COUNTY OF LOS ANGELES
DEPARTMENT OF AUDITOR-CONTROLLER

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January 21, 2005

TO: Supervisor Gloria Molina, Chair
Supervisor Yvonne B. Burke
Supervisor Zev Yaroslavsky
Supervisor Don Knabe
Supervisor Michael D. Antonovich

FROM: J. Tyler McCauley
Auditor-Controller

SUBJECT: **FIRE PROTECTION DISTRICT BUDGET REVIEW**

At your request, we have reviewed the budget performance of the County Fire Protection District (Fire or District). The purpose of our review was to identify reasons for the District's fiscal year (FY) 2003-04 year-end fund balance of approximately $71 million. Our review included comparing the Fire District's budget to actual financial performance for the last three fiscal years. We also reviewed the District's budget monitoring procedures, grants, contract city billings, trust, and revenue and expenditure accounting. We also compared the District's financial position with two other county fire agencies.

Review Summary

Overall, the District's financial performance compared to its budget has resulted in favorable variances. In addition, the District is doing a good job of accounting for their revenues and expenditures and maintains adequate controls over their grants and trust funds. We noted some areas where the District can improve their budget development and monitoring.

Our review indicates that the District's higher than anticipated ending fund balance was primarily due to 1) higher than expected revenue as a result of a continued increase in property tax revenues and 2) the District including the prior year-end fund balance in their expenditure budgets which exceed their projected expenditures. We have recommended that the District discontinue including these excess amounts in their budgets and use budgetary designations to manage amounts in excess of projected expenditures.

Our review also indicated that the District needs to ensure that it uses the most up-to-date information available to monitor its financial status. In addition, our comparison of the Fire District's financial position to two other county fire agencies indicates that the District's year-end fund balance appears reasonable.

The following are the detailed results of our review and our recommendations for corrective action.

Background

The District provides fire prevention and suppression, rescue services, management of hazardous materials incidents, and ocean lifeguard services in the County. The District has 4,097 budgeted positions and a FY 2004-05 budget totaling $748 million. The District is funded primarily through the County-wide tax levy (1% property tax) and the Voter Approved Special Tax that the Board establishes each year based on recommendations by the District. Fire also receives some revenue from the State and federal governments and contract cities. The District is a separate legal entity from the County and accounts for its operations separately in a special revenue fund. District management indicated that, because they are a special district, they operate with budgetary caution to ensure they can maintain essential service levels. Management indicated that this includes trying to maintain a reasonable level of fund balance to help finance the following year's budget.

The District indicated that part of their financial management process is reviewing their projected fund balance and working with the CAO and the Independent Citizens' Oversight Committee (ICOC) to review the appropriate level of the Voter Approved Special Tax to ensure adequate levels of funding are available to meet fire and emergency medical service needs. The District indicated that they evaluate their operational needs and financial condition in making recommendations to the Board of Supervisors for changes in the tax rate.

Budgetary Performance

We compared the District's actual financial results to its budget for the last three fiscal years. For the three years, the District had an ending fund balance of $71.5 million, $27.3 million and $19.5 million. It should be noted that the budget amounts and corresponding variances are presented prior to the effect of the Auditor-Controller's year-end closing budget adjustments. The results are summarized below:

Fiscal Year 2003-04

	Budget	Actual	Over or (Under) Budget
Fund Balance, Beginning	$ 27,338,820	$ 27,338,820	
Revenue	$ 632,168,000	$ 647,314,948	$(15,146,948)
(Expenditures)	$(648,259,000)	$ (603,110,674)	$ 45,148,326
Total Financing Available	$(16,091,000)	$ 44,204,274	$(60,295,274)
Fund Balance, Ending	$ 11,247,820	**$ 71,543,094**	$(60,295,274)

Fiscal Year 2002-03

	Budget	Actual	Over or (Under) Budget
Fund Balance, Beginning	$ 19,533,903	$ 19,533,903	
Revenue	$ 583,769,000	$ 582,291,011	$ 1,477,989
(Expenditures)	$(600,716,000)	$ (574,486,094)	$ 26,229,906
Total Financing Available	$ (16,947,000)	$ 7,804,917	$(24,751,917)
Fund Balance, Ending	$ 2,586,903	**$ 27,338,820**	$(24,751,917)

Fiscal Year 2001-02

	Budget	Actual	Over or (Under) Budget
Fund Balance, Beginning	$ 17,441,249	$ 17,441,249	
Revenue	$ 540,355,000	$ 540,462,739	$ (107,739)
(Expenditures)	$(557,483,000)	$ (538,370,085)	$ 19,112,915
Total Financing Available	$(17,128,000)	$ 2,092,654	$(19,220,654)
Fund Balance, Ending	$ 313,249	**$ 19,533,903**	$(19,220,654)

For FY 2003-04, the District overrealized their revenue budget by approximately $15 million (2%) and underspent their expenditure budget by approximately $45 million (7%). The revenue variance was mostly due to an increase in property tax revenues. The $45 million expenditure variance was due to several factors including the following:

- The District includes amounts in their expenditure budgets in excess of their projected expenditures. County departments and districts are supposed to develop their expenditure budgets based on their historical expenses, plus expected increases in expenses. However, our review indicates that the Fire District overestimates their expenditure budget by adding their projected prior year-end fund balance to their expenditure appropriations as provisional amounts. In FY 2003-04, the District included provisional amounts of $11.1

million in its salaries and employee benefits (S&EB) budget and $2.5 million in the services and supplies (S&S) budget.

- In 1992, the State required counties and districts to shift part of their property tax revenues to the Educational Revenue Augmentation Fund (ERAF) for eventual distribution to schools. A 1999 State Controller (SCO) audit of Los Angeles County's allocation of property tax revenues concluded that the District owed ERAF millions of dollars. The SCO audit finding was based on a narrow interpretation of a 1997 law passed by the State Legislature which exempted the Fire District from the 1992 ERAF shift. The issue was litigated and the District received a judgment of approximately $137 million plus interest, to be paid annually in $18 million installments. The first installment was received in FY 2003-04.

  The District prepared a budget adjustment to increase their revenue budget by $18 million and appropriated $16.7 million to S&EB and $1.3 million to S&S. However, the $16.7 million appropriated to S&EB was not spent. The District should have elected to place the ERAF money in "Appropriation for Contingencies," or alternatively, they should have designated the money for a particular District future need.

- The District's budget overestimated retirement and workers' compensation costs by $8 million. These costs were budgeted based on the levels recommended by the Chief Administrative Office (CAO).

- Purchasing delays in the District resulted in $6 million in unspent funds.

For 2002-03 and 2001-02, the District over-budgeted their expenditures by $26 million (4%) and $19 million (3%), respectively. These variances were due in part to including excess amounts in their expenditure budgets, which totaled $11.9 million in FY 2002-03 and $12.8 million in FY 2001-02.

Overall, the District's financial performance compared to its budget has resulted in favorable variances. The FY 2002-03 and 2001-02 variances were relatively minor and several of the FY 2003-04 variances were outside the District's control. However, the excess amounts included in the budget can misstate the District's financial position and do not represent the best estimate of actual expected costs. We recommend that the District discontinue including excess amounts in their expenditure budget and develop the District's expenditure budget based upon the projected expenditures for the budget year. If the District wants to have funds available for unmet needs or unexpected events, the additional funds should be established as budgetary designations (see discussion later in this report).

Recommendation

1. **District Financial Management discontinue including amounts in their expenditure budgets in excess of their projected expenditures and develop their expenditure budget based upon the projected expenditures for the budget year.**

Budget Monitoring

The District prepares several monthly and quarterly management reports at the District and unit levels to monitor budget and actual performance. The District also prepares Budget Status Reports (BSRs) for submission to the CAO, usually three times a year, after the 5th, 9th, and 11th months. In addition, the District prepares three-year fiscal forecasts based on historical and current year trends. The forecasts are used to assist in developing the projected amounts included in the BSRs.

We reviewed the District's FY 2003-04 budget monitoring process and the District's May 2004 (11th month) BSR and noted several factors which resulted in the BSR underestimating the District's FY 2003-04 ending fund balance. For example:

- Fire did not use the most current available actual data to prepare the May 2004 month BSR. We noted that the District used March data rather than May data to project their services and supplies expenditures. As a result, the BSR overstated the estimated expenditures by $6.8 million.

- Fire included $5.2 million in their projected S&EB expenditures. $3 million was for proposed salary increases that were expected to be retroactive to January 2004 which did not materialize, and $2.2 million was as a result of double counting expenditures related to Emergency Medical Services enhancements.

- Fire did not include cancellation of prior year commitments totaling $1.8, even though the commitments were cancelled in March 2004.

As a result, the District's 11th month BSR for May 2004 underestimated the District's projected year end fund balance by approximately $18 million. In order to effectively monitor their budget and to ensure projected year-end fund balance is accurate, Fire Financial Management needs to ensure that they use the most current actual data to prepare their budget monitoring reports, that assumptions regarding future expenses are appropriate and the monitoring reports are properly completed. Fire management is aware of the discrepancies in completing the May 2004 11th month BSR and indicated that subsequent estimates and reports, including the FY 2004-05 5th month BSR, will be properly completed and supported by the most current information.

Recommendation

2. **Fire management ensure that they use the most current actual data to prepare their budget monitoring reports, that assumptions regarding future expenses are appropriate and that the reports are properly completed.**

Comparison to Other Fire Departments and Use of Designations

As part of our review, we compared the District's FY 2003-04 financial results to the Orange County Fire Authority (OCFA) and the Santa Barbara Fire Protection District (SBFPD) for the same period. The results are summarized below:

FY 2003-04 Financial Results (in millions)

	District	OCFA	SBFPD
Fund Balance, Beginning	$ 27.3	$ 32.7	$ 4.5
Revenue	$ 647.3	$ 177.8	$ 20.4
(Expenditures)	$(603.1)	$ (169.1)	$ (20.9)
Fund Balance, Ending	$ 71.5	$ 41.4	$ 4.0

The District's ending fund balance of $71.5 million is approximately 12% of the District's total expenditures. The ending fund balances for OCFA and SBFPD totaled $41.4 million and $4 million and represented 24% and 19% of their expenditures, respectively. Based on this comparison, the District's year-end fund balance appears reasonable.

We did note that OCFA and SBDPD place most of their year-end fund balance into Designations or Reserves for operating contingencies. The OCFA has a formal policy to designate 10% of their operating expenditures for unplanned emergencies. This allows the funds to be used for emergencies with the approval of the governing body.

As noted earlier, the District indicated that they attempt to ensure their long-term financial stability by maintaining an adequate fund balance (3-5% of expenditures per the District). However, there is no formal policy for establishing budgetary designations or appropriations for contingencies to account for the fund balance as part of their budget process. As previously discussed, the District's practice is to include these amounts, which are in excess of their projected expenditures, in their expenditure budgets.

In order to maintain long-term financial stability and to establish designated reserve fund levels, we recommend that the District work with the CAO to develop a formal policy on the level of unreserved fund balance that should be maintained. Those funds should then be appropriated into a budgetary designation for operating contingencies. The District should also develop a plan to spend the available fund balance in excess of the amount that will be designated for operating contingencies.

As of the November 2004 5th month BSR, the District is projecting an ending fund balance of approximately $80 million. Based on that projection, the District should designate a portion of those funds for contingencies in their FY 2005-06 budget in accordance with policy to be developed above. The District should also develop plans to spend the remaining fund balance. If approved by the Board, these modifications should be incorporated into the District's FY 2005-06 Final Budget.

Recommendations

Fire District Management:

3. **Work with the CAO to develop a formal policy on the level of unreserved fund balance that should be maintained as a budgetary designation for operating contingencies.**

4. **Designate a portion of the estimated FY 2004-05 ending fund balance in accordance with the approved policy and develop plans to spend the remaining available fund balance.**

Review of Report

District management was very cooperative during our review and actively participated in the review process. Management recognizes the need for improvement and indicated its commitment to correcting the problem areas noted. In addition, the District is drafting a spending plan which addresses both the available fund balance for FY 2005-06 and the ERAF settlement funds. The District's response is attached.

Overall, the District agrees with our recommendations. If you have any questions regarding this report, please contact me or have your staff contact Jim Schneiderman at (626) 293-1103.

JTM:MMO:JS:AA
Attachment

c: David E. Janssen, Chief Administrative Officer
P. Michael Freeman, Chief
Violet Varona-Lukens, Executive Officer
Public Information Office
Audit Committee

COUNTY OF LOS ANGELES

FIRE DEPARTMENT

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FIRE CHIEF
FORESTER & FIRE WARDEN

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January 21, 2005

TO: J. TYLER MCCAULEY
AUDITOR-CONTROLLER

FROM: P. MICHAEL FREEMAN

FIRE PROTECTION DISTRICT BUDGET REVIEW

We have reviewed the draft of the subject report provided to us on January 11, 2005, and discussed the findings and recommendations with your staff on January 18, 2005. Based on our exit conference on that date, the District is in general agreement with the findings made by your staff.

As indicated in your report, we have already implemented the Auditor's recommendations with regard to completing our Budget Status Reports (BSR) as reflected in the District's 5th month BSR provided to the Chief Administrative Office. It is important to note that our estimates in preparing the BSRs are based on the best information available at the time. Events out of our control such as the recent winter storms require additional resources that could change our projected year-end fund balance from one BSR to another.

We also wish to emphasize that the Special Tax has been lowered and raised by the Board of Supervisors in the past as recommended by the District, with the concurrence from the Independent Citizen's Oversight Committee, based on our ending fund balance and financial stability. The Special Tax is being managed in a prudent and responsible manner according to the original intent of the Special Tax, which is to provide supplemental funding for fire and emergency medical services when needed.

We will provide you an action plan including timeframes for implementing the recommendations by February 15, 2005. The District is currently taking action on some of the recommendations and anticipates full implementation prior to forwarding you our action plan.

If you have any questions, please contact me or your staff may contact Deputy Chief Mark Cooper at (323) 881-2426.

PMF:MAC:lyg