Los Angeles County:

Balanced Budgets Will Be a Continuing Challenge

March 1996
96018

Table of Contents

Summary

Audit Highlights...

- ☑ ***Los Angeles County produced balanced budgets in each of the last five fiscal years, after initially announcing shortfalls ranging from $277 million to $1.2 billion;***

- ☑ ***To balance its fiscal year 1995-96 budget by year end, the county needs federal approval of a $346 million health relief package, and departments must meet a 20 percent reduction in net county cost; and***

- ☑ ***Some of the causes for the fiscal crisis are:***

  - ***Property tax shift to schools***
  - ***Reliance on short-term solutions***
  - ***Provisions in labor agreements and employee contracts***

Results in Brief

Los Angeles County (county) is one of California's original 27 counties and is responsible for providing public welfare, health, and public safety services to its citizens. Under the provisions of the California Government Code, Section 29088, the county must approve a balanced budget by August 30 of every fiscal year. In preparing its budgets for each fiscal year between 1991-92 and 1995-96, the county announced that it had budget shortfalls ranging from $277 million in fiscal year 1991-92 to $1.2 billion in fiscal year 1995-96. However, by the time it adopted a budget for each year, the county had produced a balanced budget through the use of layoffs, program curtailment, one-time financing to raise revenue, increased taxes and fees, and use of fund balance. Our review focused on the county's fiscal condition as well as the conditions and actions that have contributed to the budget shortfalls. Specifically, we noted the following:

- In January 1996, the county announced that its shortfall for fiscal year 1996-97 is $517 million. In addition, the likelihood of the county's achieving a balanced budget in fiscal year 1995-96 is subject to its successfully obtaining approval by the federal government of a $346 million health-relief package and having many of its departments meet their targeted 20 percent net county cost reduction, producing a savings of $155 million.

- Several factors, including property tax shifts to schools, have caused the county's fiscal crisis. For example, between fiscal years 1992-93 and 1995-96, the county will have transferred a total of $3 billion to school districts and community college districts.

- Until fiscal year 1995-96, the county relied heavily on short-term solutions to resolve its budget shortfalls. For example, in fiscal year 1992-93, the county raised cash to cover its operating expenditures by encumbering a major county asset, Marina del Rey, and selling $160 million in bonds. The county will pay principal and interest on these bonds until the year 2008.

- The county has been limited in the actions it can take to address budget shortfalls due to provisions in past collective bargaining agreements and employee contracts that have stipulated increases in employees' salaries and benefits. Also, the county has limited discretion over the spending of 90 percent of its General Fund revenue because these funds are specifically designated for operation of state and federal programs.

- Future balanced budgets will be difficult to achieve because the county will need additional funding to implement the Three Strikes law, repair county-owned buildings damaged in the Northridge earthquake, and implement state and federal welfare reform. In addition, the legality of certain increases in the county's taxes may be challenged.

Recommendations

To ensure achieving a balanced budget for the current and future fiscal years, the county should:

- Continue its efforts to finalize Phase I of the 1115 Waiver. In addition, the county should pursue the necessary changes to state and federal legislation so it can implement its planned changes to its health care system in Phase II of the 1115 Waiver.

- Closely monitor all affected county departments to ensure that they reach their targeted 20 percent reduction in net county costs.

- Continue its emphasis on far-reaching strategies for solving budget shortfalls begun in fiscal year 1995-96.

- Continue the policy of negotiating no salary increases in collective bargaining agreements until its economic situation improves.

- Continue the hiring-freeze policy but grant exceptions where limited staff as well as public health and safety requirements create a strain on departments' abilities to fulfill their missions without current employees working unreasonable overtime hours.

- Ensure that all departments establish and maintain controls over the authorization and use of overtime.

Agency Comments

The county generally agrees with our recommendations and is proceeding with efforts to implement them. In addition, the county concurs with the objective of achieving greater consistency in the authorizing of overtime among departments and will be working to ensure existing procedures and controls are more uniformly followed.

Blank page inserted for reproduction purposes only.

Introduction

Established on February 18, 1850, Los Angeles County (county) is one of California's original 27 counties. Located in the southern coastal portion of the State, it covers 4,083 square miles, and in 1995 had a population of 9.2 million people. In terms of population, the county is larger than 42 states in the United States and is the largest county in the nation.

Under the provisions of the county charter, county ordinances, and state and federal mandates, the county is responsible for providing public welfare, health, and public safety services and for maintaining public records. The county provides health services through a network of 6 county hospitals, 6 comprehensive health centers, and 39 health clinics, some of which are operated in conjunction with private providers. While many of the patients served at the county facilities are indigent or covered by the California Medical Assistance Program (Medi-Cal), the county health care delivery system provides health care to the entire community. The county provides municipal services to and operates recreational and cultural facilities in the unincorporated areas. It also provides services such as law enforcement and public works to cities within the county that reimburse the county for the costs.

Governing the county is a five-member board of supervisors who are elected by district to serve four-year alternating terms at elections held every two years. The assessor, district attorney, and sheriff are also elected officers. Appointed officials head all other departments. The county operates on a fiscal year that runs from July 1 through June 30. Under the provisions of the California Government Code, Section 29088, the county board of supervisors is responsible for approving a balanced budget by August 30 of every fiscal year.

In preparing its budgets for each fiscal year between 1991-92 and 1995-96, the county announced that it had budget shortfalls ranging from $277 million in fiscal year 1991-92 to $1.2 billion in fiscal year 1995-96. However, by the time it adopted a budget for each year, the county had produced a balanced budget in accordance with state law. Over the past five years, the county has addressed the shortfalls by taking a number of actions, including layoffs, program curtailment, one-time financing to raise revenue, increased taxes and fees, and use of fund balances. These actions have had both short-term and long-term impacts on current and subsequent shortfalls. Other actions that are still pending will have an unknown ultimate effect.

Scope and Methodology

Chapter 518, Statutes of 1995, mandated the Bureau of State Audits' review of the county's fiscal condition as well as the determination of the conditions and actions contributing to the budget shortfall. Specifically, we were directed to:

- Review and assess the county's projection of revenues and expenditures;

- Compare the county's budgeted revenues and expenditures with actual revenues and expenditures, including an analysis of any significant variances;

- Review budget actions that the county took in recent years to meet short-term and long-term funding needs and that have had or will have an impact on county budgets;

- Identify potential barriers to the implementation of corrective measures, including the county's charter, collective bargaining agreements, and maintenance of effort requirements imposed by state and federal governments;

- Review the sources, uses, and terms of long-term debt financing entered into by the county and the extent to which it funded ongoing operating expenditures; and

- Recommend, as appropriate, improvements in the efficiency and effectiveness of the county's operations.

To determine the process that the county used to estimate its expenditures and revenues, we interviewed budget analysts in the Chief Administrative Office (CAO) and in selected departments. We also reviewed recent audit reports for other issues related to the revenue and expenditure process. We compared budgeted and actual amounts for expenditures and revenues for the past four fiscal years. We calculated variances between the budget and actual numbers, and we determined the reasons for these differences for the county budget as a whole and for the 12 largest budget units.

To determine the actions taken in recent years to meet short-term and long-term funding needs that have had or will have an impact on county budgets, we obtained schedules of the budget shortfalls from the CAO and determined the actions taken by the county and the impact of these actions. We also calculated the fiscal impact these actions will have on future budgets. We then analyzed these actions and ascertained additional steps that the county could consider to address the budget shortfalls.

To identify potential barriers to the implementation of corrective measures, we reviewed the county charter for mandates that could reduce the county's ability to take corrective action. We also interviewed personnel in the CAO and read the collective bargaining agreements to determine provisions that could reduce the county's ability to implement corrective measures. In addition, we determined the extent of maintenance of effort requirements imposed by the state and federal governments and whether the county could negotiate waivers of these requirements. Further, we determined the percentage of revenues received by the county that must be spent for specified purposes.

We reviewed the sources, uses, and terms of long-term financing entered into by the county and the extent to which it funded ongoing operating expenditures. We also analyzed the county's use of long-term leases, leases of county-owned property, and bond anticipation notes to determine if the county used them to its best advantage.

Finally, in this, the first of five reports, we focused on employee compensation. We analyzed the changes in the county's payroll and benefits structures from July 1, 1989, through December 31, 1995. We also reviewed the county's internal controls over the use of overtime.

Blank page inserted for reproduction purposes only.

Chapter 1

Los Angeles County's Fiscal Year 1995-96 Balanced Budget Is Predicated on Achieving Certain Conditions

Chapter Summary

Los Angeles County (county) ended fiscal year 1994-95 with a fund balance of $208.5 million in its General Fund. For fiscal year 1995-96, the county estimated that it would require General Fund revenues of $8.4 billion in addition to its $208.5 million ending fund balance to meet its estimated expenditures of $8.6 billion. As of January 22, 1996, the county expected to end fiscal year 1995-96 with a $0 fund balance in its General Fund. However, the likelihood of achieving a balanced budget in fiscal year 1995-96 is subject to the following conditions:

- A $346 million increase in health-related revenues through the approval by the federal government of a health relief package, also known as the 1115 Waiver;

- Achieving the targeted 20 percent net county cost reduction by all affected county departments for an estimated savings of $155 million;

- Transfer of $50 million from the Los Angeles Metropolitan Transit Authority to the county;

- An increase of $17 million in state revenue for funding the county's probation camps;

- Layoffs and attrition of permanent county employees in addition to the 20 percent reductions for an estimated savings of $12 million; and

- The Commission on State Mandates' approval of the county's request for relief from the mandated minimum general assistance cash grant resulting in an estimated savings in fiscal year 1995-96 of $25 million.

When preparing the budget in June 1995, the county used these balancing actions with the understanding that they required further work or time to implement. The county achieved four of the six major budget-balancing items as of February 23, 1996. Further, the approval of the 1115 Waiver is pending and the 20 percent reduction in net county cost is in progress. Since we completed our field work on February 23, 1996, the county has received an indication from the federal Department of Health and Human Services that the federal government would be prepared to issue formal approval of the 1115 Waiver by the end of March 1996.

Two Budget Balancing Actions Are Not Yet Complete

As of the end of February, the county was working to complete two budget balancing actions, which total $501 million. The 1115 Waiver, the most critical to the county's budget balancing program, depends on the federal government's approval. The other action, a 20 percent reduction of net county cost, will take the cooperation of all affected county departments and requires constant monitoring by the Chief Administrative Office (CAO).

The 1115 Waiver Is a Key Element in Resolving the Budget Shortfall

In June 1995, the county faced a $655 million deficit in its health care budget for fiscal year 1995-96. County hospitals serving a disproportionate share of indigent patients were confronted by a potential substantial reduction in California Medical Assistance Program (Medi-Cal) revenues as a result of hospital-specific limits on federal funding adopted by Congress in the Omnibus Budget Reconciliation Act of 1993 (OBRA 93). In the past, these federal funds have served as a key factor in maintaining county hospitals. Recognizing that the county could no longer afford to maintain its public health care system as it was currently structured, the county made plans to close health centers, lay off or demote employees, and possibly close one or more hospitals.

The 1115 Waiver is intended to stabilize the county's health care system to provide time to implement reforms.

State, federal, and county officials created a plan to stabilize the county health care system and provide time for implementing reforms in a reasonable fashion and averting a shutdown of hospitals and clinics. The plan, commonly referred to as the 1115 Waiver, was developed pursuant to Section 1115(a) of the federal Social Security Act and Article 7 of the California Welfare and Institutions Code, which authorizes the director of the State Department of Health Services to seek development of alternative forms for the financing and delivery of health services.

On December 4, 1995, the county's request for an 1115 Waiver entered a 30-day public comment phase, which means that a draft of the proposal was prepared and distributed to interested members of the health care community for their comments. As of February 23, 1996, the county and the State Department of Health Services were working to incorporate the public comments into the official state waiver request to be sent to the federal government. The county expects the federal Department of Health and Human Services to issue a decision by the end of March 1996.

Phase I of the waiver will provide an additional $346.3 million in federal fiscal relief.

The request describes a project that is to remain in place for five years and includes two phases. The county developed Phase I to stabilize the system financially by providing federal fiscal relief to the county and to begin the process of restructuring. The county anticipates that Phase II will involve fundamental changes in both the financing and delivery of health care services.

In total, the relief plan will provide the county with $346.3 million, $40 million of which will create a reserve to help reduce the projected funding shortfall for fiscal year 1996-97. The elements of the relief plan are the following:

- **Federal Medicaid matching payments of $34 million for indigent care at county clinics**. This additional funding will be present throughout the five years the 1115 Waiver is in effect. The county anticipates shifting the emphasis in the way it delivers health care away from inpatient hospital services to outpatient services. The shift from inpatient to outpatient services will be facilitated, in part, through the provision of federal matching Medicaid funds for services rendered to indigent patients in outpatient settings, such as county clinics.

- **An interagency agreement between the State and the county for funding of indigent care in hospital settings totaling approximately $92 million**. This additional funding will also be present throughout the 1115 Waiver period and involves amounts that would otherwise be excluded from federal matching payments due to the passage of OBRA 93. In certain Medi-Cal programs, the federal government matches state funds, which are then allocated to public and nonpublic hospitals providing services through the Medi-Cal program. Public hospitals are those hospitals owned or operated by the State or a unit of government within the State. The State's share of the funds are moneys contributed annually by the public hospitals; nonpublic hospitals are not required to contribute. The county contributes on behalf of its public hospitals and also contributes the nonpublic hospital share. Under the interagency agreement, the county will continue to contribute for both the public and nonpublic hospitals. However, the nonpublic hospital share will be included as a valid Medi-Cal expenditure in the calculation of the limits set by OBRA 93, thereby increasing reimbursements the county receives for providing these services. The county's portion of the administrative fee charged by the State to administer the Medi-Cal program will also be included as a valid Medi-Cal expenditure, further increasing reimbursements to the county.

- **County recalculation of its hospital revenues in determining revenue limits imposed by OBRA 93**. The recalculation will generate approximately $79 million in additional payments during fiscal year 1995-96 for the hospitals participating in the Disproportionate Share Hospital program. This program allows hospitals that provide service to an exceptionally large number of low-income patients to receive additional Medi-Cal funding.

- **A revised payment plan to defer the county's obligation for a portion of its fiscal year 1995-96 contribution to the State's match of federal funds in the Medi-Cal program**. This will result in a benefit to the county of an additional $125 million for fiscal year 1995-96, subject to final calculation of the county's obligation. As part of this agreement, the county hospitals' Medi-Cal disproportionate share payments will not be reduced by the limits imposed by OBRA 93. Under the terms of the agreement, any repayment based on federal determination that payments received by the county exceeded what the county should have received for fiscal year 1995-96 will be deferred until after December 31, 1997.

- **A package of public health service grants totaling $16 million**. Although not expressly a part of the 1115 Waiver, the federal Department of Health and Human Services has agreed to provide an additional $16 million in grants to assist the county in carrying out public health activities.

In anticipation of federal approval of the 1115 Waiver, the county utilized these health relief funding measures to avoid hospital closures, partially restore outpatient services in health clinics scheduled for closure, and address a portion of the fiscal year 1996-97 anticipated health services shortfall. However, even with these restorations, it was necessary for the county to take other steps to eliminate the remaining fiscal year 1995-96 deficit and to reduce its cost of providing health care.

Overall, to balance the fiscal year 1995-96 health budget, the county reduced expenditures and increased revenues. Specifically, the board of supervisors reduced expenditures by adopting $63 million in reductions to health services administration, $217 million in reductions to direct services, and $20 million in cost savings. Increased revenues included $159 million in one-time revenues such as a transfer of funds from the Los Angeles Metropolitan Transit Authority (transit authority) and $403 million in anticipated revenues, which included the health relief package and other Medi-Cal adjustments. These increases in revenue allowed the county to reserve $40 million to apply towards the next year's projected health budget deficit. During the implementation of these actions, it was necessary for the county to recognize $107 million in new costs and an

To reduce the cost of operating its health clinics, the county is developing partnerships with private health care organizations to provide outpatient services.

additional $60 million in unrealized Administrative Claims Program (SB 910) revenues.

Additionally, as of October 31, 1995, the county entered into six public-private partnership contracts under which private health care organizations provide health care to county residents in six of the county's health clinics. This effort was an emergency stabilization strategy for reducing county costs and preserving the availability of community health services that would otherwise be lost.

The county anticipates continued development of public-private partnerships to expand access to primary care. It plans to finalize another 22 contracts for these partnerships by June 30, 1996, with the goal of reducing the county's expense for operating the health clinics. Financing for outpatient indigent care delivered in these clinics will be available through the forthcoming 1115 Waiver. Much of the health care the county has traditionally provided in expensive, hospital-based settings will move to more cost-effective, outpatient care settings. To meet the projected increase in primary and preventive care, the county will need to find additional service capacity in public and private facilities. The county believes that continued development of public-private partnerships is one way it can increase the availability of outpatient care for its indigent population.

During Phase II, the county will begin restructuring its health services delivery system to comprehensive care with an emphasis on prevention and primary care. Planning for Phase II is to start in fiscal year 1995-96, with implementation to begin in fiscal year 1996-97, contingent on necessary federal and state legislation. Although it will work to reduce county inpatient services by providing accessible outpatient care, the county cannot successfully achieve this reduction within the traditional financing structure. Under current provisions, special funding is available in the form of additional payments for hospital inpatient services based on the volume of care provided. The shortcoming with this payment method is that it may encourage the overuse of expensive inpatient services and undermine the county's ability to provide cost-effective, nonhospital, outpatient care to the Medi-Cal and indigent populations, since such care services are now excluded from Medi-Cal programs. State legislation is necessary to

During Phase II, the county hopes to de-emphasize expensive inpatient services to focus on less-costly outpatient care.

implement the planned modifications, but such legislation is contingent on federal approval of the concept of de-emphasizing hospital inpatient services in the distribution of Medi-Cal funding and the inclusion of costs for nonhospital outpatient services. The county anticipates that as service delivery changes and the demand for inpatient and emergency room services decreases, legislation will continue to provide Medi-Cal funds, but that the funds will support the entire health care system rather than only a portion of it.

The fiscal impact of the restructuring efforts are unknown at this time because specifics have not been identified. However, the goals of Phase II include the following:

- Increasing the availability of outpatient services in county facilities by providing services through smaller health clinics;

- Contracting with community clinics and other private providers for additional outpatient services and additional service sites;

- Exploring ways to consolidate various programs and funding streams to establish a single level of eligibility for all medically indigent persons;

- Restructuring the payment mechanisms for county inpatient and outpatient services; and

- Developing comprehensive primary care services in the county's health clinics and the comprehensive health centers. Currently, in addition to primary care services, the health clinics provide preventive care, and the comprehensive health centers provide specialty care.

County Departments Have Not Met 20 Percent Net County Cost Reductions

For fiscal year 1995-96, the approved budgets for many of the individual county departments reflected a 20 percent reduction of their prior year net county cost. The county estimated that this would resolve $155.7 million of its budget shortfall. However, on January 22, 1996, the CAO issued a report to the board of supervisors estimating that county departments funded by the General Fund would overspend their approved budgets for the year by $21.9 million. If the departments are not able to correct for this overspending, the actual savings from the 20 percent reduction in net county cost will be $133.8 million rather than the $155.7 million originally projected. Seven departments were overexpending their budgets by at least $1 million each, as shown in Table 1.

Table 1

Departments With Budget Overruns at January 22, 1996 (in Thousands)

Budget Unit	Budgeted Net County Cost	Actual Net County Cost	Budget Overrun
Superior Court	$ 133,832	$ 144,382	$10,550
Municipal Court	54,149	59,235	5,086
Public Social Services—Assistance	344,003	347,076	3,073
Probation Department	180,382	182,296	1,914
Public Defender	76,205	78,034	1,829
Music Center Operations	2,842	4,046	1,204
Registrar-Recorder/County Clerk	10,950	11,951	1,001
Other budget units	1,519,264	1,516,519	(2,745)
Total	**$2,321,627**	**$2,343,539**	**$21,912**

Seven departments are projected to exceed their budgets by at least $1 million.

- ***Superior Court*** estimates it will exceed its budget by $10.5 million. This figure includes $6.3 million in salaries and wages, $3.1 million in services and supplies, $0.8 million less in intrafund transfers, and $0.2 million less in revenues.

- ***Municipal Court*** estimates it will exceed its budget by $5 million. The court's budget overrun is primarily due to a shortfall in anticipated fines, forfeitures, and civil assessments revenues of $5.3 million. Additionally, the court will exceed its salaries and wages by another $0.7 million, but it has other savings of $0.9 million.

- ***Public Social Services—Assistance*** estimates it will exceed its budget by $3 million. This overspending is the result of a $6 million deficit caused by an estimated one-month delay in the Commission on State Mandates' approval of the county's application to reduce General Relief cash grants and a $3 million surplus related to a decline in the caseload for the Aid to Families with Dependent Children (AFDC) program.

- ***Probation Department*** estimates it will exceed its budget by $2 million. This overrun relates to the loss of federal funding for probation camps.

- ***Public Defender*** estimates it will exceed its budget by $1.8 million. This overrun results from more salary and benefits expenditures paid than budgeted for much of the fiscal year.

- ***Music Center Operations*** estimates it will exceed its budget by $1.2 million related to less-than-anticipated parking revenues.

- ***Registrar-Recorder/County Clerk*** estimates it will exceed its budget by $1 million related to workload increases resulting from implementation of the National Voter Registration Act of 1993, recent certification of two new political parties, the 37th Congressional District special election, and use of unbudgeted overtime to meet legal requirements and to deposit county funds promptly.

The County Has Completed Four Budget Balancing Actions

As of February 23, 1996, the county had achieved four of its budget balancing actions totaling $104 million for fiscal year 1995-96.

Transfer of $50 Million From the Los Angeles Metropolitan Transit Authority

The governor approved SB 727 (Chapter 518, Statutes of 1995) in October 1995 authorizing a $150 million transfer to the county from the transit authority. These funds come from county sales and use tax revenues that otherwise would be allocated from the county's local transportation fund to the transit authority. The legislation specifically required this money be used for funding county-owned and contracted health services, and that these funds not be used to supplant other county funds that have historically been used to fund county health services. In addition, the legislation also required the county to repay, over a five-year period, any amounts transferred from the transit authority over $50 million.

On September 26, 1995, the county accepted a grant of $50 million from the transit authority to be applied towards the budget shortfall within the Department of Health Services. As of February 23, 1996, none of the $50 million had been transferred, although the county plans to make three monthly transfers of $15 million beginning in March 1996. The county plans a final transfer of $5 million in June 1996. To avoid undertaking another debt that it will have to repay from future county revenues, the county does not anticipate transferring any of the remaining $100 million authorized by the legislation.

Probation Camp Funding

State legislation added $17 million to the county's budget for probation camps.

On February 2, 1996, the governor signed AB 1483 (Chapter 7, Statutes of 1996), which provides $17 million in state funding for the county's probation camps. This funding, to be received in four payments, allows the county to keep its 18 probation camps open for the remainder of fiscal year 1995-96 and to rescind layoff notices to its probation camp employees.

In a separate funding issue, as of January 1, 1996, the federal government stopped providing federal reimbursement to counties for probation costs under one of its emergency assistance programs. This elimination of funding caused an additional budget shortfall of $25 million in the probation department budget for fiscal year 1995-96. The county's budget forecast for fiscal year 1996-97 shows a full year's reduction of this federal revenue of $53.2 million. Consequently, the funding of the county's probation camps will continue to be an issue in the next fiscal year.

Layoffs and Attrition of Permanent County Employees

To meet its target of a 20 percent reduction in net county costs, and because of the serious budget shortfall in the Department of Health Services, the county, in October 1995, laid off full-time and part-time employees. These staff reductions occurred in addition to a hiring freeze, projected to generate $12 million in savings, that the county had established in August 1995. The effect of the 20 percent reduction in net county cost and the hiring freeze from July 1 through December 31, 1995, has been a net reduction of more than 2,800 permanent employees, 3,500 temporary employees, and a savings of approximately $70 million in gross salaries of permanent employees paid through the General Fund.

Approval of County's Request To Reduce General Relief Cash Grants

On November 13, 1995, the county submitted an application to the Commission on State Mandates asking it to find that the county was suffering significant financial distress and to approve the reduction of its General Relief cash grants. The General Relief program provides cash assistance and social services to indigent persons who do not qualify for state or federal aid programs. The county submitted this application under the provisions of the California Welfare and Institutions Code, Sections 17000.5 and 17000.6. The county asserted that without the reduction in General Relief cash grants it would be unable to provide basic county services.

The approval of relief from mandated minimum general relief grants will save the county $25 million this fiscal year.

As part of its application for relief, the county provided descriptions of unmet needs in all three of its mandated service areas: health, public welfare, and public safety. Further, county staff testified about the county's financial limitations at the Commission on State Mandates hearing on January 12, 1996.

On February 6, 1996, the Commission on State Mandates approved the county's application for relief from the mandated minimum level of general assistance grants for 12 months. The board of supervisors voted on February

13, 1996, to reduce the General Relief cash grant from $285 to $212 per month effective March 1, 1996, for an estimated savings of $25 million through the end of the current fiscal year and an additional savings of $53 million for fiscal year 1996-97.

Conclusion

The county is highly dependent on certain conditions occurring in order to achieve a balanced budget for fiscal year 1995-96. Although it has made some progress in reaching this objective, the county must still successfully complete two critical elements. Federal approval of the $346 million health relief package is particularly critical at this point in the fiscal year. In addition, if individual departments do not end the year in accordance with their reduced budgets, the county will have great difficulty balancing its budget. Unless it accomplishes these two essential measures, the county will not be able to meet a balanced budget for fiscal year 1995-96 as required by statute.

Recommendations

- The county should continue its efforts to finalize Phase I of the 1115 Waiver. In addition, the county should pursue the necessary changes in state and federal legislation so it can implement its planned changes to its health care system in Phase II of the 1115 Waiver.

- The county should closely monitor all affected departments to ensure that they reach their targeted 20 percent reduction in net county cost.

Blank page inserted for reproduction purposes only.

Chapter 2

Past Actions Make Balancing Future Budgets More Difficult

Chapter Summary

Los Angeles County's (county) fiscal crisis arises from several factors, including:

- Property tax shifts to schools that began in fiscal year 1992-93 and that have continued in subsequent fiscal years;
- Designated funding and maintenance of effort requirements of state and federal programs that comprise most of the county's General Fund budget; and
- Questionable actions the county took to balance prior years' budgets.

Collectively, these factors have reduced the county's financial resources by a total of at least $3 billion over the last four years or have limited its ability to adjust how it spends money for the programs it operates.

Property Tax Shifts to Schools Have Resulted in a Reduction of County Resources

In September 1992, the governor approved SB 617 (Chapter 699, Statutes of 1992), which required all counties to annually transfer a portion of their property tax revenue to a county Educational Revenue Augmentation Fund. Each county is to use the moneys in this fund to augment the funding of school districts and community college districts in the county. The original calculation method was revised by SB 1135 (Chapter 68, Statutes of 1993). As a result, the county transferred $263 million in property taxes in fiscal year 1992-93, $927 million in fiscal year 1993-94, and $1.05 billion each year in fiscal years 1994-95 and 1995-96. Starting in fiscal year 1996-97, the county's continuing annual obligation under this property tax realignment is about $1.012 billion. The State partially offset this transfer by legislation and the passage of Proposition 172, which made a temporary 0.5 percent sales tax permanent, the proceeds of which are allocated to local governments for public safety purposes. The county estimates that it will receive about $388 million from this additional sales tax in fiscal year 1995-96.

Designated Revenues and Maintenance of Effort Limit the County's Flexibility

Of the county's total adopted budget for the General Fund of $8.6 billion for fiscal year 1995-96, about 67 percent is revenue that the county receives from the state and federal governments. This revenue totals $5.8 billion and is to be used to fund specific state and federal programs. These consist primarily of social welfare programs, such as Aid to Families with Dependent Children (AFDC), In-Home Supportive Services, Adoption Assistance, and Foster Care. For fiscal year 1995-96, the county expects to receive approximately $3.3 billion in aid money, $776 million for county administrative costs, and $1.6 billion for other specific purposes. The county would not receive these moneys unless it was administering the specific programs.

In addition to the designated funding, the county is also required to use some of its own resources to support various programs. For fiscal year 1995-96, the county estimates that it will use $1.9 billion of its own General Fund resources to match activities mandated by the State. This $1.9 billion is approximately 23 percent of the county's total General Fund budget. Included in the $1.9 billion is $761 million for public safety, $527 million for health programs, $451 million for social welfare programs, $194 million for trial court funding, and $33 million for other programs.

Past County Actions Have an Impact on Future Budgets

Past efforts to balance the budget will cost the county $36 million in fiscal year 1996-97 and $15 million in 1997-98.

In an effort to mitigate budget shortfalls as they were occurring, the county took actions that forestalled the immediate crises but will impact future budgets. Specifically, the county relied heavily on short-term solutions to balance previous annual budgets, implemented an early separation program in fiscal year 1992-93, sold Marina del Rey bonds in fiscal year 1992-93 to help fund the county's operating costs for that year, and sold Pension Obligation Bonds in fiscal year 1994-95. As a result of these actions, the county will have to fund costs over normal county operations of $36 million in fiscal year 1996-97 and $15 million in fiscal year 1997-98.

The County Has Relied Heavily on Short-Term Solutions To Reduce Budget Shortfalls

Over the past four fiscal years, the county has used a variety of methods to reduce its budget shortfalls. However, the county has relied heavily on short-term solutions that consisted of using available fund balance and retirement system savings and of deferring expenditures. These short-term solutions have merely delayed decisions on more far-reaching measures, such as program curtailment. While these solutions would have worked to the county's advantage if the economic climate had improved in one or two years, they have only prolonged the county's fiscal crisis. The table below shows how the county used short-term as contrasted to long-term solutions to balance its budgets over the past four years.

Table 2

Los Angeles County's Use of Short-Term Versus Long-Term Solutions in Fiscal Years 1992-93 Through 1995-96 (in Thousands)

Fiscal Year	Shortfall	Short-Term	Percentage	Long-Term	Percentage
1992-93	$ 531,600	$294,100	55.3%	$237,500	44.7%
1993-94	1,163,900	561,600	48.2	602,300	51.8
1994-95	1,236,400	999,900	80.9	236,500	19.1

1995-96	1,270,100	434,000	34.2	836,100	65.8

The county cannot continue to rely on short-term solutions to balance its budgets. For fiscal year 1994-95, it used short-term solutions to reduce its budget shortfall by nearly $1 billion. The county relied heavily on a new provision within the Medicaid program that officials believed would allow the county to claim additional money for administrative costs. This money did not materialize, and this failure caused additional problems in balancing the county's fiscal year 1995-96 budget. In addition, although the county was able to use $150.5 million in excess investment earnings of the Los Angeles County Employees' Retirement Association (LACERA) to reduce the county's fiscal year 1994-95 pension obligation in the General Fund,
the county should not count on this funding in the future. The county's agreement with LACERA requires 75 percent of LACERA's excess investment earnings be applied against the county's pension obligation each year between fiscal years 1995-96 and 1999-2000. However, the county cannot count on LACERA's having excess investment earnings every year.

In fiscal year 1995-96, the county significantly reduced its reliance on short-term solutions. It put into effect a hiring freeze and a 20 percent reduction in some departments' net county cost. The county also increased taxes on hotel occupancy, entertainment, and landfill users, and implemented other long-term solutions to reduce its budget shortfall by $836 million.

The county has relied on available fund balance, postponing expenditures, and retirement system savings to balance its budgets.

The county has relied on available fund balance, deferrals of expenditures, and retirement system savings to help balance its budgets. However, at January 22, 1996, the county estimated that it will end fiscal year 1995-96 with a $0 fund balance in its General Fund and does not know how much, if any, savings will be available from a reduction in county contributions to the retirement system. Consequently, the county cannot continue to rely on short-term solutions to help balance its future budgets. In addition, the county will continue to feel the impact of some of its short-term solutions for several years.

County's Early Separation Program Generated Some Savings but Added Costs to Future Fiscal Years

In fiscal year 1992-93, the county implemented an early separation program to reduce the number of county employees and lower salary and wage costs. This program had three options:

- An offer of severance payments to full-time employees with a minimum of 10 years of service before October 1, 1992. The county would defer the cash payments until July 1, 1993, and then make annual payments over a five-year period.

- An offer of two years of additional retirement credit for early separation. The county would cover the cost of this option by paying five annual payments to the Board of Retirement beginning in fiscal year 1993-94.

- An offer to allow employees who opt for the severance pay plan to waive part of the cash payment and direct the county to buy up to two years of additional retirement credit.

In order to generate the maximum savings in fiscal year 1992-93, the county originally designed the program to postpone the first payments until fiscal year 1993-94. However, in accordance with generally accepted accounting principles, the county accrued the first year cost of the program in fiscal year 1992-93, which negated that portion of the intended budget savings. The county limited the early separation program to employees whose positions were scheduled to be eliminated and whose department heads certified in writing that they could meet their departmental mission without the position.

In September 1992, the county expanded the early separation program to include both represented and nonrepresented employees. The county also extended the date for entry to the program to January 15, 1993, and enhanced the benefits.
The additional benefits included a revised severance rate, a small lump-sum payment to the employee upon separation, outplacement services, and annuities.

After the cutoff date of January 15, 1993, the Chief Administrative Office (CAO) prepared an analysis showing that 1,943 employees elected to participate in the program with an estimated annual savings generated by the program of $48.1 million in fiscal year 1992-93, $77.3 million for each of the fiscal years 1993-94 through 1997-98, and $104.9 million each year thereafter. The $77.3 million savings was computed by deducting the $27.6 million annual cost for the early separation program in the first five years from the $104.9 million annual savings. The county prepared this analysis based on the assumption that there would be no natural attrition and that the program would produce a long-term reduction in the size of the county work force. These assumptions were not accurate.

Not only were the savings originally projected from the early separation program not realized, the program will cost the county $23 million annually for the next three years.

The early separation program appears to have reduced only temporarily the number of employees working for the county. The number of permanent, full-time employees in county service totaled 77,570 at July 1, 1992, (the beginning of the early separation program), decreased to 74,912 at June 30, 1993, and further decreased to 74,813 by June 30, 1994. However, the number of county employees increased to 76,919 by June 30, 1995, which offsets the impact of any remaining savings from the early separation program. Our analysis also shows that the salaries and wages for permanent, full-time employees paid by the county from the General Fund increased from $2.07 billion in fiscal year 1992-93 to $2.1 billion in fiscal year 1993-94. This increase was probably a result of the general salary increases given to remaining county employees, which exceeded the savings from the loss of employees from the early separation program. We discuss general salary increases at page 26.

Because it is obligated to pay $23 million every year from fiscal year 1995-96 through 1997-98 for the remaining costs of the early separation program, and because it has since added back as many of the positions as it eliminated under the program, the county has not achieved the savings that it originally projected. The early separation program has resulted in increases to the subsequent budget shortfalls. In June 1995, the current chief administrative officer did not endorse another early separation program that was proposed, noting that such programs are expensive ways to downsize.

The Prudence of Selling Marina del Rey Bonds Is Questionable

By selling the 1993 Marina del Rey Certificates of Participation (certificates) in fiscal year 1992-93, the county entered into a long-term borrowing and encumbered a county asset to produce cash it could use to finance that year's operating expenditures. According to the chief of the CAO's debt management unit, the purpose of the transaction was to raise as much cash as possible for the county's immediate needs. As a result, the county must now use marina lease revenues to meet debt service payments and use General Fund money to meet the costs of maintaining the marina.

Lease revenues are earmarked to repay bonds, leaving limited General Fund resources to pay for marina operations.

Specifically, the county issued the certificates as part of its solution to balancing its fiscal year 1992-93 budget, which called for the reduction of county operations and staffing because of a $531.6 million budget shortfall. In order to increase its revenues to continue paying for operations while the reductions were carried out, the county sold and simultaneously repurchased its interest in Marina del Rey ground leases. The county also agreed to use the revenues generated over the subsequent 15 years from the Marina del Rey ground leases as the means to repay the certificates.

The certificates provided $160 million to the General Fund in fiscal year 1992-93 for general operations and an additional $12.5 million that the county applied as interest payments on the marina debt in fiscal year 1993-94. As a result of this action to raise money for its fiscal year 1992-93 operations, lease revenues averaging $20.7 million per year will go to loan payments and will not be available for marina operations. Consequently, the county will need to use limited General Fund resources to operate the marina.

Results of the Sale of Pension Obligation Bonds Have Been Beneficial

In October 1994, the county took actions to fund its unfunded actuarial accrued liability (unfunded liability) to

LACERA. An unfunded actuarial accrued liability is simply a projection of the amount of shortfall in the pension fund to meet the fund's future obligations to its members. These actions also resulted in a reduction in the county's current pension expense. To achieve this funding, the county entered into three agreements:

- The sale of $1.9 billion of pension obligation bonds;
- A side agreement with LACERA that decreased the county's fiscal year 1994-95 net pension contribution of the General Fund by $150 million; and
- A debt service deposit agreement (agreement), effectively selling the future interest earnings on amounts to be deposited annually to the pension bond's interest and principal payment accounts.

The board of supervisors stipulated that the pension obligation bonds needed to sell for 8 percent or less. Because of an increase in interest rates, the county entered into an agreement whereby it received a $56 million premium on the bonds, which the county used to satisfy partially its fiscal year 1994-95 pension obligation. This transaction in turn released county General Fund money to pay for some of the costs of issuing the bonds. An additional $23 million from the agreement also paid for some of the costs of issuing the bonds.

By issuing pension obligation bonds to fund its unfunded liability, the county reduced its cash commitments by $303.8 million over the 17-year bond life.

In fiscal year 1994-95, LACERA earned more on its investments than originally projected. LACERA has agreed to use these excess earnings to reduce the county's current pension obligation. Specifically, in fiscal year 1995-96, the county's contributions to LACERA on behalf of its employees paid through the General Fund were reduced by $87.5 million. The county hopes a similar reduction in its fiscal year 1996-97 pension costs will occur.

We calculated the difference in cash flow between what the county had been doing—that is, amortizing the unfunded liability over time—and the pension bond debt service schedule. By issuing pension obligation bonds to fund its unfunded liability rather than continuing to amortize it, the county has reduced its cost by $303.8 million over the 17-year life of the bonds.

Conclusion

The county has been constrained in what it could do to address budget shortfalls of the past few years because most of its General Fund moneys are restricted for use to specific state and federal programs. In fiscal year 1995-96, 90 percent of the county's General Fund resources was required to operate programs of the state and federal governments. Also, since fiscal year 1992-93, the State has required the county to transfer a portion of county revenue to school districts. These transfers of funds, which in fiscal year 1996-97 will total over $1 billion, will continue to impact future budgets.

Further, the county will have difficulty balancing future budgets because its solutions to past shortfalls have created costs that will persist for years into the future. In fiscal year 1992-93, for example, the county sold Marina del Rey bonds to help fund the county's operating costs for that year; the county will be repaying the certificates for 15 years. However, in fiscal year 1995-96, the county reduced its reliance on these types of solutions by implementing a hiring freeze and a 20 percent reduction in net county cost.

Recommendation

The county should continue its emphasis on far-reaching strategies for solving budget shortfalls begun in fiscal year 1995-96.

Chapter 3

The County's Efforts To Address Employee Compensation Issues Are Starting To Show Savings

Chapter Summary

In fiscal year 1994-95, Los Angeles County (county) decreased its General Fund salaries and wages by more than $10 million. In addition, the county is projecting a further reduction in its salaries and wages for fiscal year 1995-96. However, these savings have occurred after at least four consecutive years in which the county's General Fund salaries and wages had increased. Although some of the decrease in the county's salaries and wages in fiscal years 1994-95 and 1995-96 can be attributed to employee layoffs and attrition, part of the decreases result from the county's eliminating salary increases for its employees. In fiscal years 1994-95 and 1995-96, the collective bargaining agreements negotiated during 1992 began to expire. Once this occurred, the county had the opportunity to slow salary and wage growth by eliminating salary increases for its represented employees. Except in one case, the collective bargaining agreements that the county and the unions negotiated and that became effective after September 1992 do not have salary increases. Similarly, the county has generally not granted salary increases to its nonrepresented employees since September 1992.

We also learned that the introduction of enhanced flexible benefit programs to county employees had the unintended effect of dramatically increasing the county's obligation to the county retirement system. By the time the county acted to limit these increases, it had incurred a $265 million liability for its nonrepresented employees and nearly half of its represented employees.

Another compensation issue that merits the county's attention is the amount of overtime worked by county employees. While payments for overtime have decreased in fiscal year 1995-96 from 1994-95, the county needs to improve compliance with its procedures for ensuring that overtime receives proper authorization before employees work extra hours.

Collective Bargaining Agreements and Other Employee Contracts Limit the County's Ability To Reduce Salary Costs

Through fiscal year 1993-94, the amount that the county spent on salaries and wages, benefits, and overtime increased. This increase was due partly to provisions in the county's past collective bargaining agreements and other negotiated employee contracts. These past provisions have hindered the county's ability to slow salary growth.

The county has annual salaries and wages funded by the General Fund of approximately $2 billion. The county pays salary expenditures for most departments—including the Sheriff's Department, Probation Department, and Department of Public Social Services—through the General Fund. It pays salaries for other departments, such as the Department of Health Services and the Fire Department, through other county funds. As shown in Table 3, the county increased its salaries and wages over the period July 1, 1989, through June 30, 1994. In fiscal year 1994-95, the county decreased its General Fund salaries and wages by over $10 million.

While the county has experienced budget shortfalls during the past four fiscal years, it has also attempted to reduce the amounts paid for salaries and wages. Total salaries and wages paid from the General Fund continued to increase through fiscal year 1993-94, although the pace of the increase began to slow in fiscal year 1992-93. Salaries and wages began to decrease in fiscal year 1994-95 because the county negotiated no salary increases in the collective bargaining agreements with its represented employees and generally did not grant salary increases to its nonrepresented employees after September 1992. Nonrepresented employees are those that may have individual employment contracts but are not subject to the provisions of the collective bargaining agreements.

The county continues to reduce its salaries and wages in fiscal year 1995-96 through layoffs, a hiring freeze, and by not providing salary increases.

The salaries and wages that the county paid from its General Fund increased by more than $160 million in fiscal years 1990-91 and 1991-92. In fiscal years 1992-93 and 1993-94, when the county was experiencing significant budget shortfalls, its salaries and wages increased by $46.5 million and $39.5 million, respectively, despite efforts to reduce the county workforce. In fiscal year 1994-95, the county reduced its salary and wage payments by $10.8 million and is continuing to reduce its salaries and wages significantly in fiscal year 1995-96 through layoffs, a hiring freeze, and elimination of salary increases. We estimate that if the county continues with these actions, it will achieve a General Fund salary and wage reduction of more than $150 million by the end of the current fiscal year.

Table 3

Los Angeles County General Fund Salaries and Wages During Fiscal Years 1989-90 Through 1995-96 (in Thousands)

Fiscal Year	Salaries and Wages	Dollar Change	Percentage Change
1989-90	$1,685,437		
1990-91	1,856,381	$ 170,863	10.14%
1991-92	2,024,542	168,161	9.06
1992-93	2,071,032	46,490	2.30
1993-94	2,110,570	39,538	1.91
1994-95	2,099,740	(10,830)	(0.51)
1995-96	1,944,055	(155,685)*	(7.41)

* Estimated

Part of the overall decreases that began to show in fiscal year 1994-95 and continued into fiscal year 1995-96 can be attributed to the county's eliminating salary increases for nonrepresented employees after September 1992, limiting salary increases included in collective bargaining agreements entered into after June 1992, and implementing the employee layoff and attrition program in fiscal year 1995-96. We discuss the employee layoff and attrition program on page 13.

Salary Increases for Represented Employees

We analyzed payroll salary increases that the county gave over the period July 1, 1989, through December 31, 1995. We separated the information into two categories: represented employees and nonrepresented employees. Represented employees are covered by collective bargaining agreements between the county and the employee labor unions. These agreements cover approximately 89 percent of all county employees. The county has 54 bargaining units represented by 18 individual labor unions. For issues such as salaries and wages, the county enters into collective bargaining agreements with each union for the bargaining units that it represents. For other areas such as fringe benefits, 13 of the unions have created a coalition and will negotiate for all bargaining units represented by those unions to reach one agreement; the other 5 unions negotiate their own fringe benefit agreements with the county. In Appendix A we present the terms of the collective bargaining agreements for a sample of four of the county's represented employee groups.

Most of the salary increases that occurred before fiscal year 1995-96 were negotiated prior to June 1992.

The negotiation process for agreements entered into before June 1992 had determined represented employees' salary increases that occurred before fiscal year 1995-96. Because these salary increases were part of a legal contract, the county could not refuse to provide them. Most of the county's current collective bargaining agreements expired at the end of September 1995. Many of these agreements had effective periods of three to five years. The county is currently entering into one- and two-year agreements with the unions because neither party is willing to make a long-term commitment while the county's finances are so uncertain. None of the collective bargaining agreements that the county entered into during fiscal year 1995-96 included any salary increases.

Salary Increases for Nonrepresented Employees

Appendix B shows that the county gave salary increases to its nonrepresented employee classes, which total 1,700 classes, during four of the past six years. For example, during fiscal year 1989-90, the county granted general salary increases to all of the nonrepresented groups of employees. These increases ranged from 3 percent for the other nonrepresented employees with salaries greater than $90,000 to 10 percent for the county's department heads with salaries greater than $90,000.

Similar salary increases were awarded to the nonrepresented employees in fiscal years 1991-92 and 1992-93, although the increases were smaller than the general salary increases of fiscal year 1989-90, averaging about 2 percent overall. In fiscal year 1993-94 and beyond, only two groups of employees, the department heads and the court employees, received increases. While the salaries of nonrepresented employees have increased over the past six years, many had their salaries adjusted for specific periods of time, as part of the county's response to its fiscal crisis. Nonrepresented employees have been subject to two salary adjustments imposed by the county—one in which the county imposed a suspension of the scheduled 3 percent pay increases for the period September 1992 through June 1993. The county also imposed a 2 percent salary reduction in October 1993 that was effective from that date until June 1994. In effect, these salary adjustments were only temporary since these employees were ultimately paid back this lost salary in the form of cash payments or added vacation time in subsequent fiscal years. The county has not adjusted salaries since September 1, 1992, for nonrepresented employees, with the exception of the department head classes and court employees whose salaries are adjusted when comparable represented classifications receive salary increases.

Department heads received the highest salary increases even during the period of budget shortfalls.

The department head class, a group of approximately 40 nonrepresented employees, also took the two salary adjustments discussed above. However, the department heads' salaries show the highest salary increases even during the period of budget shortfalls. The board of supervisors sets these salaries, which are included in the employment agreements with the individual department heads. The employment agreements for department heads appointed before February 1994 include a cost-of-living adjustment clause that is tied to the Consumer Price Index. Employment agreements with individuals appointed as department heads after February 1, 1994, do not include these clauses.

Benefits Packages Provided by the County Increased Pension Costs

The introduction of enhanced flexible benefit programs to county employees had the unintended effect of dramatically increasing the county's obligation to the county retirement system. An amendment to the County Retirement Law of 1937 prompted the unintended effect. Specifically, by the time the county acted to limit increases in pension costs related to the new flexible benefit programs, it had incurred a $265 million unfunded liability to the retirement system for its nonrepresented employees and nearly half of its represented employees.

In January 1985, the county established a flexible benefit plan, including medical, dental, and life insurance, for nonrepresented employees. The plan expanded in January 1991 to include most leave benefits, such as vacation and sick leave. Between July 1989 and July 1992, the county implemented similar flexible benefit plans for represented employees.

Under these flexible benefit plans, often called "cafeteria plans," the county makes a fixed dollar contribution to an employee, who then chooses how to spend the contribution on an array of fringe benefits. If the chosen fringe benefits exceed the county contribution, the employee makes up the difference in pre-tax dollars. If the county contribution exceeds the chosen benefits, the employee receives the difference as taxable compensation.

By the time the county realized that flexible benefits plans unexpectedly increased its retirement liability, $265 million in obligations had accrued.

In 1992, the county became aware that the flexible benefits plans had unexpectedly increased the county's retirement liability by providing excess benefit dollars to employees and allowing cash payments. In November 1992, the county counsel, the Los Angeles County Employees' Retirement Association, and an independent counsel agreed that the county contributions under the flexible benefit plans were pensionable compensation. Pensionable compensation is any amount included in an employee's wages and benefits for the purpose of calculating retirement payments.

By the time the county realized the significant implications of the flexible benefit plans on retirement contributions, bargaining agreements extending through September 1995 were already in effect for represented employees. In November 1992, the Los Angeles County Citizens Economy and Efficiency Commission estimated that the impact of expanding flexible benefits for the county's nonrepresented employees and nearly half of the county's represented employees was $265 million in unfunded liability to the Los Angeles County Employees' Retirement Association. To rectify this situation, the county sponsored legislation at the state level to exclude cafeteria plan contributions and other allowances from pensionable compensation. The governor approved this legislation in September 1993.

In February 1994, the county limited the share of the benefits contributions it paid for nonrepresented employees and the amount that they could take in cash. This limited increases in future pensionable compensation for these employees. The Chief Administrative Office (CAO) estimated that the first-year cost savings resulting from this limitation would amount to $144,000. Cost savings will increase over time as the cost of salaries and health care premiums increases.

In fiscal year 1995-96, the county and the unions agreed that employees hired after January 1, 1996, would not have county contributions to flexible benefit plans counted as pensionable compensation. In exchange, the county agreed to increase its funding of a deferred savings plan by $3.85 million in fiscal year 1996-97 and $7.65 million in subsequent years. The same provisions were adopted for nonrepresented employees in a separate resolution approved by the board of supervisors on December 6, 1995.

According to our calculations of the present value of this agreement, the county obtained a long-term benefit from this action of $28.6 million. However, the shortcoming to this action is an increase in short-term General Fund cash requirements over the first nine years of the program. We estimate an additional cost to the county of $28 million over the next nine years, thus increasing the current and near-future shortfall problems.

The County Can Improve Its Controls Over Overtime Expenditures

If current trends continue, projected overtime costs for fiscal year 1995-96 will be $78.8 million.

Another aspect of its employee compensation program that merits the county's attention is the amount of overtime worked by county employees. During the last four fiscal years, overtime expenditures paid by the General Fund rose from 2.9 percent to 3.8 percent of salary and wage expenditures. The county's expenditures for overtime paid from the General Fund increased from $66 million in fiscal year 1992-93 to $87.3 million in fiscal year 1994-95. The county has decreased the amount paid for overtime in fiscal year 1995-96, and we estimate that, if the current trend continues, the county will pay $78.8 million in overtime expenditures by the end of the current fiscal year.

Departments control overtime expenditures through procedures requiring pre-authorization of overtime, approval of overtime actually worked, recording of overtime by a designated timekeeper, and calculation and payment of overtime by the county's automated payroll system. The county maintains limited control over department overtime expenditures through CAO review and board of supervisors' approval of annual department budgets that include specific allocations for overtime. However, our review of overtime controls at four county departments showed that the county can improve the implementation of these control procedures.

We reviewed overtime payments made by four departments since December 1994. These departments are the Sheriff's Department, Probation Department,

Department of Children and Family Services, and the Los Angeles County/University of Southern California (LAC/USC) Medical Center. In all cases, we found that overtime payments were properly recorded, paid, and approved after the fact. We also found, however, that three departments did not have sufficient documentation to determine whether a supervisor had actually approved overtime before the employee worked the extra hours. The fourth department, LAC/USC Medical Center, did not have sufficient documentation for us to determine the number of hours that supervisors had pre-authorized. Out of eight instances we could test for pre-authorizations, five were not pre-authorized. Pre-authorization is essential to ensure that overtime is actually required and the overtime worked does not exceed authorized levels.

The four departments estimated that they are significantly over their budgets for overtime expenditures based on their actual expenditures for the first half of fiscal year 1995-96. They range from $2.6 million to $14.5 million over budgeted levels. The budget overruns are partially offset by lower-than-budgeted salary expenditures in these departments. According to department staff, as permanent employees leave county service and are not replaced because of the hiring freeze, the remaining employees must work overtime to meet public health and safety requirements.

Conclusion

Until recently, provisions of past collective bargaining agreements and employee contracts have limited the county's ability to reduce the county's cost for salaries and benefits. In fiscal year 1994-95, the county decreased its General Fund payroll by over $10 million and projects a further reduction for fiscal year 1995-96. One way that the county has slowed the growth of its payroll has been to eliminate salary increases for most of its represented and nonrepresented employees. Except in one case, collective bargaining agreements for represented employees that became effective after September 1992 do not have salary increases. Similarly, the county has not granted salary increases to its nonrepresented employees since September 1992. In addition, the county took action in

1994 to limit its liability to the county retirement system under its enhanced flexible benefit programs. For the nonrepresented employees and nearly half of its represented employees, the county had incurred an unfunded liability of $265 million. Finally, another aspect of its employee compensation program that merits the county's attention is the amount of overtime worked by county employees. In our review we found overtime worked that had not received pre-authorization, as required by county procedures.

Recommendations

The county should implement the following recommendations in order to reduce its General Fund expenditures so that it can continue to adopt balanced budgets in the future:

- Continue the policy of negotiating no salary increases in collective bargaining agreements until its economic situation improves.
- Continue the hiring-freeze policy but grant exceptions where limited staff as well as public health and safety requirements create a strain on departments' abilities to fulfill their missions without current employees working unreasonable overtime hours.
- Ensure that all departments establish and maintain controls over the authorization and use of overtime.

Blank page inserted for reproduction purposes only.

Chapter 4

The County Is Facing Numerous Future Challenges To Balance Its Budgets

Chapter Summary

The Los Angeles County (county) is already estimating a budget shortfall of $517 million for fiscal year 1996-97.

In addition to the budget issues for fiscal year 1996-97, the county needs to address other issues in the near future. Specifically, the county will need to stretch already tight resources to find new revenue streams to fund the costs of Three Strikes court cases, repairs of earthquake-damaged county-owned buildings, and federal welfare reform. The amounts needed to address some of these issues can be estimated, and others cannot. When these issues will need funding is also uncertain. However, the county is aware that it will need to address these issues and that some could overwhelm its already overstretched resources.

County's Projection of $517 Million Shortfall for Fiscal Year 1996-97 Is Tentative

Although too early to accurately predict, indications show the county will have difficulty meeting its fiscal year 1996-97 service requirements.

On January 22, 1996, in preparation for the budget meeting held by the board of supervisors on January 25, 1996, the Chief Administrative Office (CAO) projected a budget shortfall of $517 million. Based upon a $0 fund balance in the county's General Fund at the 1995-96 fiscal year-end, this projection estimates a $169 million shortfall in the county's health services and a $348 million shortfall in general county operations. However, this projection does not account for an estimated $280 million in costs related to Three Strikes court cases.

It is too early to predict a firm budget shortfall for fiscal year 1996-97, although figures indicate that the county will have difficulty meeting its service requirements with available resources. The county will not know its actual collections of property tax revenue until April. How the State's budget will affect the county's finances is another current unknown.

The county cannot determine its ending fund balance in the General Fund until it closes its books in August.

Costs for Three Strikes Court Cases Will Increase Over the Next Few Years

In November 1995, the Countywide Criminal Justice Coordination Committee (committee) submitted a report to the board of supervisors on its year-long study of the impact of
the Three Strikes law (law) on the county's criminal justice system. This law, effective March 7, 1994, was intended to ensure longer prison sentences and greater punishment for those who commit a felony and have one or more qualifying prior felony convictions, known as "strikes." The report found that although the law caused severe increases in workloads and case backlogs, the county has thus far averted major breakdowns in the justice system by reprioritizing and redirecting resources, deferring current costs, and incurring future liabilities. The committee's specific findings include:

- Although Three Strikes court cases constitute 13 percent of the new felony filings, they are tying up an excessively disproportionate share of justice system resources for prosecution, indigent defense, trial courts, and jails;

- Three Strikes court cases are backlogging the justice system and remaining open for significantly longer time periods; and

- The sheriff is housing an increasing number of pre-adjudicated, high-security inmates for longer time periods.

The "Three Strikes" law has cost the county an estimated $98.7 million since its implementation.

The county estimates that new and increased costs resulting from Three Strikes court cases from March 1994 through September 1995 totaled $98.7 million. The county plans to file an administrative claim with the Commission on State Mandates requesting reimbursement for certain of the new or increased service costs it incurred in implementing the law. Theoretically, significant long-term benefits would be derived if recidivism were reduced and crime rates lowered. However, the county must deal with the short-term costs to the justice system in the next few fiscal years.

Repair Costs for Earthquake Damaged Buildings Are Significant

In an August 1995 report to the board of supervisors, the CAO gave an update on the status of the county's efforts to effect repairs to county-owned buildings that were damaged in the Northridge earthquake. The report focused on the nearly 400 buildings in which damage was structural in nature and, therefore, most critical. Approximately 80 of these buildings were so severely damaged as to be unusable. The CAO also reported that the county had submitted architectural and engineering (A&E) evaluations, the first phase of the claiming process, totaling $386.6 million to the Federal Emergency Management Agency (FEMA), of which the county had thus far received only $19.5 million. Negotiations with FEMA have been ongoing and the county has submitted 52 A&E evaluations to FEMA as of the end of February 1996. The county plans
to submit the remaining A&E evaluations to FEMA by May 30, 1996.

Federal Welfare Reform May Impact County's Health Care and Social Programs

In budget negotiations at the federal and state levels, welfare reforms have been a frequent discussion topic. These discussions have revolved around the use of block grants to state and local governments. Block grants usually reduce the number and degree of mandated activities, but they mayalso limit the amount of money that is available for the program. Some of the programs that could be affected by these reforms are Medicare, California Medical Assistance Program (Medi-Cal), Aid to Families with Dependent Children (AFDC), and other social programs.

Large reductions in state and federal money could have a significant impact on the county's health care and social programs. For example, reduced eligibility for certain federal welfare programs could cause more people to apply for the county-funded General Relief program.

Past Increases in Some Taxes May Be in Jeopardy

Approximately $294 million in tax collections are in question because of a California Supreme Court ruling.

In September 1995, the California Supreme Court upheld the constitutionality of Proposition 62, a 1986 initiative that requires voter approval of all new or increased local taxes. Certain taxes first imposed or increased without voter approval after the effective date of Proposition 62 may be invalidated. The county estimates that between the effective date of Proposition 62, November 4, 1986, and June 30, 1995, it collected approximately $294 million in such taxes. The county has asked the court to clarify whether its ruling applies to prior years. The California State Association of Counties is also pursuing legislative relief related to prior-year collection.

Asset Management Could Be a Way To Meet the County's Mission More Efficiently

In September 1995, the Los Angeles County Citizen's Economy and Efficiency Commission released a report entitled "Asset Management Strategies for the Los Angeles County Real Estate Portfolio." This report recommended 26 specific actions that the county could take to control its real estate portfolio more efficiently, including adopting a mission statement and asset management goals; establishing specific criteria for the optimum utilization of county property; preparing a comprehensive information system for real property land holdings; and identifying changes to federal, state, and local legislation to enable the disposition of surplus assets. The report also cites one-time and ongoing savings of $20 million and $27 million, respectively, that the implementation of these recommendations would create. In February 1996, the CAO issued an assessment of the Los Angeles County Citizens Economy and Efficiency Commission report, which concurred with much of that report. However, the CAO also cautioned that the magnitude of the reported cost savings could be too optimistic.

We believe these recommendations are important for the county to consider and implement as they fit into the county's mission to provide services more efficiently. It is important for the county to know the real estate it possesses in order to develop strategies for consolidating services or for the identification and disposal of surplus property. During our review, the county informed us that it was in the process of developing a comprehensive inventory of its real estate portfolio.

We conducted this review under the authority vested in the state auditor by Section 8543 et seq. of the California Government Code and according to generally accepted governmental auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,

KURT R. SJOBERG
State Auditor

Date: March 28, 1996

Staff: Steven M. Hendrickson, Audit Principal
Nancy C. Woodward, CPA
Nasir Ahmadi
George Alves
Jacqueline Conway
James Sandberg-Larsen

Blank page inserted for
reproduction purposes only.

Appendix A

Review of Memoranda of Understanding With Four Bargaining Units

- ***Peace Officers***—The term of the Memorandum of Understanding (MOU) dated December 15, 1989, was effective through January 31, 1993. It included salary increases of 3 percent in both January and October 1990 and 5 percent in June 1991 and June 1992. On March 3, 1992, the Los Angeles County (county) and the Association for Los Angeles Deputy Sheriffs (union) entered into an amendment to the MOU to be effective from June 1, 1993, through January 1995. This amendment included a 4 percent salary increase on both June 1, 1993, and June 1, 1994. In October 1993, the county and the union entered into an amendment to the MOU to be effective from February 1, 1995, through January 1996. That amendment included no salary increases.

- ***Clerical and Office Services Employees***—Of the three available MOUs that we reviewed, the first MOU with this unit was dated January 22, 1990, effective through September 30, 1991. The second MOU was dated March 26, 1992, effective through September 30, 1993. These two agreements included a 3 percent salary increase on each of the effective dates. The third MOU was dated October 1, 1993, and was effective through September 30, 1995. This agreement required a 2 percent reduction of employees' current pay for the period October 1, 1993, through June 30, 1994.

- ***Registered Nurses***—Of the three available MOUs that we reviewed, the first MOU with this unit was dated October 26, 1989, effective through September 1991. This agreement included salary increases of various percentages to take effect in October 1989, July 1990, October 1990, and July 1991. The second agreement was dated December 23, 1991, effective through September 1993. This agreement included salary increases of 6 percent in December 1991 and 7 percent in October 1992. The third agreement was dated October 1, 1993, effective through September 1995. This agreement did not include any salary increases.

- ***Dental Professionals***—Of the two available MOUs that we reviewed, the first MOU with this unit was dated November 9, 1989, effective through September 1991. This agreement included a 3 percent salary increase in October 1989, October 1990, and July 1991. The second MOU was dated April 17, 1992, effective through September 1994. It included salary increases that are linked to the change in salaries for state employees for a particular time, not to exceed 2 percent.

Appendix B

Percentage Changes in County Salaries Fiscal Years 1989-90 Through 1995-96

	Fiscal Years						
Unit	**1989-90**	**1990-91**	**1991-92** [1]	**1992-93** [2]	**1993-94**	**1994-95**	**1995-96**
Represented							
101	1.00%	3.50%	2.75%				
111/112/121/122							
341/342/431/432	3.50	3.00	2.75	2.00%	2.00%		
131/132/501/502							
511/512	3.00	3.00	7.75	4.00	4.00		
201	3.50	3.00	2.75	3.00	3.00		
211/221	3.00	3.00	2.75	3.00	3.00		
301/421/821	3.00	3.00	2.75	3.00	4.00		
311/312	11.50	3.00	8.75	7.00			
323	3.50	3.00	2.75	3.00			
321	3.00	3.00	2.75	2.50	4.00		
325	3.75	3.00	2.75	7.00	3.00		
331		11.00	2.75	3.00			
332	3.75	3.00	2.75	3.00	3.00		
401	3.00	4.50	8.00	5.00			
411/412	3.00	2.00	3.00	4.00	4.23		
601/602/611/612	6.00	5.00	5.00	4.00	4.00		
613/641/642	3.00	3.00	5.00	5.00	4.00	4.00%	
614/621	3.00	3.00	2.75	10.00	5.00		
631/632	3.00	3.00	2.75			2.00	2.00%
701	9.50	2.00	3.00	5.00	4.00	4.00	
702	4.00	7.50	3.00	5.00	1.50	5.50	
711	3.00	3.00	2.75	5.50		5.50	5.50
721	3.00	3.00	2.75	3.00	4.00		7.75
722	3.00	3.00	2.75	4.50	4.00		
723	3.50	3.00	2.75	3.00		5.50	7.75
724	3.50	3.00	2.75	7.50	4.00		7.75
729	3.00	3.00	2.75	4.50	4.00		
731	4.00	3.00	2.75	2.00	2.00		
732	3.00	6.00	3.25	2.00	2.00		
777	3.00		2.75	3.00		5.50	7.75
811	3.00	3.00	2.75	2.00	2.00		
Court Employees[3]							
Annual Salary Less Than $90,000							
Municipal Court Classes	6.16	6.10	3.61	0.54	0.56		
Marshal Classes	5.33	6.04	2.12	2.99	2.16	0.06	
Superior Court Classes	4.68	6.55	2.27	1.49	0.06		
Annual Salary More Than $90,000							
Municipal Court Classes	4.53	9.64	1.75	1.68	2.16	1.33	
Superior Court Classes	5.00	5.25			5.00	3.00	

Unit	Fiscal Years						
	1989-90	1990-91	1991-92 [1]	1992-93 [2]	1993-94	1994-95	1995-96
Nonrepresented							
Annual Salary Less Than $90,000							
Performance-Based Pay Class	4.35	6.65	6.04	3.43			
Department Head Classes	6.45	1.83	4.60	2.43	2.27	0.50	
Physicians Pay Plan Classes	3.01	5.82	3.01	5.83			
Other Nonrepresented Classes	5.73	5.15	0.94	3.65	(0.04)		
Annual Salary More Than $90,000							
Performance-Based Pay Classes	3.83	6.43	5.67	3.01	0.00		
Department Head Classes	9.69	10.95	3.50	2.60	2.07	1.71	
Physicians Pay Plan Classes	5.17	6.48	3.00	5.86	0.00		
Other Nonrepresented Classes	2.75	2.72	1.51	2.98			

[1] In October 1992, the county imposed a 3 percent salary reduction for the period January 1992 through June 1993.

[2] In October 1993, the county imposed a 2 percent salary reduction for the period October 1993 through June 1994.

[3] Salaries for Superior Court employees are prescribed primarily in the California Government Code, Section 69894. Salaries for Municipal Court and Marshal employees are prescribed in the California Government Code, Section 72609. Salaries of Superior Court and Municipal Court judges are prescribed by the California Government Code, Section 68202.