CITY OF ATLANTA

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April 1, 2008

Honorable Mayor and Members of the City Council:

Enclosed is a copy of our report on the city's 2008 general fund budget process for your review. It is scheduled to be presented at tomorrow's Finance/Executive Committee meeting.

We conducted this performance audit in response to Resolution 08-R-0186. We primarily focused on assessing whether the 2008 general fund budget was developed using sound budget principles and practices and whether the methods for developing revenue and expenditure projections were reasonable. We also updated previous work conducted pro bono for the city by Bain & Company, reviewing historical trends and benchmarking against peer cities, to provide context for the current budget shortfall.

Our recommendations are intended to address structural financial problems by better aligning city policies and practices with state and local budgeting guidelines and by beginning to address escalating pension costs. Due to time constraints, we did not ask management for written comments or specific agreement with our recommendations to be included in this report. We briefed management of our conclusions throughout the audit and will continue to work with the appropriate parties to refine our recommendations and develop a timetable for implementation.

The Audit Committee has reviewed this report and is releasing it in accordance with Article 2, Chapter 6 of the City Charter. We appreciate the courtesy and cooperation of city staff throughout the audit.

Leslie Ward
City Auditor

Fred Williams
Audit Committee Chair

Cc:
Janice Davis, Chief Financial Officer, Department of Finance
Gregory Giornelli, Chief Operating Officer, Mayor’s office
Greg Pridgeon, Chief of Staff, Mayor’s office
David Edwards, Senior Policy Advisor, Mayor’s office
Ray Zies, Controller, Department of Finance
Tanya Jackson, Chief, Office of Budget and Fiscal Policy, Department of Finance
Ginny Looney, Ethics Officer
Elizabeth Chandler, City Attorney, Department of Law
Beverly Isom, Director of Communications, Mayor’s office
Rhonda Dauphin Johnson, Municipal Clerk
Larry Stokes, Committee Analyst
Audit Committee

CITY OF ATLANTA
City Auditor's Office
Leslie Ward, City Auditor
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April 2008

Performance Audit:

Review of the FY 2008 General Fund Budget

Why We Did This Audit

The mayor and chief financial officer projected in January 2008 that the city will face a $70M shortfall by the end of the fiscal year. The City Council passed Resolution 08-R-0186 requesting a performance audit of the City of Atlanta 2008 general fund budget process.

What We Recommended

Our recommendations are intended to better align city policies and practices with state and local budgeting guidelines and to begin to address escalating pension costs.

The City Council should:

- Amend the City Charter to remove the requirement to anticipate revenue of no more than 99% of prior year actual receipts and to eliminate Budget Commissioners' personal liability for overestimated revenues
- Establish financial policies to guide long- and short-term financial planning and monitoring, including maintaining fund balance, uses of non-recurring and surplus revenues; presentation of 5-year financial forecasts; and interim financial reporting

The chief financial officer should:

- Present alternatives to reduce pension costs or offset the increased costs
- Review revenues to consider opportunities for increased fees and charges

The chief operating officer should:

- Review service levels and goals to prioritize and make strategic budget cuts, rather than implement across-the-board budget cuts

Please contact Eric Palmer at 404.330.6455 or epalmer@atlantaga.gov. for more information.

What We Found

While we confirmed some of the errors and poor practices that the mayor and chief financial officer have cited as reasons for the current year shortfall, the city's primary problem is structural – ongoing general fund revenues are not sufficient to cover ongoing costs. Current year expenditures exceeded current year revenues for six of the last ten years, and escalating pension costs will continue to pressure the general fund. The city's long-standing budgeting policies and practices have contributed to and largely hidden this structural deficit. The change in fiscal year also delayed identification of the current budget shortfall.

- Charter provisions dating from 1937 make revenue anticipations artificially low. Consequently, the city has relied on cash carry-forward – the difference between prior years' actual receipts and actual expenditures – to balance its annual budgets.
- The city has budgeted more carry-forward than it ended up with at the close of the year. The cumulative overestimation since 2003 was $241M. Hence, the city drew down its fund balance even as revenues exceeded anticipations by nearly 12%.
- Budget variances did not identify the impending shortfall because the city received more revenue than projected and spent less than budgeted in fiscal years 2002 through 2005.
- The city overspent its budget in the first six months of 2006 (the transition period to a new fiscal year) and in fiscal year 2007 (July 1, 2006 – June 30, 2007). City departments (excluding non-departmental expenditures) spent nearly $90M over the adopted budget in fiscal year 2007. However, most of this overspending was in categories not under departments' control, including $34M in employee benefits and $42M in internal service charges.
- The city had budgeted to use to $64.6M carry-forward from FY 2007 in the FY 2008 budget, but had less than $1M cash available when the FY 2007 books were closed.

Bain & Company, which provided pro bono assistance to help city officials identify the scope of the 2002 budget gap, identified similar issues. Our analysis and recommendations build on this previous work.

General Fund Budget Review

City Auditor's Office
Leslie Ward, City Auditor
Amanda Noble, Deputy City Auditor
Audit Team: Gerald Schaefer, Eric Palmer, Brandon Haynes, Melissa Davis, and Dawn Williams
April 2, 2008

Background

- In January 2008, the Chief Financial Officer announced at the Finance Executive Committee Meeting that there would be a shortfall in FY 2008.
- Mayor Franklin addressed the Finance Executive Committee on January 30, 2008, and announced the shortfall is expected to be $70M.
- Mayor Franklin described the shortfall as the result of incorrect budgeting practices, the change from cash to accrual-based accounting, budgeting errors, and unanticipated or higher than expected costs.

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On January 30, 2008, Mayor Franklin presented a fact sheet on the fiscal year 2008 budget to the Finance Executive Committee. In her presentation, the Mayor said that the City of Atlanta is facing a projected shortfall of $70M this fiscal year, arising from a series of variances from the budget that was adopted in June 2007:

- historical budgeting practices, including under-budgeting expenses such as fuel, utilities, and legal costs
- unanticipated items, such as APD over-time settlement and pre-2004 IRS payroll penalty payments
- budgeting errors and omissions, such as the $8 million subsidy for Underground Atlanta
- the city's change from cash to accrual accounting during which the city depleted reserves by paying amounts due from prior years to the pension funds and eliminating the accrued deficit related to solid waste
- using reserve funds to cover known expenses, such as pension payments

Audit Objective & Scope

City Council passed Resolution 08-R-0186 requesting a performance audit of the City of Atlanta 2008 general fund budget process.

This report addresses the following objectives:

- Was the 2008 general fund budget developed using sound budget principles and practices?
- Were the methods for developing revenue and expenditure projections reasonable?

Audit Scope:

- Reviewed budget data from FY 1988 to the present

Conclusion:

- The city's longstanding methods of projecting revenue and expenditures have contributed to and largely hidden the city's financial condition. This is a structural problems, which requires structural solutions.

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The Chair of the City Council's Finance Executive Committee was concerned that some of city's budgeting practices led to a deficit.

We finalized the scope statement on January 31, 2008, and distributed to the Mayor, City Council and management.

This audit was conducted in accordance with generally accepted government auditing standards.

We conducted our audit fieldwork in February and March 2008.

Overall conclusion:

While we did confirm some of the mistakes and poor practices that the Mayor and Chief Financial Officer have described, the city's primary problem is structural. Ongoing revenues are not sufficient to cover ongoing costs. The city's long-standing methods for projecting revenues and expenditures have contributed to and largely hidden this problem. Revenue projection and other budgeting practices are inconsistent with recommended practices. We make recommendations to strengthen revenue projections, better monitor expenditures, and to begin to address escalating pension costs. Problems aren't simply a few people making mistakes. Structural problems require structural solutions.

Revenue Anticipations Masked Problems

- 1937 charter provisions make revenue anticipations artificially low
- City relied on cash carry-forward to balance the budget
- Budget variances did not identify problem
- FY 2008 revenue anticipation was partially based on revenue that is not necessarily sustainable
- Revenue budgeting policy and practices are inconsistent with GFOA, NACSLB, and ICMA guidelines

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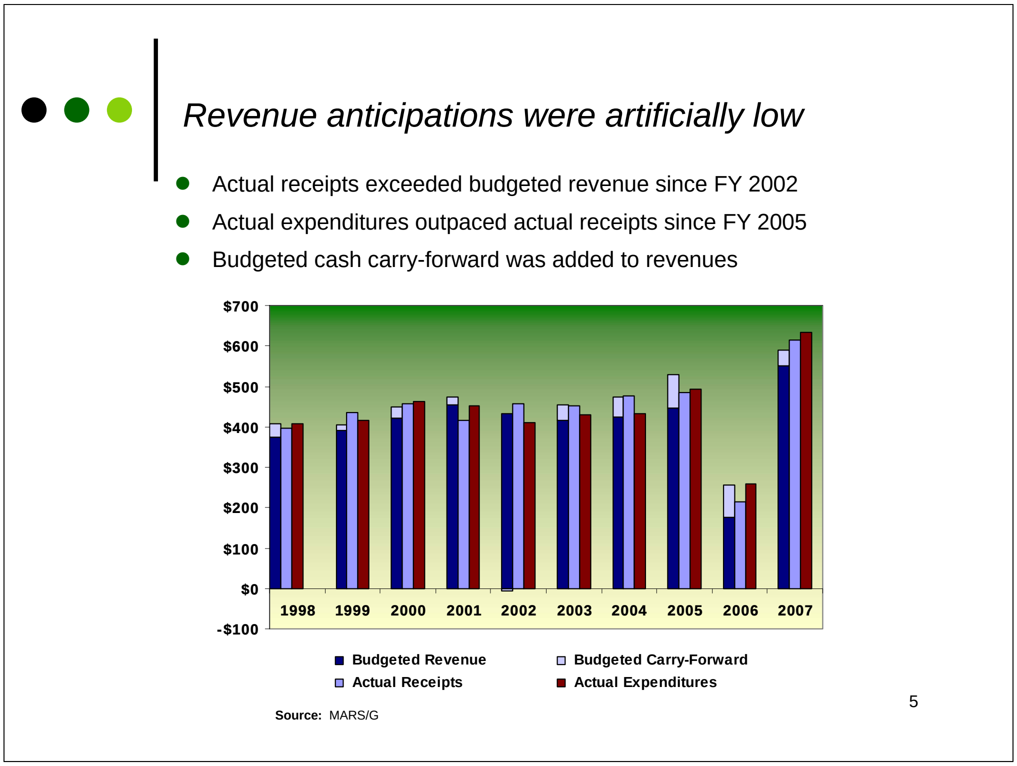
This slide summarizes the main points of the next few slides that describe how revenue projection policy and practice contributed to and masked problems.

GFOA=Government Finance Officers Association

NACSLB=National Advisory Council on State and Local Budgeting

ICMA = International City and County Managers Association

All of our figures are on a cash basis and come from either the general ledger or the adopted budgets.



Charter provisions from 1937 require that the city anticipate current year's general fund revenue at no more than 99% of last year's actual revenue. Since 2003, the Budget Commission has set the anticipation rate at 96%.

The graph shows that actual receipts (PERIWINKLE bar in the middle) exceeded budgeted revenues (DARK BLUE bar on the left) every year except 2001, illustrating that revenue anticipation is conservative. On average, actual receipts were 8.5% above budgeted revenues over the last ten years and 11.5% since 2002.

Expenditures (RED bar on the right) exceeded budgeted revenues (DARK BLUE bar on the left) most of the years on the chart (all except 2002). The city budgeted cash carry-forward - surplus cash from prior years to make up the difference. In other words, the city didn't budget expenditures at the 96% anticipation level. The LIGHT GRAY bar on top of revenues shows budgeted cash carry-forward. Cash carry-forward increased as a percentage of the adopted budget when the anticipation rate was lower.

The graph also shows that actual expenditures (RED bar on the right) exceeded actual receipts for the last three years, including the 2006 transition period – and in 1998, 2000 and 2001 – all years leading up to a budget shortfall.

We'll talk more in-depth about revenue anticipation and cash carry-forward on the next few slides and return to this last point about current year expenditures exceeding current year revenues.

Revenue anticipations were artificially low

- According to the GFOA, revenue estimates should be based on reasonable expectations
- Revenue estimates for the city have been significantly below actual receipts
- ICMA identifies problems with routine underestimation of revenue:
  - Reduces trust in budget office
  - Results in unnecessary reductions in expenditures
  - Creates of a pool of unallocated resources

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While the intent was to be conservative, GFOA and ICMA recommend basing revenue estimates on reasonable expectations.

While underestimating revenues may provide a safety net, and is better than overestimation, it can have unintended effects:

•Routine underestimation creates a general mistrust of the budget office and discourages decision-makers from taking the number seriously as a constraint – political pressure to adjust the numbers upwards without adequate justification.

•Low estimates may also cause unnecessary reductions in departmental staffing or delay capital purchases.

•Low revenue estimates may ultimately create a pool of unallocated revenue that can be spent at the discretion of decision-makers during the fiscal year; thus, low estimates may hold down budgeted expenditures without limiting actual expenditures.

•This type of unbudgeted spending undermines accountability and efficiency because it tends to occur with little publicity or competition among requests.

City relied on cash carry-forward to balance budget

- Each year, the city estimates how much revenue to anticipate for the coming fiscal year
- The anticipation figure is based on prior year actuals minus any non-recurring revenue multiplied by 96%
- However, budgeted expenditures have routinely exceeded anticipated revenue

FY 2008 Example:

Anticipated Revenue		Budgeted Cash Carry-Forward		Budgeted Expenditures
$605M x 96% = $580M	+	$65M	=	$645M

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If the city balanced its budget solely on this anticipated revenue rate, it would have to spend less each year.

Because expenses are not decreasing, additional funds are necessary to balance the budget.

Consequently, the city must include the cash carry-forward in budgeted revenue to balance the budget.

The cash carry-forward is the difference between prior years' actual receipts and actual expenditures.

In FY 2008, the city budgeted its surplus cash before we know we have it.

City overestimated actual cash carry-forward

- Cash carry-forward was overestimated by $241M from FY 2003 through FY 2008

Cash Carry-Forward for FY	Budgeted	Actual	Difference
1999	$14,055,637	$25,712,320	**$11,656,683**
2000	$25,773,571	$34,355,098	**$8,581,527**
2001	$16,837,213	$35,762,592	**$18,925,379**
2002	($6,600,000)	$12,114,736	**$18,714,736**
2003	$39,076,404	$13,315,828	**($25,760,576)**
2004	$49,973,780	$17,634,015	**($32,339,766)**
2005	$83,295,972	$26,532,504	**($56,763,468)**
2006	$80,278,669	$37,445,317	**($42,833,352)**
2007	$39,578,122	$17,056,304	**($22,521,818)**
2008	$64,573,562	$3,864,461	**($60,709,101)**

Source: Fund Balance

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The chart shows budgeted and actual cash-carry forward from 1999 through fiscal year 2007. Fiscal Year 2006 is the 6-month transition period. Notice that the city budgeted negative carry-forward in 2002 – expected a deficit. Since 2003, the city budgeted to use more cash carry-forward than it ended up with at the close of the year. The cumulative overestimation since 2003 was $241M.

Excess revenue has not made up for overestimated cash carry-forward for FYs 2005 through 2007. Looking at the graph, we see that actual revenue was short of the budgeted receipts plus cash carry-forward in several years – most notably in 2005 and the 2006 transition.

Timing has contributed to the estimation problems – used to adopt the budget after the beginning of the fiscal year. Higher 4th Quarter expenditures, lag in “closing books” and “appropriations forward” also contributed to less cash carry-forward

In FY 2008, the city budgeted the cash carry-forward before the close of FY 2007; city anticipated a surplus of $64.6M.

Cash carry-forward estimated early for FY 2008

- At the end of the FY 2007 3rd Quarter, the city estimated the amount available to carry forward into the FY 2008 budget
- In the 4th Quarter of FY 2007, expenditures reduced the amount available
- At close-out, the city actually had less than $1M to carry forward, but had already included $64.6M cash carry-forward in the FY 2008 budget

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Timing and the change in fiscal year especially affected the cash-carry forward estimate going into the FY08 budget.

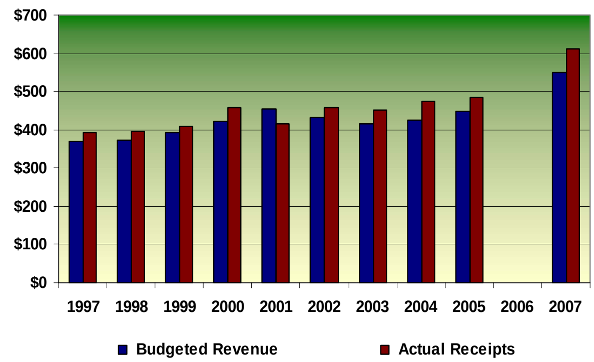
In April 2007 – end of the 3rd Quarter FY07 - the city estimated a $64.6M cash carry-forward for FY 2008.

As we closed FY 2007, the general fund “absorbed” negative fund balances for both the sanitation and traffic courts funds (partially due to change in fiscal year and timing of sanitation assessments). These transactions reduced the general fund balance by $35.2M at the beginning of FY 2008. Higher than anticipated 4th Quarter expenditures further reduced the amount available.

After the year end close-out process, the available fund balance was $780K. But the city had planned to use $64.6 M. At the beginning of FY08, the city had a shortfall of $63.8 million.

Budget variances would not have identified the problem

- Actual revenues were higher than budgeted for FYs 2002 through 2007



Source: MARS/G

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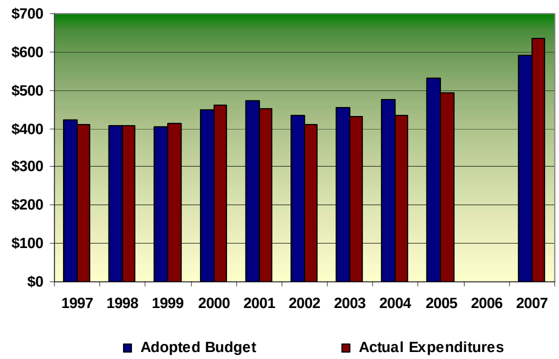
For this slide and the following slide, we excluded the 6-month transition period in 2006.

Without considering cash-carry forward, budget variances – the difference between actual and budgeted revenue – didn't show a problem.

The graph shows that revenue budget variances were positive most years and every year leading to the current budget shortfall – actual revenues were higher than anticipated revenues.

Budget variances would not have identified the problem

- Actual expenditures were lower than budgeted FYs 2002 through 2005



Source: MARS/G

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Budget variances were also positive on the expenditure side 2002 through 2005.

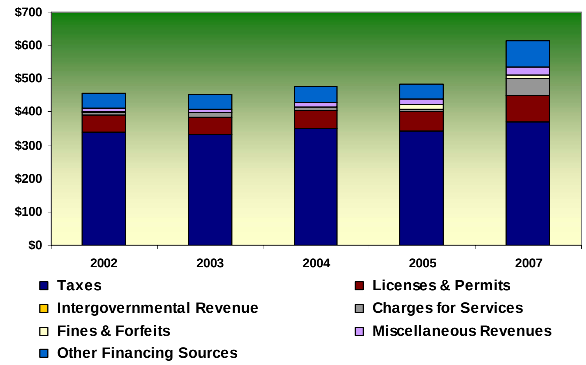
Just looking at budget variances wouldn't highlight a problem. When you look at the budgeted expenditures and the actual expenditures in this chart, it looks like the City should be in sound financial shape because the actual expenditures are usually lower what was budgeted. However, because the city overestimated cash carry-forward and the excess revenue (amounts above the anticipation) wasn't enough to make up the difference, the city spent its surplus cash before FY 2008 started.

As previously seen in slide #5, current year expenditures exceeded current year revenues for six of the last ten years, including FY 2006. This condition is referred to as a structural deficit.

The Budget Office held biweekly meetings called, Departmental Analysis Discussions (DADs). In these meetings, the analyst met with the Budget Chief and gave a half hour presentation on the department's expenditures, revenues, positions, and any follow-up work requested from previous meetings. Budget was monitoring expenditure variances, but only reporting them internally. However, this analysis wouldn't necessarily catch this kind of problem, because these expenditures were allocated at the end of the year.

FY 2008 revenue anticipation was partially based on revenue that is not necessarily sustainable

- Revenue increase in FY 2007 is largely due to including solid waste fees ($44M) in the general fund and operating transfers from other funds ($30M)



Source: MARS/G

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The apparent large increase in general fund revenue in FY 2007 doesn't reflect sustainable growth, but results from including solid waste fees ($44 M) not included in the general fund in prior years and an increase of $30 M in operating transfers from other funds, such as the internal service fund, the water PILOT, and the courts fund.

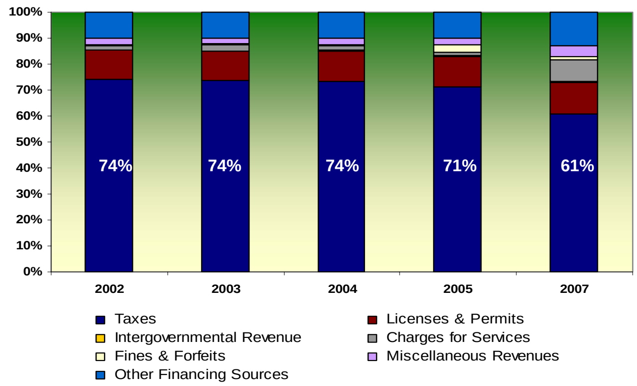
As shown in chart, taxes averaged 2% annual growth from FY 2002 through FY 2007 and trailed the average annual national economic growth of 5.7%. Property tax rollbacks, sales tax allocation formula, and TADs may affect this.

Although the city's other funding sources, such as licenses and permits, have experienced better growth, they may be more affected by the current economic downturn.

Licenses and permits, for example, averaged 9% annual growth from FY 2002 through FY 2007.

FY 2008 revenue anticipation was partially based on revenue that is not necessarily sustainable

- As a percent of total revenue, taxes decreased, while charges for services and funding from other financing sources increased



Source: MARS/G

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Graph:

As shown in the graph, taxes made up a smaller portion of total general fund revenue in FY07 than in previous years, while charges for services and other financing sources made up high proportions.

As previously stated, charges for services increased due to the inclusion of the solid waste fee revenue.

Both slides show that what appears to be an increased level of revenue is not necessarily sustainable.

Revenue budgeting policy and practices are inconsistent with NACSLB guidelines

Charter provisions on revenue anticipations force the city to be too reactive:

- Budget Commission provisions do not address use of cash carry-forward
- Reliance on cash carry-forward is inconsistent with NACSLB guidelines
- City does not prepare long-range forecasts of revenue or expenses
- Policies are too vague to guide operational allocation decisions

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The Charter provisions force the city to react to last year's revenues instead of projecting expected revenues based on the economy and expected expenditures based on needs. GFOA recommends that municipalities adopt financial policies to guide financial planning, revenues and expenditures. Policies should be reviewed during the budget process to ensure continued relevance and to identify gaps.

NACSLB recommends specific policies on:

•Stabilization Funds - creation, maintenance, and use of resources for financial stabilization to protect against reducing service levels or raising taxes

•Fees and Charges - how set and the extent to which they cover the costs of services provided

•Use of One-Time Revenues - Limits use of one-time revenues for ongoing expenditures to minimize disruptive effects on services

•Use of Unpredictable Revenues - Identifies unpredictable sources, defines how they may be used, tentative actions to be taken if revenue is less or more than projected

•Balancing the Operating Budget- Defines a balanced operating budget, encourage commitment to a balanced budget under normal circumstances, and provides for disclosure when a deviation from a balanced operating budget is planned or when it occurs

•Revenue Diversification - Encourages a diversity of revenue to improve a government's ability to handle fluctuations in revenues and potentially help to better distribute the cost of providing services

While the city has financial policies covering maintenance of fund balance, use of fees and charges, revenue diversification, and use of one-time revenues, the policies don't provide clear thresholds. For example, the policy does not define what "sufficient" levels of operating fund balance are to absorb unpredictable revenue shortfalls. The city does not define when a user charge should be used.

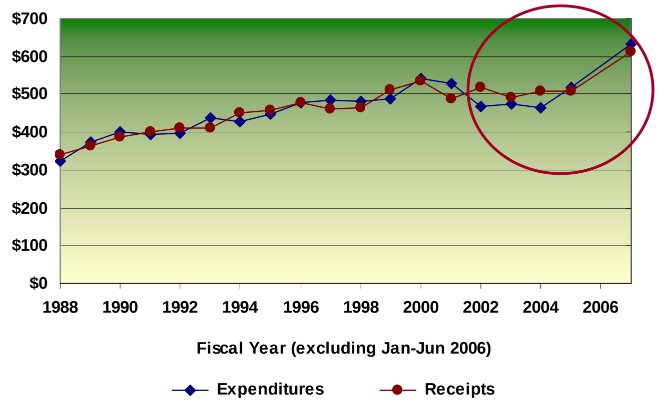
Excess Spending Preceded Both FY 2002 and 2008 Shortfalls

- Current year expenditures exceeded current year revenues for six of the last ten years ('97, '98, '00, '01, '05, '07)
- However, overspending in FY 2007 was largely on citywide expenses not controlled by individual departments

We'll talk about the expenditure side for the next few slides. Then I'll go into more detail about what's driving expenditures.

Historically

- General fund expenditures increased through the late 80s and 90s
- Expenditures mostly tracked actual receipts



Source: MARS/G

Note: *Figures in the graph are adjusted for inflation (2007 dollars)*

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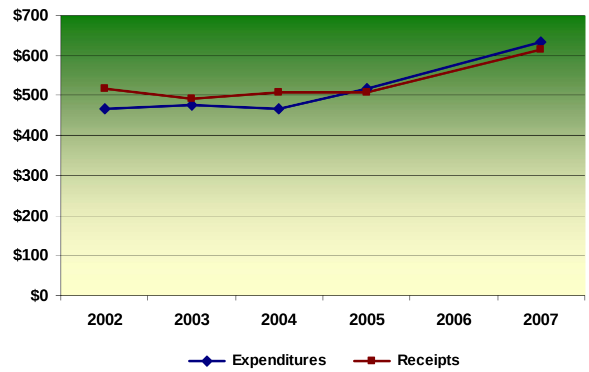
As shown in the inflation-adjusted graph, the city overspent its revenue in the late 90s and early 2000s, which precipitated the budget crisis in FY 2002.

The red circle in the graph highlights the past five years. We will focus on this period in the next slide.

Recently

- City spent less than actual revenue in FYs 2002 through 2004
- Expenditures were greater than actual revenue since FY 2005



Source: MARS/G

Note: ***Figures in the graph are adjusted for inflation (2007 dollars)***

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Actual yearly expenditures were higher than actual yearly receipts in 2005, the 2006 transition period and fiscal year 2007. The shortfall in the current (FY2008) budget year started in 2005. Remember that in 2005, actual expenditures were below budgeted expenditures. We didn't really see "overspending" until fiscal year 2007 – and this was largely beyond departments' control.

Overspending in FY 2007 was not under departments' control

- In fiscal year 2007, city departments spent nearly $90M over the adopted budget
- City departments were over budget in benefits by $34M, data processing by $21M, and motor equipment repairs and fuel costs by $21M.

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Departments do not set the allocation for pension, other employee benefits, or internal service expenses.

For example, the Atlanta Police Department was over-budget approximately $34M in FY 2007, of which $16M was in pension costs.

The APD was approximately $2M over in worker's compensation and about $16M in data processing, which is an internal service fund.

The APD also spent $6M in fuel and motor repairs, which should also be covered by internal service funds.

Increased Benefits and Lower Investment Earnings Drive Pension Cost Growth

- Changes in 2001 (Police, Firefighters) and 2005 (all 3 plans) made benefits more costly
- Investment losses and lower earnings since 2002 reduced growth in assets available to fund benefits

The result:

- City contributions have grown, while funding status of pension plans has deteriorated

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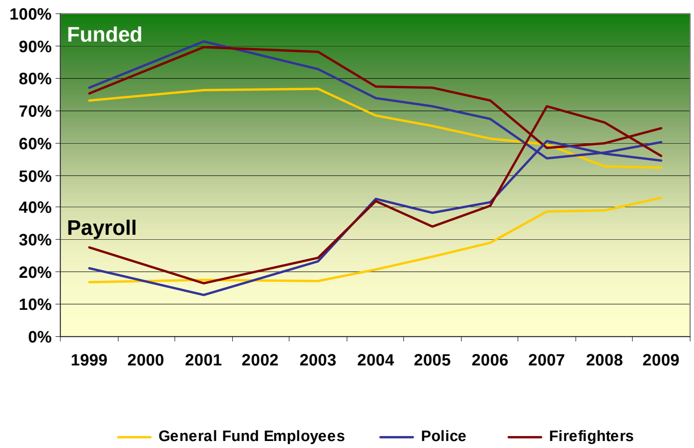
In 2001, the City Council amended the Police Pension Plan to increase the “salary multiplier” (the percentage of salary for each year of service used to calculate an employee’s retirement benefit) from 2% to 3%, up to a maximum of 80% of salary. Also in 2001, the council approved a similar change for the Firefighters Pension Plan, but only for future years of service, not prior years. These changes increased the cost of retirement benefits in both plans. The actuary’s report on the Police plan for 2002 increased the City’s required contribution from 12.77% of sworn officers’ payroll to 23.33%. The report noted that the increase in contribution rate was primarily due to the plan amendment to improve benefits. The City’s required contribution to the Fire-fighters plan increased from 16.5% to 24.3%, again attributed to the higher benefits by the 2002 actuary’s report.

In 2005, changes in all 3 pension plans improved benefits (the General Employees plan as well as both public safety plans). The 3% salary multiplier for Firefighters was extended to all years of service, including those before 2002. The 15-year requirement for full vesting was reduced to 10 years for all 3 plans, and age penalties were eliminated for retirement with 30 years of service. (The Council adopted the 2005 changes after receiving the 2004 report of the pro bono Pension Technical Advisory Committee, and some of the changes were consistent with the committee’s recommendations.) In their 2006 report, the actuaries for the General Employees plan increased the City’s required contribution by more than $14 million. They determined that the benefit changes alone increased the contribution by almost $19 million. Adding 5 years to the amortization period for unfunded liability, as well as other factors, partially offset the increased cost of benefits.

All 3 plans also have experienced investment losses and lower-than-expected investment earnings since 2002. For example, the General Employees plan actuary attributes $24 million, or about one-half of the increase in the City’s required contributions since 2002, to investment performance. The actuaries assume that earnings will average 7.5% to 8% per year, over the long term. When earnings exceed the benchmark, the City’s costs should decrease if there are no other changes in the plan. When earnings are lower or negative, the City’s costs rise.

City contribution to pension plans grew; funding status of plans worsened



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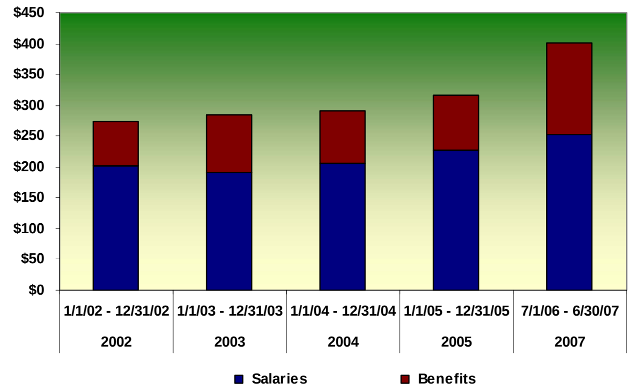
The graph shows the city's required payroll contributions increasing from 1999 through 2009, while the percentage of funded pension obligations has decreased.

Over the last ten years, the percentage of funded pension obligations for general fund employees has decreased from 73 to 52%. For police employees, the percentage of funded pension obligations has decreased from 77 to 60%, while for fire employees, it has decreased from 75 to 64%.

For fire employees, pension as a percent of payroll has doubled over the last ten years, while for general fund and police employees, it has more than doubled.

Pension changes in fiscal years 2001 and 2005 increased costs

- Cost of benefits has increased more than salaries and doubled over the past five years



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The graph shows that benefits paid from the general fund have increased at a greater rate than salaries over the past five years.

Salaries have increased from $201M in FY 2002 to $253M in FY 2007. Over the same period, benefits increased from $72M to $148M.

Salaries include wages, overtime, and other compensation (e.g hearing officer, sick leave bonus).

Benefits include pension contributions, workers' compensation, unemployment compensation payments, health insurance, life insurance, and the Medicare contribution.

The pension portion of benefits has increased from half in 2002 to 62% in 2007.

Little Change Compared To Benchmark Cities Since FY 2002

- We reviewed the 2002 Bain & Company Budget Analysis and Benchmarking Report, and updated the benchmark comparisons of Atlanta's expenditures to other comparable cities
- The results of the 2002 review are similar to what we are seeing now:
  - The city ended 2001 with a negative general fund balance and additional financial commitments without clear funding sources.
  - Spending outpaced revenue growth in the years leading up to the budget crisis; and
  - The city had relied on "unanticipated" revenue to balance the budget.

Bain & Company offered pro bono assistance to help city officials identify the scope of the 2002 budget gap. The report covered historical trends, similar to what we've just covered in the previous slides, benchmarking against peer cities, and budget development.

The results of the 2002 review are similar to what we are seeing now.

• The city ended 2001 with a negative general fund balance and additional financial commitments without clear funding sources.

• Spending outpaced revenue growth in the years leading up to the budget crisis; and

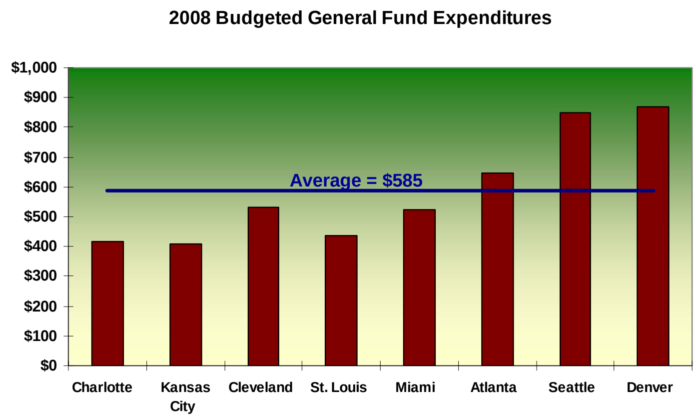
• The city had relied on "unanticipated" revenue to balance the budget.

The benchmarking study compared Atlanta to seven other municipalities with similar populations using 2001 city budgets and found that Atlanta spent 2% to 4% more per capita for the same types of services than the benchmark average. Bain also found that Atlanta's workforce was larger.

We updated comparisons of general fund expenditures using fiscal year 2008 budgets. We did not update the workforce comparisons due to problems with data (Bain also noted personnel data were unreliable).

Benchmark comparisons don't take into account differences in cities, but do provide reference points for discussion.

General Fund expenditures are relatively high compared to benchmark cities



Source: FY 2008 Budgets

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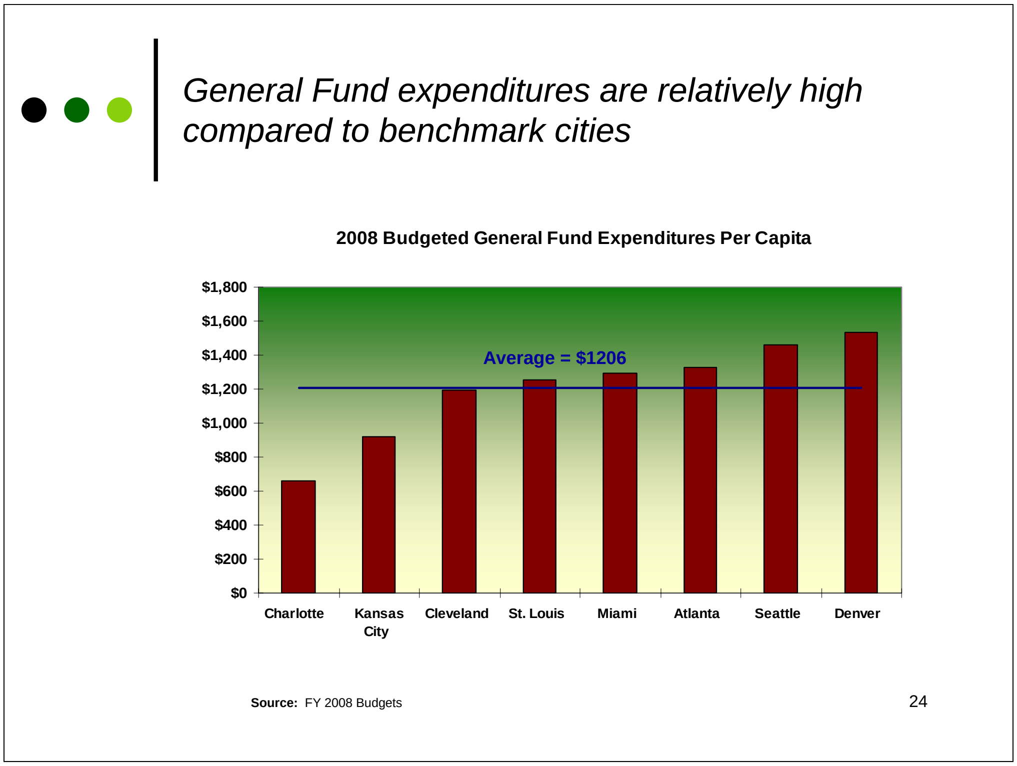
Atlanta's general fund expenditures budgeted in FY08 – overall and per capita – are about 10% higher than the 8-city average.

In 2001 when Bain & Company did its analysis, Atlanta's general find expenditures were about 3% higher than the benchmark average overall and 14% higher per capita.

Seattle and Denver were highest in 2001, too.

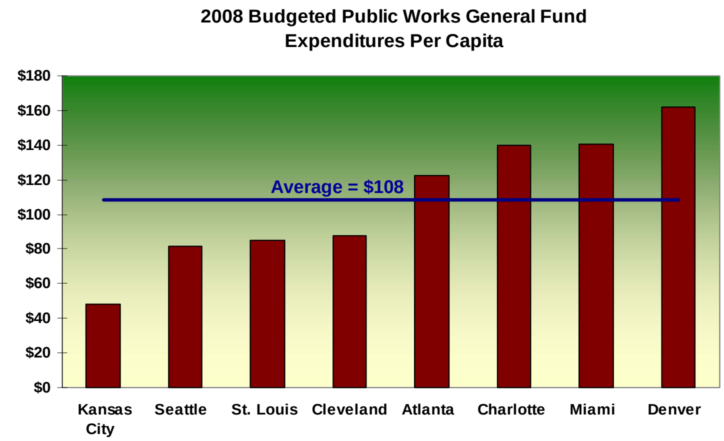


General fund expenditures per capita range from a low of $663 to a high of $1,531.

Along with Charlotte, Atlanta has experienced the most population growth (17%) among the benchmark cities since 2001.

• Explains why relative to other cities our per capita expenditures have come down (from 14% above average to 10% above average), while overall expenditure have increased.

General Fund expenditures are relatively high compared to benchmark cities



Source: FY 2008 Budgets

25

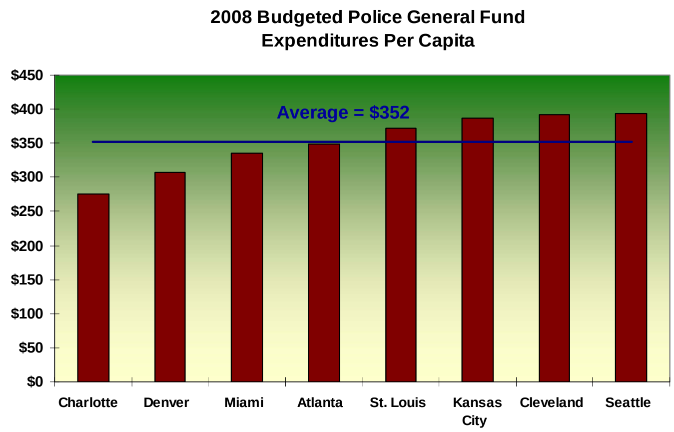
Our general fund Public Works expenditures per capita ($123) are 13% higher than the 8-city average ($108).

These figures all include solid waste. In its analysis, Bain & Company removed solid waste because the city was planning to fund solid waste from an enterprise fund. However, solid waste has been budgeted in the general fund for the past 2 years and in fact operates from the general fund (payments are made from the cash pool), so including solid waste better reflects how the city operates.

In 2001, Atlanta's budgeted expenditures per capita for public works – without solid waste – was 10% lower than the benchmark average.

Per capita costs per city range from a low of $48 to a high of $162.

General Fund expenditures in public safety are near the average



Source: FY 2008 Budgets

Note: ***Figures exclude airport police budget***

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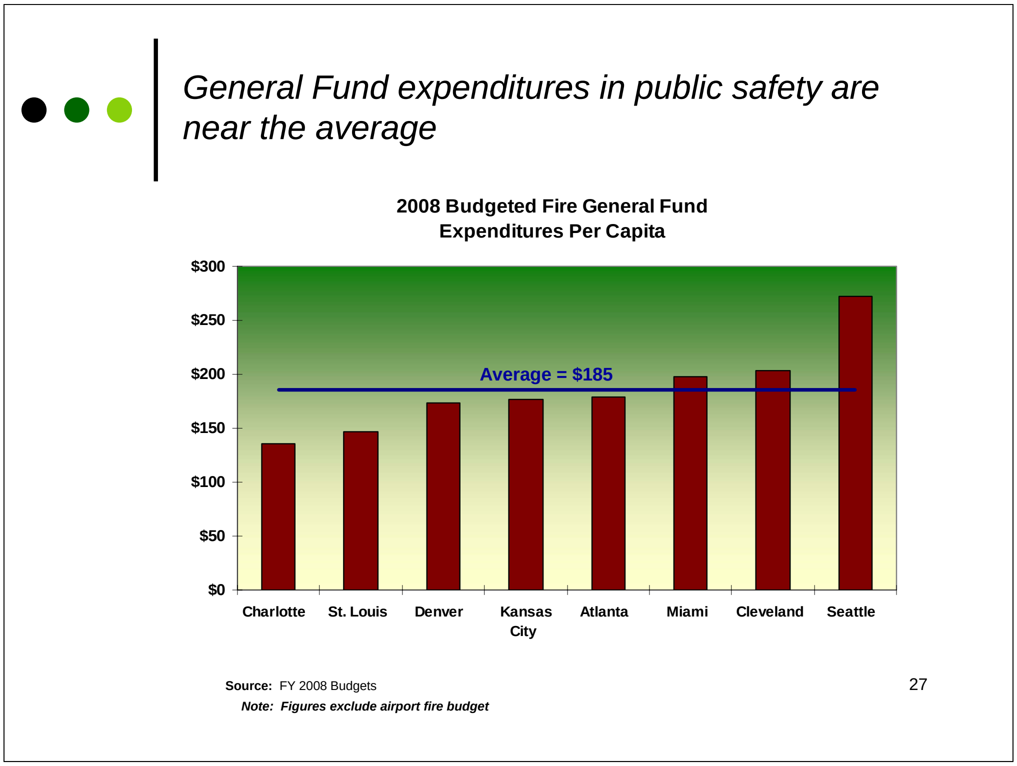
(Excludes Airport Police budget)

As in 2001, Atlanta's general fund police budget per capita is equal to the average of the 8 cities.

There is less variation in expenditures for police, probably reflecting similar core activities and funding. Per capita costs range from a low of $276 and a high of $394.



(Excludes Airport Fire budget)

Also as in 2001, the Fire Department budget per capita is below the average of the 8 cities.

- 3.7% below in 2008
- 3.0% below in 2001

Per capita costs on Fire range from a low of $135 to a high of $272.

What Went Wrong in the FY 2008 Budget Development Process

- Budget development problems identified in FY 2002 remain
- Specific errors and changes in practices affected the shortfall in FY 2008
- Some budgeting practices are inconsistent with recommended practices and/or guidelines
- Budget staff is qualified, but turnover is high

We also looked at what went wrong in the 2008 budget development process.

A number of issues Bain & Company identified as problems in the budget development cycle for FY 2002, still appear to be problems. We also confirmed some specific errors and changes in practice that affected the FY 2008 budget and noted areas where the city's budgeting practices were inconsistent with recommended practices.

There's been suggestion that the city has the wrong type of staff employed in the budget office, we don't necessarily think that is true, although there appears to be a lack of communication between budget and accounting staff.

Most of Bain & Company's observations about budget development in FY 2002 have not been addressed

1. Cost centers do not reflect actual activities/costs
2. Published documents lack trends and explanations of program changes
3. Published documents are difficult to access
4. Published documents do not clearly link expenditures to outcomes
5. There is a lack of visibility with regard to expenses beyond the current year
6. Revenue forecasting does not take advantage of statistical projections based on economic indicators
7. Department and agency managers lack in-year visibility to spending versus budget
8. City budget analysts could be more closely linked with the development of departmental budgets
9. Department and agency budget submissions contain inconsistent detail, making comparisons difficult
10. Personnel data required for the budget process is cumbersome to use
11. The city's budget cycle occurs over a shorter period of time.
12. The city's budget cycle extends into the fiscal year for which the budget has been developed

Bain & Company made a number of observations about the budget development process in its review. Based on our interviews with staff and review of documents, as well as our own experiences in budget preparation, most of these issues have continued to be problems:

•The transition to Oracle shows that cost centers have not always reflected actual activities and costs (1)

•The city hasn't published a budget document since 2005 (2,3,and 4)

•The city hasn't done multi-year revenue or expenditure forecasts (5 and 6)

•Allocations that affect department spending aren't under the departments' control (7 – Bain said department managers didn't have access to simple monthly reports summarizing financial performance of their areas of responsibility)

•Personnel data continues to be unreliable (10 – Bain said PeopleSoft data were manually reconciled with financial data and multiple "hand counts" of employees were necessary; budget analysts told us that PeopleSoft data are unreliable and we've had difficulty reconciling PeopleSoft and Department data in audit work)

However, the city has addressed the timing of the budget cycle, referenced in points 11 and 12.

In addition, the new Oracle system and chart of accounts should help with points 1 and 7.

It is important to note that we did not review departmental budget submissions (points 8 and 9).

Budgeting errors and under-funded line items are not the primary cause of shortfall

Confirmed Specific Errors

- City recorded $42M in revenue from the Hotel/Motel tax, but did not correctly budget for required pass-throughs; only allowed to keep about 29% ($12M)
- The FY 2008 budget detail presented to City Council was $24M short

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Overall:

The Mayor and CFO have identified specific line item errors and poor practices that have contributed to the shortfall in the current year budget. We confirmed some of these errors and practices and agree that they are problems, but they are not the primary cause of the shortfall.

Bullet #2:

Budget presented a spreadsheet to City Council that did not sum all the appropriations; the total listed of $645M was a “plug number.” The actual column sum was $669M, approximately $24M short. The former budget director said that the intent was to hold 5% of the personnel budget as a reserve to reflect salary savings that result from normal turnover.

Budget ordinance does not match first month’s appropriation in the general ledger or close-out.

Budgeting errors and under-funded line items are not the primary cause of shortfall

Confirmed Changes in Financial Practices

- City increased overtime budget in FY 2008; has already spent entire budget by January 2008
- City budgeted $0 for the fuel fund in the general fund in FY 2007 and spent $4.5M; in FY 2008, city budgeted $5.6M and spent $382,000 through January 31, 2008
- Unanticipated items equal $11M, about 2% of the general fund, which should be covered by reserves and contingency funds

Some budget preparation practices are inconsistent with recommended practices

The budget office did develop:

- a budget calendar;
- budget guidelines and instructions;
- mechanisms for coordinating budget preparation and review;
- procedures to facilitate budget review, discussion, modification, and adoption; and
- identify opportunities for stakeholder input

However, the budget office has not:

- prepared a public budget document since FY 2005; GFOA recommends preparing and presenting a budget document for the public
- consistently prepared interim financial reports; GFOA recommends quarterly financial reports that note significant deviations from the budget

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We reviewed budget preparation practices recommended by GFOA and NACSLB.

According to NACSLB, “a government should establish an administrative structure that facilitates the preparation and approval of a budget in a timely manner. Procedures should be established for ensuring coordination of the budget process.”

The budget office followed each of the five recommended practices for developing a process to prepare and adopt a budget.

However, some of the city’s practices are inconsistent with recommended practices.

On this last point, we did see evidence that the budget office monitored departments’ expenditures throughout the year. (Describe DAD process). However, we did not see evidence that reports were provided to others outside the budget office.

As we discussed earlier, budget variances wouldn’t have flagged a problem.

Budget staff is qualified, but turnover is high

- Job descriptions for budget analysts require budgeting experience and college degrees
- Staff has varied educational backgrounds and experience levels, but generally meet requirements
- Turnover in budget office has been high since 2005. Thirty-two people have worked in the budget office since 2005 (half have left Finance). The current staff of 9 has an average of 1.2 years in BFP

The current budget office staff have degrees or considerable relevant experience and are working toward a degree.

Half the staff has studied accounting, economics, or business.

Two-thirds of the professional staff in BFP have advanced degrees in varying fields of study.

Based on years of practical experience and educational backgrounds, the BFP staff appears to be qualified to satisfy budgeting responsibilities for the city.

However, the budget office does not have documented internal procedures; employees only receive on-the-job training

Training is recommended to ensure BFP staff remains aware of recommended and the latest budgeting practices.

Of the 32 people who have worked in the budget office since 2005, 16 have left Finance or city employment, 7 still work in Finance, and 9 are currently in BFP.

Only 4 of the current budgeting staff worked in BFP during the creation of the FY 2008 budget.

Recommendations

In order to address current financial issues, City Council should:

- Amend the City Charter to remove the requirement to anticipate revenue as a percentage of prior year (provide for forecasting expected revenues) and eliminate Budget Commissioners' personal liability for overestimated revenues
- Establish the following financial policies to:
  - Create a reasonable fund balance
  - Define acceptable uses of non-recurring and surplus revenues
  - Prepare and present 5-year forecasts of revenues and expenditures
  - Prepare and present interim financial reports
  - Prepare budget document annually
  - Periodically review internal service fund costs and allocations
  - Budget for needed operating transfers among funds

Sub-Bullet #2:

Don't routinely budget cash carry-forward

Recommendations

The Chief Financial Officer should:

- Present alternatives to reduce pension costs or offset the increased costs, including consideration of the 2004 Pension Technical Advisory Committee's recommendations
- Review revenues to consider opportunities for increased fees and charges

The Chief Operating Officer should:

- Review service levels and goals to prioritize and make strategic budget cuts, rather than implement across-the-board budget cuts

Bullet #1

Pension costs are a long-term issue. Alternatives could include raising taxes, reducing benefits for future employees, increasing employee contributions to the pension fund, and reducing other general fund expenditures.

Bullet #3

The FY 2009 budget development process relies heavily on across-the-board percentage reductions.

This strategy makes questionable assumptions about the relative efficiency of department operations, the varying degree of essential and discretionary services, and the extent to which economies of scale can be achieved.