CITY OF
FORT LAUDERDALE

Budget-7
9-5-12
Additional
Information

City Auditor's Office

Memorandum

Memorandum No: 11/12-22

Date: August 23, 2012

To: Honorable Mayor and Commissioners

From: John Herbst, CPA, CGFO, CGMA
City Auditor

Re: Review of the Proposed Budget for Fiscal Year 2012/2013

The City Auditor's Office has performed a review of the FY 2012/2013 Proposed Budget. The budget is compiled by the City Manager of the City of Fort Lauderdale, pursuant to section 4.09 of the City Charter. Our analysis consisted of staff inquiries, analytical procedures, review of documentation provided by management, and limited testing of the evidence provided to substantiate staff's assertions.

The CAO further examined items of interest identified by the City Commission and Budget Advisory Board, and considered issues that may have a considerable impact on the City going forward.

The ongoing reorganization continues to make year-over-year comparisons a challenge; however, we have attempted to re-assign costs in such a way as to allow for meaningful analysis.

CONCLUSION:

Based on the concerns outlined below, it is our conclusion that the preliminary proposed budget as presented is not balanced. There are several revenue and expenditure amounts about which we have significant reservations. We want to acknowledge the City Manager for his candor regarding the omission of some of these items from the budget in his discussions with the Commission and Budget Advisory Board.

One item that could potentially offset the shortage we anticipate is the additional revenue that will be available if the Commission approves scenario #2 of the pension obligation bond (POB) issue. Scenario #2 would add 75% of the unfunded liability component of the $28 million short-term note that is coming due to the amount already approved by the Commission for the POB. These funds could then be used to replenish the reserves and/or establish a contingency for the FEMA claim discussed in more detail below.

This is the first iteration of the budget, and the Budget Advisory Board, City Manager, and Commission will have several opportunities to modify it before it is adopted.

Objectives
The primary focus of our review was to ensure that the budget is balanced, revenue and expenditure estimates are reasonable and materially correct, and that the proposed millage is in compliance with Florida Statutes. We did not attempt to identify operational areas where additional cost savings might be achieved.

Scope
We analyzed the City Manager's Proposed Budget for FY 2012/2013 as presented to the City Commission. The material reviewed included the Budget Message, Executive Summary including supporting tables and schedules, Financial Forecast, Community Investment Plan, as well as revenue and expenditure detail reports from the City's budget preparation system.

Methodology
We performed various analytical procedures, reviewed budget support worksheets and made inquiries of the Budget Office, Finance Department, and individual department budget coordinators. Additionally, we compared the line item detail from the Proposed Budget to the projections of actual expenditures through 9/30/12. Furthermore, we analyzed trends and variances of the three prior fiscal years' budget vs. actual to gain a historical perspective to identify opportunities to improve the accuracy of revenue and expenditure estimates.

OBSERVATIONS:

Reserves
The extensive use of reserves has again resulted in a budget that is not structurally balanced. It violates City budget policies that state:

General Guidelines

- *Current, recurring revenues should equal current, on-going expenses.*
- *One-time revenues can be used to build up the undesignated fund balance or be used for truly one-time expenses without impacting service levels.*
- *Internal service funds are used by the City to provide services within the City organization. Charges to City departments should be set to cover all costs.*

Fund Balance Levels
Non-recurring revenues should not be used to balance the annual budget for recurring expenses.

While the use of reserves to balance the annual budget is a violation of City policy, the present General Fund fund balance level still exceeds the target established by the Commission and therefore may be reduced as proposed without threatening our fiscal strength or bond rating at this time. However, we have now reached the point at which any further reductions will take us below our reserve level policy.

Additionally, as further discussed below, we have concerns about the reduction in the fund balances of the Self-Insurance and Fleet Funds.

It is important to note that management has taken several steps to bring expenses in line with revenues, including departmental reorganization, staff reductions, early buyout incentives, benefit reductions, pension obligation bonds, and technology efficiencies. While significant, these efforts have not been sufficient to offset the dramatic revenue declines experienced during the economic crisis. Accordingly, the City has relied extensively on the

use of fund balance for several years to balance the budget without having to increase revenue or reduce service levels. That will not be an option for FY 2014.

Fleet Fund

We assessed the prices in the Fleet Fund for gasoline and diesel fuel. The budgeted price for gasoline is 8 cents, or 2.2% above today's spot price. The budgeted price for diesel is 15 cents, 4.4% above the spot price. The likely outlook for both commodities is for prices to rise. Inventories are tight, demand is expanding, and the geopolitical climate in the Middle East is leading to increased speculation. Accordingly, the amount included in the budget may not be sufficient to adequately fund fuel costs for the year.

Franchise Fee Revenue

Based on our analysis of the revenue received to date, we believe that the amount budgeted for the FPL franchise fee is overestimated by between $400k and $700k. The fees have been trending downward and we have experienced shortfalls in this revenue for the past two years.

Insurance Funds

Management has proposed to draw down $10.6 million from reserves in the Insurance Fund (543) to balance the budget. This leaves the Insurance Fund with an estimated reserve of approximately $1.2 million. That is separate from the $31 million set aside for incurred by not recorded (IBNR) claims. This may be insufficient to cover our deductibles in the case of a catastrophic event. That could force the City to draw down from either the IBNR reserve, the operating reserves in the General Fund, or the Water and Sewer Funds to provide funding for the two $5 million deductibles. It is important to note that unless we experience a year like 2004, the likelihood that we will need to fund the total amount of both deductibles is acceptably low.

The Self Insured Health Fund has been experiencing higher claims than budgeted and staff is anticipating balancing the FY 2012 budget using $2-$3 million of fund balance. This is also the case for FY 2013 since there is no increase in premiums at this time. Accordingly, an additional $1.9 million of fund balance has been factored into the FY 2013 proposed budget for the Health Fund.

Community Investment Plan (CIP)

In order to balance the budget, a number of projects in the CIP have been delayed or canceled to reduce the transfer from the General Fund. As noted in prior years, the continued reduction in repair and maintenance of City facilities must be addressed at some point. Maintenance cannot be deferred indefinitely. The underinvestment today will negatively impact future budgets.

FEMA

There is no funding in the budget for the FEMA reimbursement obligation, currently estimated at $10M. If management is not able to establish a payment plan or negotiate a major reduction in the amount of this payback, the City's financial position will be significantly impacted.

Fire Department Transportation Revenue

The budget includes $1.3 million in inter-facility transport fee revenue; however, this program has not been implemented and there is no historical information to support the estimate. We fully endorse the program, but feel it would be prudent to see actual results for several months before including it is a budgeted revenue source. This is similar to our position on the red light camera program in the prior year, such that the budgeted revenue failed to materialize and the ensuing shortfall had to be made up from reserves.

Emergency 911 (E911)
The City is currently in conflict resolution discussions with the county over the cost of E911 services. The proposals on the table for these costs will run the City between $1.5 and $3 million. At present, there is no funding for E911 in the budget.

FOP/IAFF Contracts Expiring
Police and Fire department contracts will expire at the end of the current fiscal year. There is currently no funding in the budget for any potential general pay increase. Every 1% in pay equates to approximately $1 million. Historically, there has been retroactive pay provided to these departments, back to the start of the fiscal year. Although there have been no proposals put forth at this time, it is important that the Commission be aware that if any pay increases are agreed to, they will need to come from fund balance.

Pension Obligation Bond (POB)
We are supportive of the POB concept. The budget includes certain savings that will be realized as a result of the issuance of these bonds. If they are not issued, or not issued in a timely manner, the savings that are anticipated will be reduced.

Five-Year Financial Forecast
Management is required to present a five-year financial forecast in accordance with the ordinance adopted last year. Unfortunately, the charts provided in the budget document do not follow the requirements of the ordinance.

> *(11) Along with the proposed budget submitted during the month of July each year, city manager shall submit a financial forecast based on recurring revenues and expenditures, projected five (5) years into the future. Proposed new revenues and expenditures will include optional variables. The forecast will include a discussion of underlying assumptions and methodology.*

Critical details regarding revenue and expenditure amounts, surplus or deficits, and the basis for the assumptions have been omitted. Accordingly, we cannot evaluate the long-term risks to the City's financial position.

We wish to thank the Budget Office staff for their cooperation and assistance in completing this review. The time period between the presentation of the budget by the City Manager and subsequent workshops with the Budget Advisory Board and City Commission has been dramatically reduced relative to prior years. Accordingly, the workload experienced by Budget Office staff has increased greatly and we appreciate their efforts to respond to our inquiries in a timely manner.

cc: Lee R. Feldman, City Manager
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