented to the Board, the Office of Sheriff stated that it expected to Sheriff's Captain retirements, in late FY 2013 and in late FY 2014, and would keep one of the positions vacant for employee transfer if the grant funding were not extended. However, the vacancy report obtained by the Management Audit Division for this budget review, dated April 28, 2014, does not include any Sheriff's Captain vacancies, making it likely that the department will have to eliminate a position if this grant funding does not continue. Accordingly, we recommend budgeting revenue from this grant. Although the previous grant was for \$328,455, we recommending conservatively budgeting \$150,000, the amount of revenue received in the current fiscal year to date.

Northern California Regional Intelligence Center

This grant pays for salary, benefits and overtime for a Deputy Sheriff assigned to the Center, which provides training to member agencies , serves as the Joint Terrorism Task Force and State Threat Assessment System contact for the Northwestern California region, helps members prepare for terrorism incidents by collecting, compiling and analyzing threat trends, disseminating information derived from those analyses, and promoting information sharing among all members. Funding for the center comes from various sources, although this particular grant is administered through the Bay Area Urban Area Security Initiative, with the funding overseen by the County of San Mateo. The Office of the Sheriff reports that "neither entity has indicated that funding for this position would be eliminated in future grant cycles.

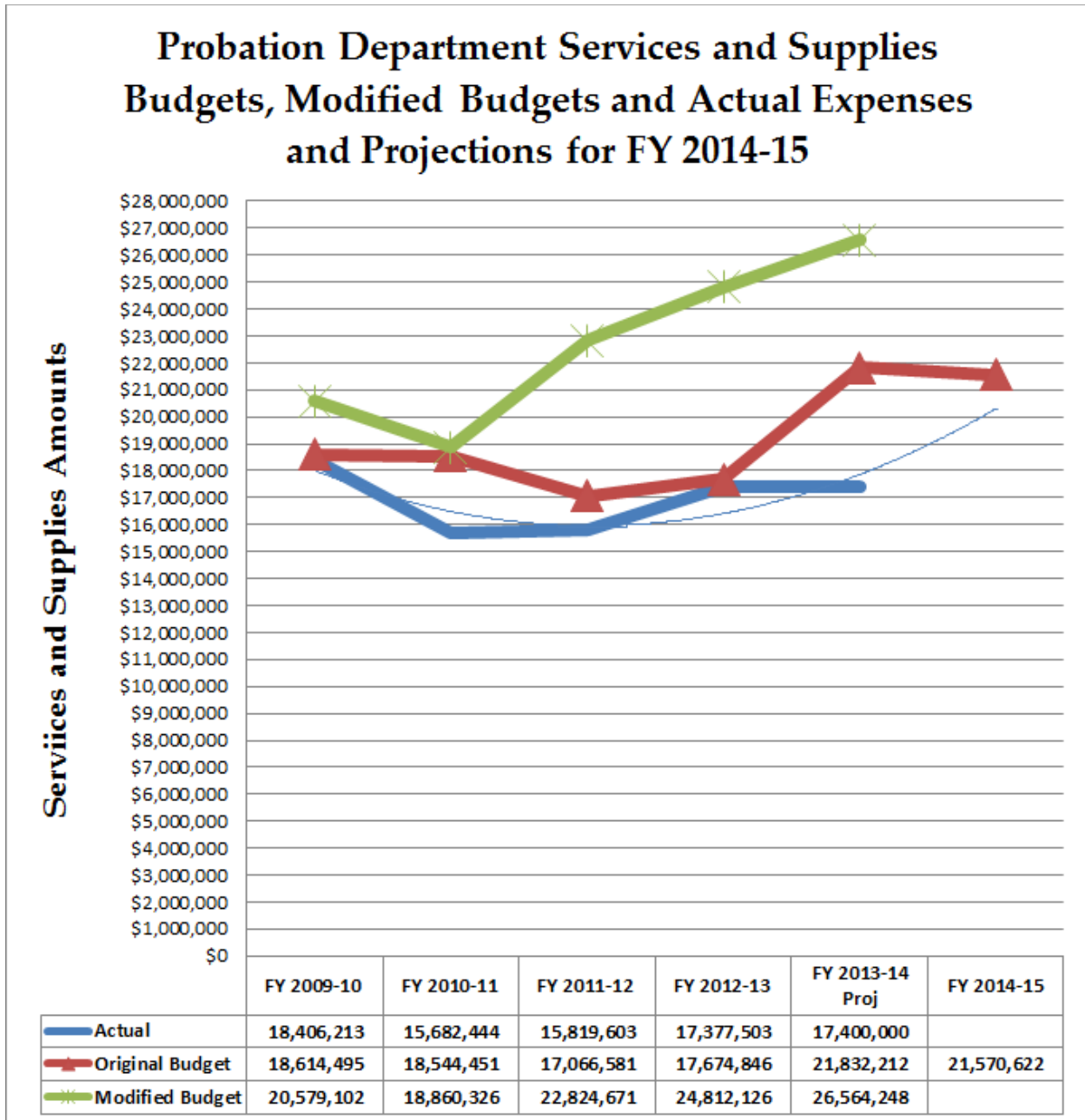
As in the San Diego-based training initiative previously discussed, the March 2014 federal bulletin reports that FY 2013-14 federal funding for Bay Area UASI will remain unchanged from the previous year, at \$27.4 million. As previously noted, proposed FY 2014-15 federal funding for such state and local grants is proposed to increase. Year-to-date funding from this source totals about \$121,500. However, to be conservative, we recommend budgeting funding from this grant at \$100,000.

In conclusion, we recommend that funding from three grant sources, totaling \$350,000, we recognized in this revenue account. The Office of the Sheriff disagrees with this recommendation, preferring to recognize the funding only through budget modifications when formal notification of the grant agreements occurs. The result of that is to require, at this time, discretionary County revenue to be budgeted to support costs that are highly likely to have a non-discretionary revenue source. We believe the essence of the budget process is to make reasonable judgments about the receipt of such non-discretionary revenues, thereby freeing up the discretionary revenue that would otherwise pay for these costs to be used for other purposes as the Board decides.

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Services and Supplies Expenditures		Multiple Accounts
County Executive	Management Audit	
<u>Recommended</u>	<u>Proposed</u>	<u>Decrease</u>
\$21,570,622	\$20,935,622	(\$635,000)

From FY 2009-10 through FY 2013-14 (projected), the Probation Department’s services and supplies (Object 2) original and modified budgets have been underspent, as shown in chart on the following page.



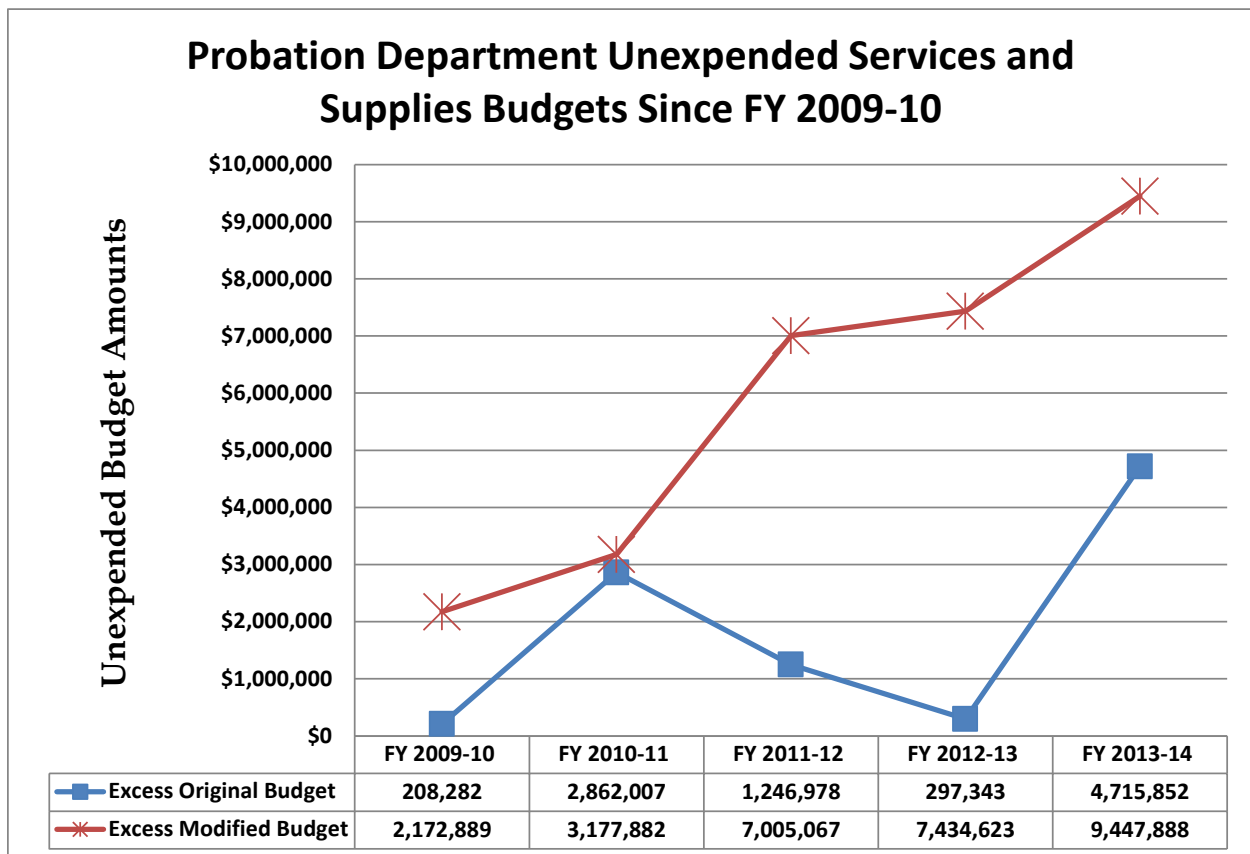
FY 2013-14 estimated actual expenditures were projected using actual expenses through June 3 2014, then adding actual encumbrances for the remainder of June. The projected amount for FY 2014-15 is predicted by statistical regression analysis. All amounts shown are General Fund dollars.

As shown on the chart, the lowest thick line represents actual expenses, and the top thick line represents modified budgets for services and supplies. The middle line represents the original budget. The thin lines represent projections based on statistical regression. As shown on the chart, the projected actual amount for FY 2014-15 is a little more than \$20 million. The Recommended Budget is \$21,570,622, or about \$1.3 million more than the projection. This amount exceeds the estimated FY 2013-14 actual costs by

24 percent. That is, to reach the Recommended Budget amount, actual expenses next fiscal year would have to increase by 24 percent compared to the current fiscal year.

On average, over the period shown, the original budget exceeded actual costs by \$1.9 million, inclusive of projected costs for FY 2013-14. The modified budget has exceeded actual costs by an average of \$5.9 million over the same five-year period. Even during the lean year of FY 2009-10, the original services and supplies budget was exceeded actual costs by more than \$200,000, and the modified budget exceeded actual costs by \$2.2 million.

The excess amounts in recent budgets are shown in chart below. All of these amounts are General Fund dollars.



All amounts shown are General Fund dollars. Amounts for FY 2013-14 are projected.

As this chart shows, the Probation Department in recent years has ended the fiscal year with between \$2.2 million and \$9.4 million¹ of services and supplies budgets unexpended. Although this difference is the gap between the modified budget and

¹ Projected for FY 2013-14.

actual costs, the modifications are additions to the original budgets, which already exceed the necessary amounts.

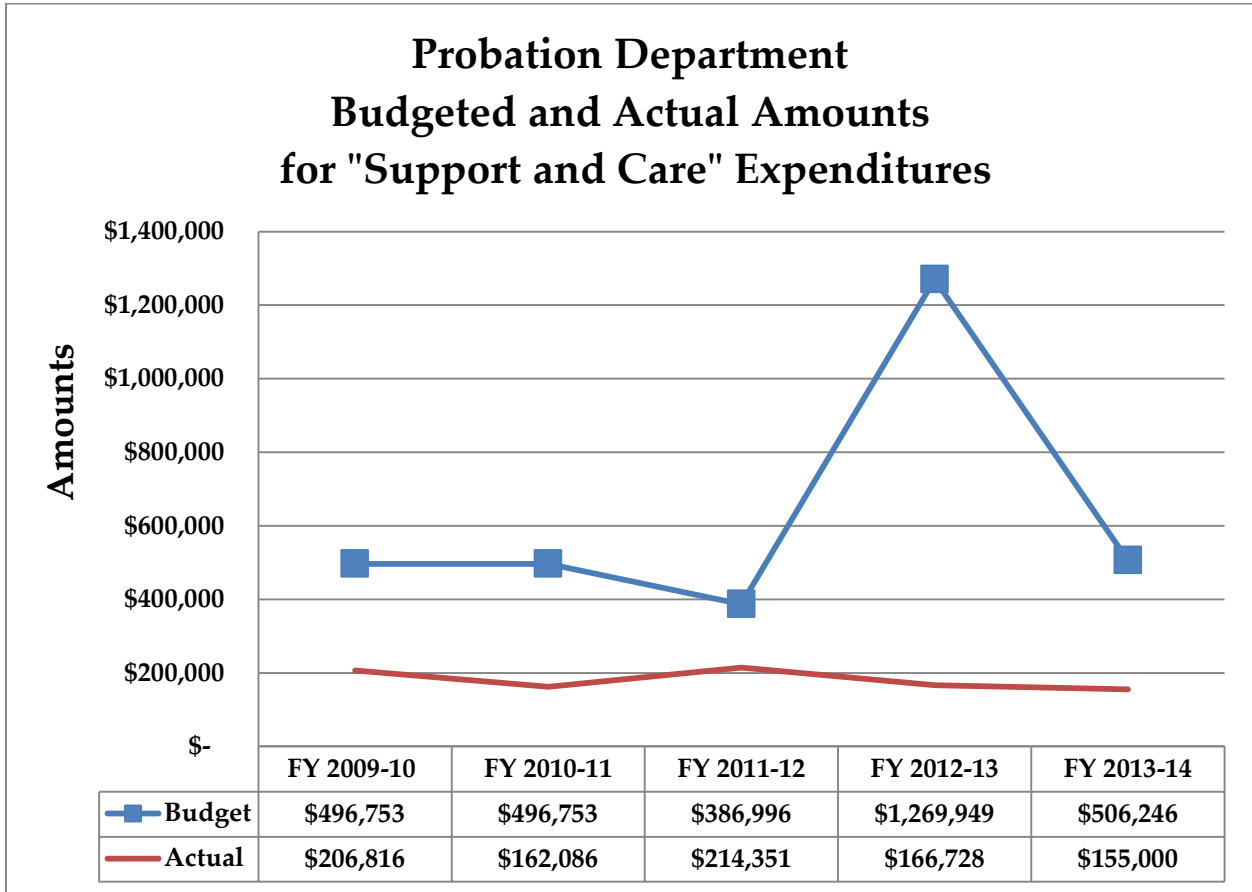
As previously indicated, to reach the Recommended Budget amount next fiscal year, actual expenses would have to increase by 24 percent compared to the current fiscal year. Instead of a 24 percent increase, we recommend an increase of 20 percent, for a reduction in the Recommended Budget of (\$635,000.) As described below, we recommend that the reduction be taken from two line items, “support and care of persons,” and “training services” within the services and supplies budget.

Expenditure Account 5300100		Support and Care
<u>County Executive Recommended</u>	<u>Management Audit Proposed</u>	<u>Recommended Budget Decrease</u>
\$509,306	\$209,306	(\$300,000)

As of June 3, 2014, the Department had spent \$36,318 of its \$506,246 FY 2013-14 budget for support and care of youth. Our projected maximum potential expenditure for FY 2013-14 is \$155,000, which assumes expenditure of \$100,000 encumbered for a contract pursuant to Board policy for placement of youth under 13 at the Bill Wilson Center while they await court orders. However, to meet that amount, the Department would have to expend the funds in 27 calendar days. The remaining expenditures are payments to the California Youth Authority for the support of incarcerated youth and to out-of-state facilities where specific youth are placed.

In the past, this account was budgeted at \$500,000 or more to match the actual costs that were incurred. For example, the actual expenditures in this account in FY 2006-07 were \$775,576. The majority of this – \$429,047 – was expended to support County youth held at the California Youth Authority (CYA). There were dozens of County youth at the CYA at that time, and the cost per month was \$35,754. However, since 2006, the number of youth sent to CYA has declined dramatically. The reason expenditures have declined from \$776,000 in FY 2006-07 to at most \$155,000 in FY 2013-14 is because the County is no longer paying for dozens of youth at the CYA. At present, the County’s monthly bill for CYA services is \$1,973, or \$23,676 per year, for one youth. Instead of being placed at CYA, youth are now rehabilitated at the Probation Department’s ranch programs. In short, the proposed budget in this line item was justified in the past, but is not justified today due to the fact that the largest cost in this line item has almost disappeared as the County has nearly ceased purchasing these services. As the chart below shows, the

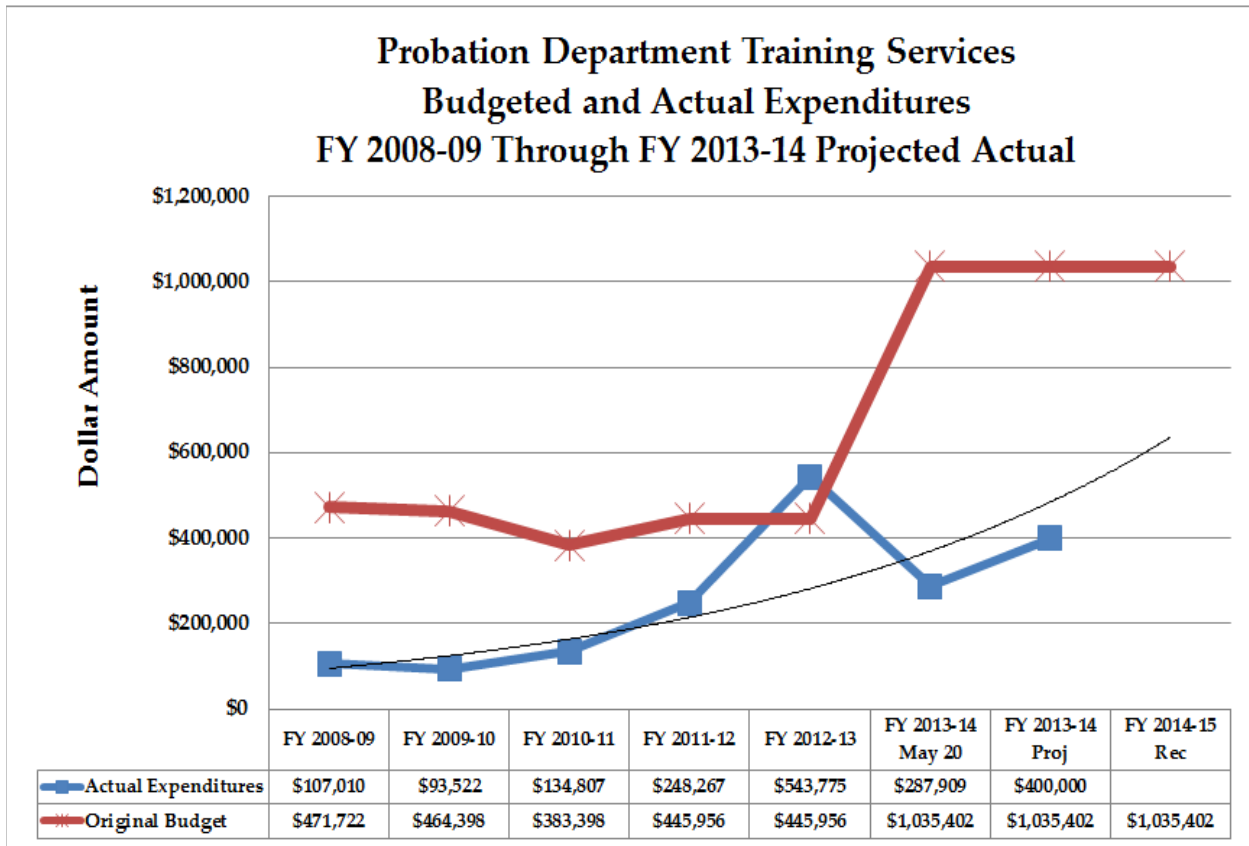
recent history of this account is that there is more budgeted than spent. If adopted, the Recommended Budget would continue this trend.



The actual maximum amount for FY 2013-14 is projected based on documented expenditures of \$36,318 through June 3 and the assumption that the entirety of an encumbered contract for \$100,000 to provide care for youth 12 and under while they await court orders will be spent over the remaining 27 days of the fiscal year. To the extent that youth under 13 are not placed in care during those days, the actual expenditures for the year will be substantially less than \$155,000. All amounts are General Fund dollars.

Expenditure Account 5257200		Training Services
<u>County Executive Recommended</u>	<u>Management Audit Proposed</u>	<u>Recommended Budget Decrease</u>
\$1,035,402	\$700,402	(\$335,000)

The training services budget provides funding for a wide variety of training within the Department. The types of training services purchased range from use of Microsoft Office software to implementation of evidence-based practices in the treatment of offenders. The recent history shows that with the exception of FY 2012-13, training services expenditures have been well below the budgeted amounts. With 27 days remaining in FY 2013-14, expenditures amounted to \$292,211. In addition, the Department had outstanding purchase orders amounting to \$109,500 in the current year as of June 3. As shown in chart on the following page, we estimate that total expenditures for FY 2013-14 are unlikely to exceed \$400,000, against a budget of \$1,035,402, leaving an estimated surplus in this line item as of June 30, 2014 of \$635,402. Note that this budget more than doubled in FY 2013-14 to \$1,035,402, far exceeding the prior-year actual expenditures of just under \$544,000.



We project FY 2014-15 expenditures at just over \$600,000, as shown by the thin line on the chart. Our recommendation is to budget just over \$700,000, rather than \$1,035,402, for a budget reduction of \$335,000.

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Revenue Account 4302400		Civic Center Parking
County Executive <u>Recommended</u>	Management Audit <u>Proposed</u>	Revenue <u>Increase</u>
\$521,386	\$625,000	\$103,614

This account receives revenue from the Civic Center Parking Garage on Hedding Street. For the current fiscal year, receipts through May 23, 2014 total \$572,281, already exceeding the current-year budget of \$555,960, and well in excess of the \$521,386 budgeted for FY 2014-15.

Projecting receipts for the April 30-May 23 period for the rest of the fiscal year, we estimate that total revenues in this account will reach about \$638,500 in the current fiscal year. In FY 2012-13, receipts totaled \$610,884. To be conservative, we propose increasing the FY 2014-15 budget to \$625,000. The Department concurs with this change, reporting that it estimated the budgeted revenue for next year earlier this year, when receipts were lagging, acknowledging that garage use has increased in recent months.

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Services and Supplies Expenditures		Multiple Accounts
County Executive <u>Recommended</u>	Management Audit <u>Proposed</u>	<u>Decrease</u>
\$32,997,407	\$32,497,407	(\$500,000)

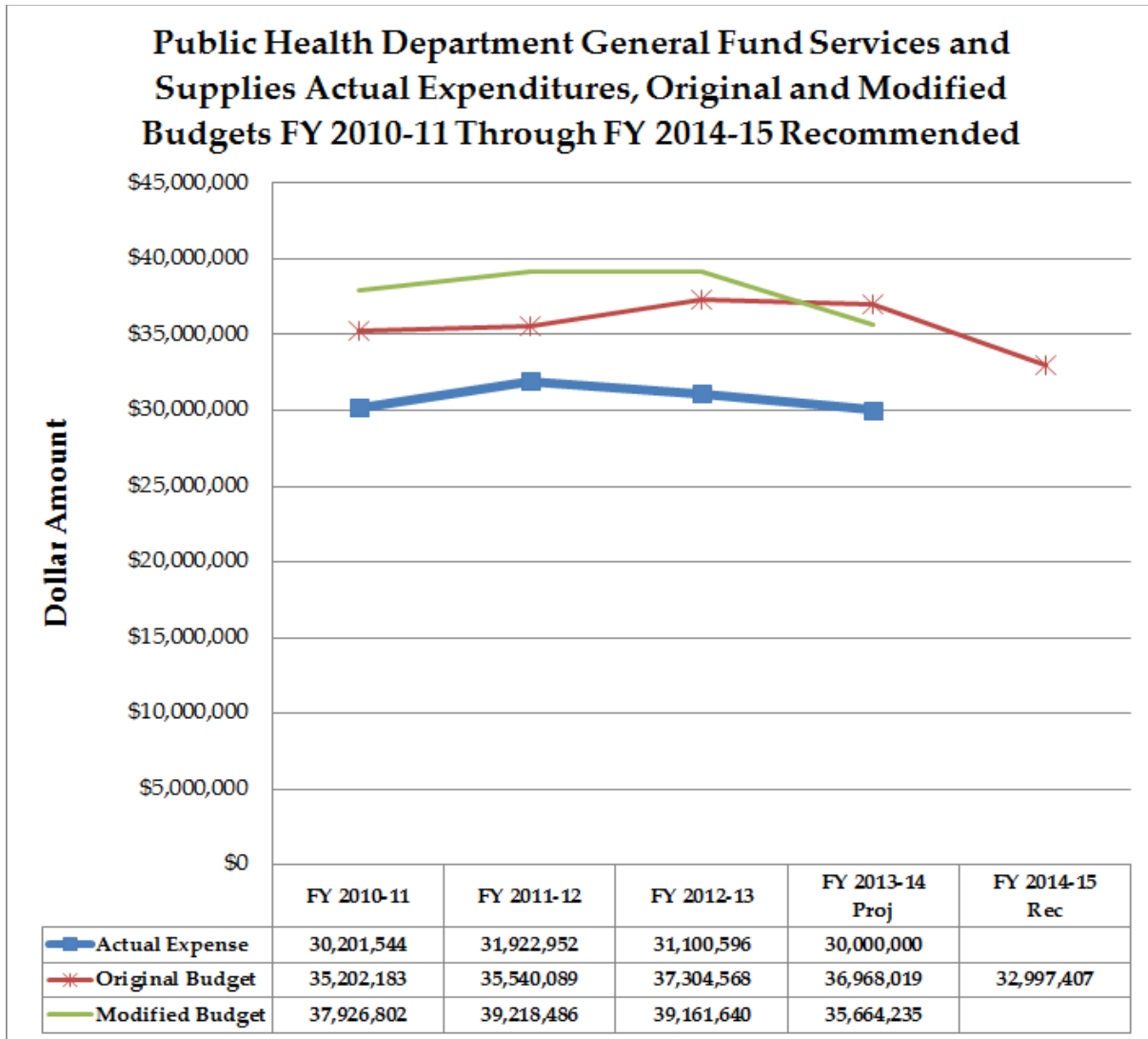
The Recommended Budget for the Public Health Department is summarized as follows.

Public Health Department

Account Type	FY 2014-15 Recommended Budget
Revenues	\$ 54,065,326
Transfers in	\$ 4,801,022
Expense reimbursement	\$ 2,345,587
Total Incoming Money	\$ 61,211,935
Salaries & Benefits	\$ (54,668,934)
Services & Supplies	\$ (36,596,788)
Total Outgoing Money	\$ (91,265,722)
<i>Budgeted General Fund Cost</i>	<i>\$ (30,053,787)</i>

As shown, the Recommended Budget for Public Health is funded with more than \$30 million in General Fund dollars. That is, more than \$30 million of the Department’s expenditures are not funded by monies coming from grants or other external sources. This is important because it means that excess amounts in the services and supplies portion of the recommended budget over and above what the Department will actually spend is appropriated from the General Fund budget.

The post-recession history of the Department’s General Fund services and supplies (Object 2) budgets and actual expenditures are shown in chart that follows.



As the chart shows, the recent history of services and supplies in Public Health is that of excess appropriations in both the original and modified budgets relative to actual costs. Over the four-year period for which actual expenditures are shown, the amount of excess General Fund appropriation in the original budget relative to actual expense has ranged from \$3.6 million to \$6.2 million. Excess amounts in the modified budget have been greater, exceeding \$8 million in FY 2012-13.

As of June 9, 2014, the Department had spent \$24.3 million of its FY 2013-14 appropriations of \$35.7 million. The Department had purchase orders (encumbrances) for an additional \$4.2 million during the current year. The actual expenditures plus the amount that is spendable on purchase orders as of June 9 was therefore a little more than \$28.5 million. We anticipate therefore that current year expenditures will not exceed \$30 million. The recommended budget for FY 2014-15 would appropriate almost

\$33 million for services and supplies, or nearly 10 percent more than the current year's projected actual costs. That is, the actual cost of the Department's services and supplies would have to increase by 10 percent over the coming 12 months to justify the recommended appropriation. Although this is possible, we think it is unlikely.

Therefore, although the Recommended Budget for services and supplies has been reduced relative to the current FY 2013-14 Budget, we believe the recommended budget allocates at least an excess of \$1 million.

In our draft version of this report, we had proposed reducing a specific line item within services and supplies against which very few actual expenditures are ever recorded. However, in its review of our draft recommendations, the Office of Budget and Analysis (OBA) determined that, although the expenditures in the account we suggested reducing are budgeted in one line item, the actual expenditures are recorded across multiple line items, all of which OBA said are backed by grant monies. In addition, OBA noted that the County does not control expenditures at the line item level, but rather at the level of the total services and supplies budget.

Therefore, we recommend that OBA reduce the total recommended services and supplies budget by at least \$500,000. This would reduce the recommended General Fund appropriations by \$500,000. Since none of this \$500,000 is expected to be expended whether it is appropriated or not, at least this portion of the total services and supplies budget will not offset by grants. Further, as shown on the first page of the analysis of the Public Health Recommended Budget, budgeted grant funds do not even cover all of the Department's salary and benefits costs. One-third of the Department's proposed budget (\$30 million) is paid for by the General Fund. At least \$1 million of the \$30 million that the Recommended Budget proposes to appropriate from the General Fund is recommended for services and supplies expenditures that almost certainly will not occur. Therefore, we recommend reducing the General Fund subsidy at the services and supplies level in the amount of \$500,000.

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Expenditure Account 5113030		Retirement-Special District (PERS)
County Executive <u>Recommended</u>	Management Audit <u>Proposed</u>	Expenditure <u>Decrease</u>
\$13,325,000	\$13,151,956	\$173,044

The Santa Clara County Central Fire Protection District (the “District”) is a *Special Fire Protection District* formed under the California Health and Safety Code.¹ The District is governed by the County of Santa Clara Board of Supervisors sitting as the Fire Protection District Board of Directors. The District provides fire protection and emergency service to 210,000 residents and about 134 square miles of territory within the cities of Campbell, Cupertino, Los Altos, Monte Sereno and Saratoga, the towns of Los Gatos and Los Altos Hills, and unincorporated areas generally west of these communities.

The District’s funding includes local property taxes, licenses and permits, intergovernmental revenues (State and federal), charges for services and miscellaneous revenues.

All eligible District employees participate in the State’s Public Employees’ Retirement System (PERS), under its own PERS plans, which are separate from the County’s PERS plans. The District’s two plans (Safety and Miscellaneous) provide retirement, disability and death benefits based on the employees’ years of service, age and final compensation.² Based on the latest PERS actuarial valuation report dated June 30, 2012, the District’s required employer contribution to PERS in FY 2014-15 amounts to \$13,151,956 including \$11,716,241 to cover eligible District employees under the Safety plan and \$1,435,715 to cover all remaining eligible employees under the Miscellaneous plan.

The FY 2014-15 Recommended Budget includes \$11,369,000 for the Safety plan and \$1,956,000 for the Miscellaneous plan, for a combined total of \$13,325,000, which is

¹ California Health and Safety Code, Part 2.7., Fire Protection District Law of 1987.

² The District also provides other retiree benefits, such as survivors’ benefits, in accordance to the governing memorandum of understanding with its employees.

\$173,000 more than the District's required contribution to PERS of \$13,151,956 for both plans in FY 2014-15. The County Executive's Office of Budget and Analysis should adjust the District's budgeted expenditures for the two plans to bring them in line with PERS required contributions as detailed in the above-mentioned actuarial valuation report. This action would result in savings of \$173,044, which would revert back to the District's balance in Fund 1524.

If the need arises at a later date, the Board of Supervisors, acting as the District's Board of Directors, could re-appropriate these savings for PERS or it could use the funds to bolster existing fire protection and emergency service or for any other legal purpose at its discretion.

The FY 2014-15 Valley Medical Center (VMC) recommended operating budget, including debt service, amounts to \$1.334 billion, or \$90.1 million (7.2 percent) more than the \$1.244 billion approved by the Board of Supervisors for FY 2013-14. If approved as recommended, the General Fund subsidy would decrease by \$17.7 million from \$167.0 million to \$149.3 million. The budget recommends a staffing level of 5,315.9 FTE positions, which includes a total of 114.7 new positions at a cost of \$14.3 million. In addition, 462.8 FTE currently vacant positions are recommended for funding at a cost of \$66.6 million. In total, the recommended budget includes approximately 577.5 FTE new and vacant positions with a total funded cost of \$80.9 million. Offsetting this cost, the budget includes salary and benefit savings of \$14.1 million, or 1.61 percent, which is down from the 1.84 percent budgeted in FY 2013-14. Although the established Board salary savings policy requirement pursuant to Board policy 4.5 is 3.00 percent to 6.00 percent, the Board policy permits exceptions for departments with unique operating requirements (Attachment 1).

Inpatient service levels are projected to increase in the recommended FY 2014-15 VMC budget as compared to FY 2013-14, by about 1,789 inpatient days from an average daily patient census of 307.3 to 312.2. However, outpatient visits are projected to decrease significantly in FY 2014-15 from 897,116 to 846,000, which is a decrease of 51,116 outpatient visits, or 5.7 percent. Lastly, the patient payor mix is expected to show continued growth in MediCal patients, which are expected to average about 21,500 patients in FY 2014-15.

The following sections of this report include areas of the VMC budget that were determined to understate or overstate estimated revenues and expenditures for the FY 2014-15 fiscal year. A total of five areas amounting to \$5.1 million are described below.

VMC Enterprise Fund 0060

Expenditure Account 5420100		<u>Operating Fund</u>
		Interest Expense
County Executive	Management Audit	Expenditure
<u>Recommended</u>	<u>Proposed</u>	<u>Decrease</u>
\$574,203	\$0	\$574,203

Revenue Account 4301100		Interest on Deposits
County Executive	Management Audit	Revenue
<u>Recommended</u>	<u>Proposed</u>	<u>Increase</u>
\$0	\$225,000	\$225,000

Working Capital Interest Expense

The FY 2014-15 Recommended Budget includes \$574,203 for VMC interest expense related to cash needs for daily working capital. A review of the Department’s calculation of its working capital interest expense in the amount of \$574,203 determined that the estimate was based on the prior year budget, since the VMC budget was based on the assumption that the Enterprise Fund would have a negative cash balance during the fiscal year and therefore incur an interest expense. An analysis of the current cash balances in the VMC group of funds and updated information provided by the Department shows that the VMC Enterprise Fund has developed a larger a positive cash balance during FY 2013-14. The positive cash balance developed during FY 2013-14 resulted from larger than expected payments by the State during the fiscal year, some of which the Department expects to have to remit back to the State during FY 2014-15 and FY 2015-16. Consequently, it is projected that VMC will not incur any operating interest expense in FY 2014-15. Therefore the Operating Fund interest expense included in the FY 2014-15 budget amounting to \$574,203 should be reduced to \$0.

Currently, the VMC Enterprise Fund 0060, its related Capital Projects Fund 0059, the Hospital Trust Fund 0296, and the Valley Health Plan Fund 0380 have a positive cash balance of approximately \$121 million. Based on this information, it is projected that the

VMC Enterprise Fund will have a positive average daily cash balance of about \$50,000,000 during FY 2014-15 after accounting for repayments to the State. Using the Controller-Treasurer's projected quarterly Commingled Fund interest rates for FY 2014-15 as shown in the following table, it is projected that VMC will generate interest income of about \$225,000 during FY 2014-15.

**Controller-Treasurer's Projected FY 2014-15
Investment Rates as of May 30, 2014**

<u>Quarter</u>	<u>Interest Rate on Positive Cash Balances</u>
July to September	0.45%
October to December	0.45%
January to March	0.45%
April to June	0.45%

Consequently, it is recommended that the VMC Operating Fund interest expense budget be reduced from \$574,203 to \$0, and an estimate for interest revenue be added to the budget in the amount of \$225,000 for a combined savings of \$799,203.

Expenditure Account 5410200		<u>Bond Fund</u>
		Interest Expense
<u>County Executive</u>	<u>Management Audit</u>	<u>Expenditure</u>
<u>Recommended</u>	<u>Proposed</u>	<u>Decrease</u>
\$21,464,446	\$21,239,336	\$225,110

Bond Fund Interest Expense – 1994 B Variable Rate Bonds

The Controller-Treasurer’s Office manages the payment of debt service on the County’s outstanding bonds, which is budgeted in Budget Unit 810. As of June 30, 2013, VMC had outstanding bonded indebtedness of \$563.3 million, not including \$857.7 million of County issued general obligation bonds, which were issued to finance the renovation and reconstruction of VMC seismically deficient facilities. Among the outstanding bonds is the 1994 B County Facilities issue, which is a variable rate issue on which interest is set weekly through financial market auctions. In developing the FY 2014-15 budget, a rate of 1.00 percent was used in projecting FY 2014-15 bond fund interest expense on the County’s \$51.5 million of outstanding variable rate bond debt for the Recommended Budget. FY 2014-15 bond interest expense is budgeted in the VMC Enterprise Fund in the amount of \$507,584, based on the assumed interest rate of 1.00 percent. This is the same projected average weekly interest rate and budgeted interest expense as used in the current year FY 2013-14 budget. However, as of June 1, 2014, with only 30 days left in the fiscal year, total interest expense on the 1994 B variable rate bonds amounted to less than \$35,000.

The weekly auction interest rates paid by the County on this variable rate bond debt has been less than 1.00 percent since November 2008, and has stayed below 1.00 percent for all but one of the subsequent 290 weeks¹ (Attachment 1). During this 5.6-year period, the average rate was only 0.19 percent, and the most recent rate for the week of May 28 to June 3, 2014 was 0.06 percent. For the past four years, we have projected some upward pressure on rates during the coming fiscal year from the very low levels that have persisted, but rates have continued at historic lows for more than five years. At some point, economic conditions will change and weekly interest rates will gradually increase. Nevertheless, for FY 2014-15 the County Treasurer-Controller is projecting an

¹ The weekly interest rate was 1.00 percent for the week of December 24 through December 30, 2008.

average yield on treasury investments of only 0.45 percent, which includes both overnight investments similar to the weekly market interest rate auctions on the County's variable rate debt, as well as longer term investments with a one-year term. Consequently, current expectations are for short-term interest rates to remain low during FY 2014-15.

Since the FY 2014-15 interest budget for the 1994 B bonds is based on an average weekly interest rate of 1.00 percent from July 1, 2014 (only a few weeks away) through June 30, 2015, given the prior 290-week history and the most recent rate level of 0.06 percent, we believe a 1.00 percent average FY 2014-15 rate taking effect in less than 30 days on July 1, 2014 is unlikely. However, to be conservative, we are recommending an interest expense budget that is based on rates gradually increasing from a projected July 1, 2014 level of 0.10 percent to a high of 1.00 percent by June 30, 2015. This projection is shown in (Attachment 2). Assuming a straight-line growth curve, the FY 2014-15 variable rate bond interest cost would amount to approximately \$282,474, or a savings of \$225,110.

The projected FY 2014-15 1994 Series B bond interest cost of \$282,474 would represent a substantial increase over the FY 2013-14 bond interest cost of less than \$35,000. While the recommended reduction in this budget would reduce the capacity to absorb cost increases in FY 2014-15, it is important to note that VMC has a second variable rate bond issue (2008 Series M), which is projected to incur total interest expense in FY 2013-14 of less than \$4,000,000, but has an interest expense budget of \$4,554,000, or more than a \$500,000 cushion. This variable rate bond is budgeted at \$4,408,100 for FY 2014-15, which continues funding of a cushion of about \$400,000. Therefore, the combined funding for the variable rate bond interest expense for the 1994 Series B bonds and the 2008 Series M bonds amounts to additional funding of more than \$600,000 in excess of estimated costs.

Revenue Account 4920100	Transfers In	
County Executive <u>Recommended</u>	Management Audit <u>Proposed</u>	Revenue <u>Increase/Decrease</u>
(\$153,373,154)	(\$153,373,154)	\$0 *

* This recommendation would substitute \$3,839,323 of surplus bond fund balances in funds 0504 and 0510 to be transferred to the VMC Enterprise Fund to pay for debt service on the 2006 Series I and 2007 Series K bond issues, rather than transferring General Fund monies from Budget Unit 119 Special Appropriations, which would be reduced by \$3,839,323.

Unexpended 2006 Series I and 2007 Series K Bond Fund Monies

In reviewing the County debt service requirements pertaining to outstanding Valley Medical Center bond issues which date back to 1994, it was determined that the 2006 Series I and 2007 Series K bond issues have unexpended principal balances in the project funds. The 2006 bonds were used for the construction of the Gilroy and Fair Oaks Health Centers and the 2007 bonds financed the construction of the Milpitas Health Center. The current balance in these funds is approximately \$2,253,189 and \$1,586,134, respectively. Since construction of the facilities for which these bonds were sold has been completed, these excess proceeds should be used to pay down the outstanding principal balances. As of June 30, 2013, the 2006 Series I bonds had an outstanding balance of about \$123,375,000 and the 2007 Series K had \$85,715,000 outstanding. Interest accrues on both bond issues at a rate of between 4.00 to 5.00 percent. For FY 2014-15, principal and interest payments of these issues total \$9,136,898, most of which is paid from the General Fund subsidy. During the past three fiscal years nearly all of the expenditures from these bond project accounts have been on bond interest costs. The Gilroy and Milpitas Health Centers have been completed and operational for nearly four years. Although one small equipment purchase for about \$13,000 was recently charged to 2007 Series K bond issue, since all of the project construction has been completed, it would be appropriate to use these balances towards payment of debt service. Equipment purchases are more appropriately financed from the annual operating budget.

<u>Realign Temporary Employee, Overtime and Call Duty Budget</u>			
Expenditure Account	County Executive <u>Recommended</u>	Management Audit <u>Proposed</u>	Expenditure <u>(Decr.)/Incr.</u>
5101100-Temp Employees	\$23,123,175	\$31,222,127	\$8,098,952
5103000-Overtime	9,802,611	17,085,273	7,282,662
5105000-Call Duty	12,999,998	18,334,121	5,334,123
5107000-Salary Savings	(13,029,348)	(35,410,963)	(20,717,736)
Net Change			\$ 0

The FY 2014-15 VMC Enterprise Fund budget continues the practice of budgeting expenditures for salaries and benefits (Object 1), as well as services and supplies (Object 2), at levels that are inconsistent with current operations and materially distort the detail of Departmental expenditures. A comparison of actual expenditures to budget for three selected Object 1 accounts: Temporary Employees, Overtime, and Call Duty illustrates this distortion as shown in the following table.

Comparison of Actual Expenditures to FY 2014-15 Budget

Fiscal <u>Year</u>	Temporary <u>Employees</u>	<u>Overtime</u>	<u>Call Duty</u>	<u>Total</u>
FY 2014-15 Budget	\$23,123,175	\$9,802,611	\$12,999,998	\$45,923,784
FY 2013-14 Projected	37,739,609	21,111,420	21,571,479	
FY 2012-13 Actual	34,703,336	19,218,623	15,096,763	
FY 2011-12 Actual	28,147,460	12,890,340	*	
FY 2010-11 Actual	26,075,654	13,168,474	*	
FY 2009-10 Actual	29,444,575	19,037,506	*	
Average	\$31,222,127	\$17,085,273	\$18,334,121	\$66,641,520
Under Funding				(\$20,717,736)

* Call Duty provisions to labor contracts were amended in recent years resulting in substantially increased costs that previously were averaging about \$2 million annually.

Because these three accounts are substantially under budgeted in the FY 2014-15 Recommended Budget, it is recommended that salary savings be increased in order to fund these accounts at levels consistent with current actual rates of expenditure. Increasing the Temporary Employees, Overtime and Call Duty accounts as recommended above would require an increase in budgeted salary savings from 1.61 percent to 3.98 percent which is more consistent with current staffing at VMC, within the Board's policy range of 3.00 to 6.00 percent salary savings, and reflective of the 577.5 vacant and new positions budgeted at a cost of \$80.9 million in the FY 2014-15 Recommended Budget.

Since each of these three accounts above are based on labor agreements negotiated and approved by the Board of Supervisors, it is important that the Board know exactly how much the County is budgeting and spending in these areas. In addition, from a budget management perspective, it is also important for staff to know the basis of all of the components in the budget so that operational results that deviate from budget can be quickly analyzed and corrective actions taken, if necessary. Due to the size of the VMC Enterprise Budget (\$1.334 billion) and its direct, dollar-for-dollar impact on the General Fund (\$149.3 million subsidy), starting the fiscal year with major expenditure accounts out of balance by more than \$20 million is problematic and not conducive to efficient, real-time budget oversight. Consequently, it is recommended that these accounts be modified as shown above and that VMC staff work with OBA to scrutinize the entire VMC budget to ensure that all major accounts are accurately estimated and supported by proper working papers.

1994 Series B Bonds
Actual Variable Weekly Interest Rates

Week	FY 2013-14 Auction Rate	FY 2012-13 Auction Rate	FY 2011-12 Auction Rate	FY 2010-11 Auction Rate	FY 2009-10 Auction Rate	FY 2008-09 Auction Rate
1	0.05	0.17	0.07	0.22	0.17	
2	0.06	0.14	0.06	0.23	0.15	
3	0.06	0.15	0.06	0.25	0.20	
4	0.06	0.16	0.06	0.27	0.30	
5	0.06	0.16	0.07	0.27	0.33	
6	0.06	0.14	0.07	0.23	0.25	
7	0.06	0.13	0.17	0.24	0.23	
8	0.08	0.16	0.18	0.29	0.23	
9	0.08	0.19	0.19	0.30	0.23	
10	0.07	0.14	0.18	0.24	0.20	
11	0.07	0.18	0.16	0.26	0.21	
12	0.07	0.18	0.12	0.29	0.18	
13	0.08	0.19	0.12	0.30	0.25	
14	0.06	0.17	0.14	0.25	0.25	
15	0.08	0.18	0.14	0.24	0.16	
16	0.09	0.22	0.11	0.26	0.20	
17	0.10	0.22	0.12	0.28	0.20	
18	0.09	0.22	0.12	0.29	0.18	
19	0.06	0.20	0.12	0.26	0.20	0.95
20	0.06	0.20	0.10	0.25	0.24	0.75
21	0.06	0.11	0.11	0.26	0.26	0.75
22	0.05	0.15	0.11	0.32	0.25	0.70
23	0.04	0.15	0.11	0.27	0.18	0.55
24	0.06	0.14	0.09	0.25	0.21	0.55
25	0.06	0.15	0.08	0.29	0.25	0.65
26	0.06	0.13	0.09	0.35	0.35	1.00
27	0.03	0.10	0.11	0.35	0.23	0.55
28	0.03	0.07	0.09	0.17	0.14	0.35
29	0.04	0.09	0.05	0.23	0.15	0.20
30	0.04	0.10	0.04	0.27	0.20	0.30
31	0.04	0.09	0.06	0.29	0.21	0.25
32	0.03	0.09	0.06	0.28	0.17	0.20
33	0.03	0.11	0.05	0.27	0.18	0.30
34	0.04	0.10	0.15	0.28	0.20	0.40
35	0.03	0.11	0.17	0.23	0.18	0.40
36	0.04	0.10	0.15	0.24	0.16	0.30
37	0.06	0.11	0.13	0.26	0.21	0.30
38	0.06	0.13	0.12	0.25	0.26	0.35
39	0.06	0.14	0.13	0.24	0.29	0.35
40	0.06	0.12	0.16	0.22	0.26	0.30
41	0.08	0.16	0.18	0.20	0.23	0.30
42	0.13	0.23	0.17	0.22	0.28	0.30
43	0.12	0.23	0.22	0.24	0.35	0.30
44	0.11	0.20	0.25	0.24	0.32	0.30
45	0.08	0.18	0.23	0.20	0.21	0.25
46	0.08	0.18	0.21	0.19	0.28	0.22
47	0.08	0.20	0.20	0.17	0.30	0.20
48	0.06	0.15	0.27	0.16	0.28	0.15
49		0.10	0.25	0.13	0.23	0.12
50		0.07	0.23	0.11	0.26	0.17
51		0.07	0.21	0.10	0.31	0.17
52		0.07	0.26	0.09	0.32	0.17
Average Weekly Rate	0.06%	0.15%	0.14%	0.24%	0.23%	0.39%

290 Total Weeks

48

52

52

52

52

34

Avg Int Rate: Nov 2008 - May 2014 = 0.192%

**Projected Variable Rate Interest Cost on 1994 Series B Bonds
Based on Gradual Rate Increase from Current Level to 1.00% on June 30**

Week	Projected Interest Rate	Interest Cost	Week	Projected Interest Rate	Interest Cost
07/01/14	0.100%	\$ 987.67	01/06/15	0.576%	\$ 5,693.63
07/08/14	0.118%	\$ 1,161.97	01/13/15	0.594%	\$ 5,867.93
07/15/14	0.135%	\$ 1,336.26	01/20/15	0.612%	\$ 6,042.22
07/22/14	0.153%	\$ 1,510.56	01/27/15	0.629%	\$ 6,216.52
07/29/14	0.171%	\$ 1,684.85	02/03/15	0.647%	\$ 6,390.81
08/05/14	0.188%	\$ 1,859.15	02/10/15	0.665%	\$ 6,565.11
08/12/14	0.206%	\$ 2,033.44	02/17/15	0.682%	\$ 6,739.40
08/19/14	0.224%	\$ 2,207.74	02/24/15	0.700%	\$ 6,913.70
08/26/14	0.241%	\$ 2,382.03	03/03/15	0.718%	\$ 7,087.99
09/02/14	0.259%	\$ 2,556.33	03/10/15	0.735%	\$ 7,262.29
09/09/14	0.276%	\$ 2,730.62	03/17/15	0.753%	\$ 7,436.58
09/16/14	0.294%	\$ 2,904.92	03/24/15	0.771%	\$ 7,610.88
09/23/14	0.312%	\$ 3,079.21	03/31/15	0.788%	\$ 7,785.17
09/30/14	0.329%	\$ 3,253.51	04/07/15	0.806%	\$ 7,959.47
10/07/14	0.347%	\$ 3,427.80	04/14/15	0.824%	\$ 8,133.76
10/14/14	0.365%	\$ 3,602.10	04/21/15	0.841%	\$ 8,308.06
10/21/14	0.382%	\$ 3,776.39	04/28/15	0.859%	\$ 8,482.35
10/28/14	0.400%	\$ 3,950.68	05/05/15	0.876%	\$ 8,656.65
11/04/14	0.418%	\$ 4,124.98	05/12/15	0.894%	\$ 8,830.94
11/11/14	0.435%	\$ 4,299.27	05/19/15	0.912%	\$ 9,005.24
11/18/14	0.453%	\$ 4,473.57	05/26/15	0.929%	\$ 9,179.53
11/25/14	0.471%	\$ 4,647.86	06/02/15	0.947%	\$ 9,353.83
12/02/14	0.488%	\$ 4,822.16	06/09/15	0.965%	\$ 9,528.12
12/09/14	0.506%	\$ 4,996.45	06/16/15	0.982%	\$ 9,702.42
12/16/14	0.524%	\$ 5,170.75	06/23/15	1.000%	\$ 9,876.71
12/23/14	0.541%	\$ 5,345.04	06/30/15	1.018%	
12/30/14	0.559%	\$ 5,519.34			

Total FY 2014-15 Variable Rate Bond Interest Cost

\$ 282,474

Average Interest Rate (FY 2013-14 = 0.04%) (290 Wk Avg = 0.19%)

0.57%

FY 2014-15 Based on July 1 - June 30 1.00% Interest Rate

507,584

Savings

\$ 225,110

General Fund and Valley Medical Center Salaries and Benefits

Salary and Benefit Savings County Executive <u>Recommended</u> \$53,541,046	Multiple Accounts Management Audit <u>Proposed</u> N/A
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The Recommended FY 2014-15 budget includes \$2,182,454,464 for salaries and benefits in the combined General Fund and Valley Medical Center budgets. This amount is reduced by budgeted reduction of salaries and benefits in the amount of (\$53,541,046), or 2.45 percent.

This budgeted amount of salary and benefit savings is consistent with actual savings, as shown in the table below in the “unexpended” column, in the General Fund and Valley Medical Center (VMC) in recent years. Over three years, unexpended funds (savings) ranged from \$22.9 million to \$65.6 million, averaging \$44.1 million over three years.

	General Fund and Valley Medical Center Personnel Cost Savings FY 2010-11 through FY 2013-14 YTD			
	<u>Original Budget</u>	<u>Modified Budget</u>	<u>Actual Expense</u>	<u>Unexpended*</u>
FY 2013-14 (as of May 31) Health Insurance	\$ 232,465,006	\$ 234,061,356	\$ 203,171,732	\$ 30,889,624
FY 2013-14 (as of May 31) All Salaries and Benefits	\$ 1,980,536,798	\$ 2,030,948,948	\$ 1,776,401,609	\$ 254,547,340
FY 2012-13 Health Insurance	\$ 218,416,826	\$ 219,309,297	\$ 211,517,155	\$ 7,792,142
FY 2012-13 All Salaries and Benefits	\$ 1,808,692,681	\$ 1,864,929,982	\$ 1,821,018,245	\$ 43,911,737
FY 2011-12 Health Insurance	\$ 211,990,825	\$ 212,912,094	\$ 199,500,600	\$ 13,411,494
FY 2011-12 All Salaries and Benefits	\$ 1,744,038,960	\$ 1,769,800,341	\$ 1,746,914,578	\$ 22,885,762
FY 2010-11 Health Insurance	\$ 209,904,469	\$ 209,934,099	\$ 203,302,634	\$ 6,631,465
FY 2010-11 All Salaries and Benefits	\$ 1,854,956,854	\$ 1,873,023,596	\$ 1,807,449,269	\$ 65,574,327
FY 2010-11 thru 2012-13 Average/GF Health Insurance	\$ 218,194,282	\$ 219,054,212	\$ 204,373,031	\$ 9,278,367
FY 2010-11 thru 2012-13 Average/GF All Salaries/Bene	\$ 1,847,056,323	\$ 1,884,675,717	\$ 1,787,945,925	\$ 44,123,942

**Unexpended for FY 2013-14 was as of May 31. Note: Totals exclude accruals.*

However, as shown in the table, a good amount of the salary savings actually realized in past years is from accounts not used by the Office of Budget and Analysis (OBA) in the development of the salary savings budget. That is, OBA uses savings on salaries,

CalPERS, FICA and Medicare in determining the salary savings budget. However, in practice, much of the savings in recent General Fund and VMC budgets is the result of unexpended health insurance appropriations.

On average, unexpended health insurance appropriations made up \$9.3 million, or 29 percent, of all actual salary and benefit savings in FY 2010-11 through FY 2012-13. This trend is continuing based on our review of FY 2013-14 estimated salary savings attributable to health insurance.

In addition, the budgeted amount is below the Board of Supervisors' minimum budgeted salary savings of 3.0 percent per Board policy. Three percent would equate to a little over \$67 million, or \$13.5 million more than is represented in the recommended budget.

Further, we believe this amount does not take full account of all new positions in the budget and vacant existing positions.

Countywide, we estimate there are 1,821 vacant¹ and new full-time equivalent (FTE) positions funded in the Recommended FY 2014-15 budget. Of these, 1,669 are in the General Fund and VMC, at a General Fund cost of \$216.1 million. Based on a list of current eligible employment candidates provided to our office by the Employee Services Agency, we estimate that about 1,013 of these FTEs have no hiring list or the list is not active or current, equating to an estimated \$130.8 million for positions that would take several months to hire.

Considering that the Recommended budget presently reflects only 2.45 percent salary and benefit savings, compared with the Board's minimum policy level of 3.0 percent, some increase to the estimated salary savings would be reasonable. The exact amount would be a policy decision for the Board to determine.

¹ For detail on these vacancies, please see the May 13, 2014 memo to the Board of Supervisors regarding vacant funded positions included in the FY 2014-15 Recommended Budget.