



COUNTY ADMINISTRATIVE OFFICE

COUNTYWIDE MESSAGE

John Nilon
County Administrative Officer

TO: Those Who Responded with Budget Suggestions **DATE:** July 20, 2010

FROM: County Administrative Office

SUBJECT: Budget Comments Response Number 2

Friends, as I review your thoughts and ideas, there seems to be an increased interest in the budget process and in the "found" money. I know that this is especially poignant given this year's discussion related to potential layoffs, increased benefit contributions, and even decreases in salary. So, I thought I would take this time to share my thoughts with you on this concern.

It's important to start with the recognition that the County of Kern is a political subdivision of the State and a general law county. This means that the County has a series of steps that must be followed in the development of a budget. If you are interested in detail you may want to visit this website:
http://www.sco.ca.gov/Files-ARD/pubs_cba_appx_b.pdf

Some of the key elements include:

- The CAO's office must receive budget requests by departments on or before June 10 of each year.
- The Board of Supervisors must approve a recommended budget on or before June 30 of each year or alternatively, pass a resolution to use the prior year budget until a new budget is adopted.
- The Board of Supervisors must approve an adopted budget no later than October 2 of each year.

Within these time frames, the County has a great deal of flexibility in the development of an annual budget.

I think it's important to emphasize that budgeting by definition is one of estimates and adjustments. Everyone who creates budgets, from a household to the federal government, makes estimates and adjustments to those estimates. For us, sometimes these adjustments are characterized as "found" money.

As background, the County often has unspent funds from one year that can be spent the next year and we call that the carry-forward balance. The County's budget relies heavily upon property taxes that the Assessor establishes in what is called the Assessment Roll. Finally, the County participates in the Teeter Program whereby the County keeps the penalties and interest on delinquent property taxes. All of these are estimated during the budget development process and all of these estimates are adjusted to actual figures after the fiscal year ends. This is exactly where the additional resources were "found" to help fill this year's budget gap.

Specifically, on June 29, the County Assessor increased his property tax estimate by \$7 million, and on July 6, I adjusted the County's net carry-forward balance estimate for an increase of \$4.2 million and on the same day, I brought forward the Auditor-Controller's adjustment for revenue related to property tax penalties and interest for an increase of \$3 million. In total, the adjustment to estimates totaled an increase of roughly \$15 million. The increase was then used to almost completely fill a budget gap of \$16 million.

This begs the question, can't you estimate any better than that? Unfortunately, the answer is probably not. Let me use net carry-forward as an example. In rough numbers, we have a \$750 million General Fund Budget. We projected that the net General Fund carry-forward balance would be between \$0 and \$5 million, and we based the budget on an estimated \$0 net carry-forward balance. The actual net General Fund carry-forward balance was \$4.2 million. That's exceptionally good estimating. But because we budgeted \$0, one could still say we were off \$4.2 million. As a comparison of the \$4.2 million actual against a \$750 million budget, that's a variance of roughly ½ of 1%. Talk to some of your business friends, as I have, and ask them if they can predict their

profit within ½ of 1%. I asked one of my banking friends and he told me if his estimates were that close some people would think he was “cooking the books.”

Let’s use an analogy for the ½ of 1% variance. Let’s say you had a budget of \$100 or 10,000 pennies. And through ups and downs of salary, utilities, equipment, supplies and the uncertainties of federal, State, and local tax revenues, your budget projection was off by ½ of 1%. That would mean out of the 10,000 pennies, your estimate was off by 50 pennies. In almost any environment, that is a remarkable estimate.

Property taxes, penalties, and interest are equally challenging to estimate and equally well estimated by your Assessor and Auditor-Controller. So, the question now becomes, if we are about as good as we can be in estimating variances, what can be done to better budget these estimates?

Even though the lion’s share of California counties operate exactly as Kern does, as mentioned above, the process allows for a great variation in the timing of the budget. And as we move towards that discussion, a cautionary note: within the fiscal year, every month we delay in adopting a budget, a greater amount of reductions will be necessary. As an example, if the County needs to lay off 100 staff, every delayed month in adopting a budget in the fiscal year means an additional 8 or 9 staff will need to be laid off. Compounding the layoff matter is the layoff process; layoffs take a minimum of three weeks to occur after the Board has taken action. Accordingly, if the County wanted to make the least number of layoffs in a fiscal year, the budget would need to be adopted no later than the second week of June of the prior fiscal year. Our budget hearings this year were held the second week of June.

The downside of adopting the budget in the second week of June is that the year-end books aren’t closed and that the property tax assessment roll isn’t finalized, creating a situation this year where adjustments to the estimates were a positive \$15 million. While this was great news, it does come with criticism.

So, in short, the timing of the budget process is a balancing act between minimizing reductions versus using projections. I have argued that during declining budgets it is more important to minimize staff and program reductions by making decisions in June even knowing that the year-end actuals will require adjustments and also knowing that these adjustments will bring into question the quality of the budget process. However, I felt that protecting the County from unnecessary reductions in programs and staff would outweigh a few negative comments.

Now, there have been a number of suggestions for improving the process and they include:

- Emphasizing the June budget is a preliminary budget that will need to be adjusted in July or August with final budget hearings. At the June budget hearings, the Board could adopt a schedule of add-backs if the year-end numbers are positive, and additional cuts if the year-end numbers are negative.
- Move the effective date of union contracts to September 1, instead of July 1, so the negotiations for increases or concessions are based on final numbers, not estimated numbers.
- Move the Budget Hearings to July or August so the budget is developed on final numbers even at the risk of additional reductions or delayed increases being necessary.
- Move the process to a two-year process where estimates and adjustments are made continually throughout the budget years.

Each of these suggestions have advantages and disadvantages which will be used in our decision making process when we go to the Board with the Fiscal Year 2011-12 budget schedule.

As always, I thank you for your comments.

I look forward to responding to more employee suggestions in the near future.