

**CITY OF OAKLAND**  
***COUNCIL AGENDA REPORT***

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

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**SUMMARY**

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

**FISCAL IMPACT**

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

**BACKGROUND**

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

**KEY ISSUES AND IMPACTS**

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

**SUSTAINABLE OPPORTUNITIES**

None.

**DISABILITY AND SENIOR CITIZEN ACCESS**

None.

**RECOMMENDATION**

Staff recommends acceptance of this report.

Respectfully submitted,

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Acting Budget Director

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City Manager's Budget Office

Approved for forwarding to  
Special Session of the City Council

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OFFICE OF THE CITY MANAGER

# **Expenditure Discipline in Oakland**

Prepared by the Oakland Budget Advisory Committee  
May 29, 2003

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

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

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

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

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

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

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

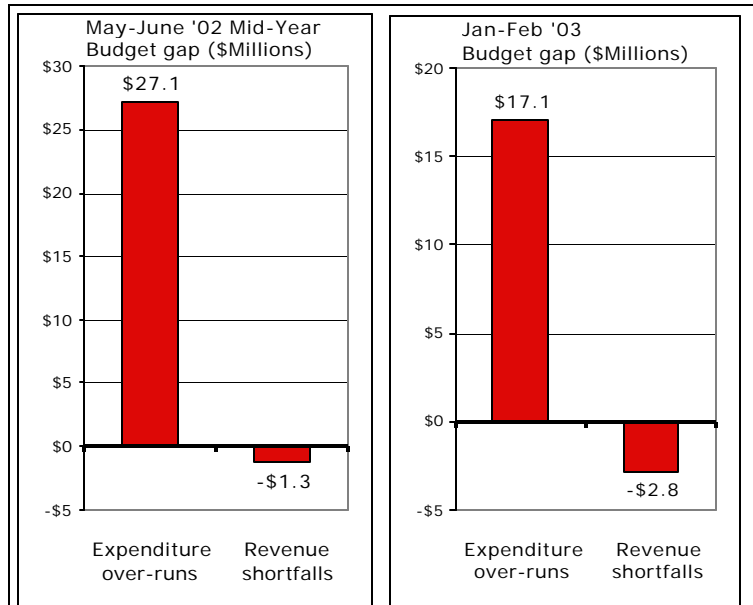
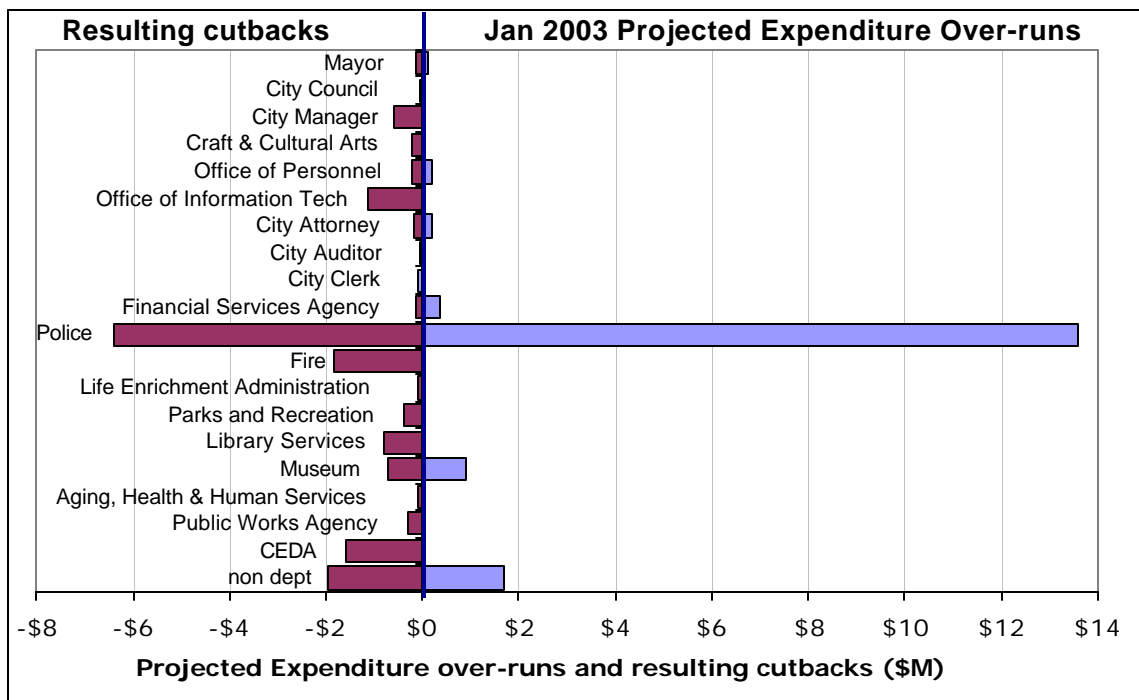


Figure 1: Comparison of the magnitude of expenditure overruns vs. revenue shortfalls in May-June 2002 and January 2003.

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

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

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



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

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

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

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

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

#### ***-Negotiated union wages and benefits***

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

#### ***-Departments overspending their budgets***

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

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

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

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

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

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

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

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

## Recommendations

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

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