California State Auditor

BUREAU OF STATE AUDITS

Los Angeles County:

The Future Holds Continuing Budget Challenges

April 1998
98018

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CALIFORNIA STATE AUDITOR

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April 30, 1998 98018

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As required by Chapter 518, Statutes of 1995, the Bureau of State Audits presents its audit report concerning Los Angeles County's (county) fiscal condition and the status of issues we previously reported. This report concludes that, despite anticipated growth of $300 million in general purpose revenues, the county may face a budget shortfall exceeding $308 million by 2000-01 unless it can identify new sources of revenue or cut costs. Factors giving rise to the shortfall include the loss of about $380 million in program-specific revenues and net cost increases of about $228 million. After 2000-01, the county may also face an additional loss of about $300 million in surplus investment earnings from its retirement system, on which it currently relies.

Respectfully submitted,

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Summary

Audit Highlights . . .

We found that Los Angeles County will be faced with fiscal challenges into the new century. Fiscal highlights through the year 2000-01 reveal:

	(Millions)
☑ ***General purpose revenue growth***	***$300***
☑ ***Program-specific revenue losses***	***(380)***
☑ ***Cost increases***	***(319)***
☑ ***Trial court funding relief***	***91***
Resulting shortfall	***$308***

Also, consumption of retirement system surplus could create an additional $300 million burden after 2001.

Results in Brief

Los Angeles County (county), one of the original 27 counties in the State, is responsible for providing public welfare, health, and public safety services to about 9.6 million residents. In our four previous audits on the county's budget, we reported that the county has produced balanced budgets for each fiscal year from 1991-92 through 1997-98 after initially projecting budget shortfalls. We also reported on the steps the county took to balance its budgets, such as the use of layoffs, program curtailments, a hiring and wage freeze, additional federal financial assistance, and one-time revenue sources.

In this final report, we consider the county's fiscal outlook through 2000-01. Despite anticipated growth in general purpose revenues, we estimate that the county may face a budget shortfall in excess of $308 million by 2000-01. As in the past, the county will have to continue monitoring its budget closely and identify new sources of revenues or implement cost-cutting measures to manage this estimated shortfall. Factors resulting in the estimated shortfall include the following:

- We estimate that general purpose revenues will grow by approximately $300 million by 2000-01. This revenue supports operations over which the county has discretion.

- Funding under the Disproportionate Share Hospital program and the Medicaid Demonstration Project which the county currently relies on is set to expire by 2000-01. Combined, this represents a loss in revenue of about $380 million.

- Approved salary increases and escalating debt service costs will add approximately $319 million to county costs in 2000-01.

- Changes in state law related to funding of trial courts will save the county about $91 million in 1998-99. This savings should continue to benefit the county in 2000-01.

In addition to the factors causing the potential shortfall, the following conditions will likely place additional burdens on general purpose revenues:

- At present, the county annually uses about $300 million of retirement system investment earnings that exceed system funding obligations. We project that this source of funding will be available past 2000-01. However, the eventual loss of this funding will place an additional burden on general purpose revenues unless the county identifies replacement funding.

- The county continues to incur overtime costs in excess of budgeted amounts. When this occurs, the county must cut other costs or identify new funding to cover the overage.

- Because of limited funding, the county has unmet needs related to capital improvements. General purpose revenues will likely be used to meet some of these needs.

Recommendations

The county should continue to closely monitor each department's budget and the major components within it to help ensure that the county continues to meet its overall budget. In addition, the county should continue to seek long-term solutions to its budget difficulties, paying particular attention to ways it can enhance its discretionary revenues while limiting increased burdens on these revenues.

Agency Comments

The county generally agrees with the recommendations that we make in this report. In addition, the county plans to begin eliminating its reliance on excess pension funds to finance ongoing programs. Further, the county is continuing to refine its multi-year budget planning effort which will include projections for revenues and costs for two years beyond the proposed budget year.

Introduction

Background

Established in 1850, Los Angeles County (county) is one of California's original counties. Located in the southern coastal portion of the State, it covers 4,083 square miles. Approximately 9.6 million people lived in Los Angeles County in 1997, making it the largest county in the United States and more populous than 42 states.

The county charter and ordinances, along with state and federal mandates, give the county the responsibility of providing public welfare, health, and safety services and of maintaining public records. The county delivers health services through a network of county hospitals, comprehensive health centers, and health clinics. It provides municipal services and recreational and cultural facilities to the unincorporated areas and furnishes additional services such as law enforcement and public works to cities within its borders, which reimburse county costs.

A five-member Board of Supervisors (board) governs the county. Board members are elected to alternating four-year terms. The assessor, district attorney, and sheriff are also elected officers. Officials appointed by the board head all other departments. The county's fiscal year runs from July 1 through June 30. Under the California Government Code, Section 29088, the board must approve a balanced budget by August 30 of every fiscal year, although it can extend this deadline to October 2.

Previous Findings Relating to the County's Budget

This is the last in a series of audits we have prepared on the county's budget and fiscal condition. In our previous audits, we reported that the county achieved budget surpluses despite initially projecting budget shortfalls ranging from as low as $277 million to as high as $1.3 billion in fiscal years 1991-92 through 1996-97. The county achieved these surpluses largely through both short-term solutions, such as using the previous year's ending fund balance, selling county assets, and obtaining federal financial assistance to restructure its health care delivery system; and long-term solutions such as countywide hiring freezes and budget reductions. We also reported on several challenges the county faced balancing its budget, such as its limited flexibility because of designated revenue and legal funding requirements. Finally, we noted those areas of opportunity where the county could achieve more savings. For example, in our November 1996 report, we suggested that the Los Angeles County Sheriff's Department could reduce costs by about $4.3 million by converting the positions of 141 sworn officers to civilian status.

In this report, we focus on the county's general purpose revenues and those county costs funded through these revenues, the use of which the board controls. We also discuss the anticipated growth in these revenues as well as factors expected to strain them in the future.

Scope and Methodology

As directed by the California Government Code, Section 30605, in March 1996, the Bureau of State Audits (bureau) reported on Los Angeles County's fiscal year 1995-96 budget and examined past events that led to the county's fiscal crisis. Section 30606 of the California Government Code mandates that the bureau perform four additional semiannual reviews of the county's finances to analyze whether it is closing its budget gap and to follow up on previous audits. This audit is the fourth and final of our semiannual reviews of the county's fiscal condition.

To assess the county's fiscal outlook, we identified those costs that the county must pay for out of its general purpose revenues. We estimated the impact of several items that will likely increase these costs as well as those items that will affect the county's general purpose revenues. Based on these estimates and on historical data, we assessed the county's fiscal outlook through fiscal year 2000-01.

To identify and estimate the impact of these items affecting the county's costs and general purpose revenues, we reviewed the county's final budget for fiscal years 1994-95 through 1997-98. In past budgets, property taxes, motor vehicle license fees, and sales and use taxes have accounted for an average 86 percent of general purpose revenues between 1994-95 and 1996-97. Using the actual data for these three years plus estimated data from the five-month budget status report for 1997-98, we prepared projections for these revenues through 2000-01. We then compared the assumptions that we made to prepare our forecast to the assumptions of other forecasters, including the Legislative Analyst's Office, the Department of Finance, and the University of California, Los Angeles. In addition, we considered the preliminary estimates the county has prepared as it begins to consider its budget for 1998-99. We also interviewed staff at the county's Chief Administrative Office (CAO) and in various departments and reviewed actions approved by the board. For the remaining general purpose revenues, we are assuming no net growth because the trend from 1994-95 through estimates for 1997-98 indicates a slight decline in these other revenues as a whole.

To follow up on issues, findings, and recommendations from our previous audits, we interviewed CAO analysts and reviewed the five-month status report on the fiscal year 1997-98 budget. Specifically, we reviewed the current status of overtime usage and assessed the county's efforts to control excessive overtime. We also interviewed analysts at specific county departments to assess their efforts at filling vacancies.

Despite Anticipated Growth in General Purpose Revenues, Balancing Budgets Will Be a Challenge

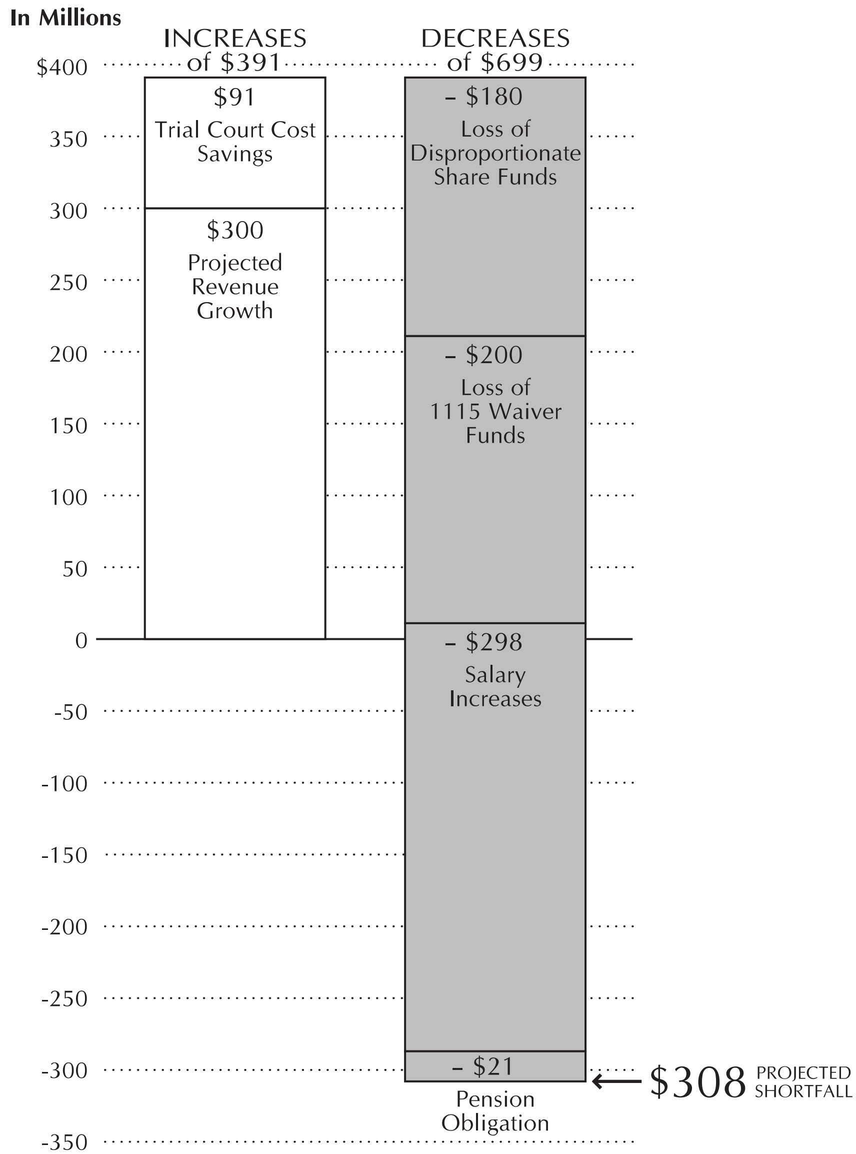
Summary

Trends of revenue activity since 1994-95 and discussions with forecasters at the State's Department of Finance, the Legislative Analyst's Office (LAO), and the University of California, Los Angeles, indicate that Los Angeles County's (county) general purpose revenues should experience moderate growth over the next three years. We estimate that general purpose revenues will likely grow by a cumulative $300 million from 1997-98 to 2000-01. This growth is due primarily to increases in property tax, sales and use taxes, and motor vehicle license fees. However, we do not expect this growth to keep pace with the loss of currently available funding sources and increasing costs. Over the same period, the county may lose approximately $380 million in program-specific revenues that are currently available under the Disproportionate Share Hospital program and the Medicaid Demonstration Project, also known as the 1115 Waiver program. If the county cannot identify new sources to replace these revenues, it would have to use general purpose revenues to pay the increased costs facing the county or implement more cost-cutting measures.

In addition to having to deal with the potential loss of program-specific revenues, the county also faces additional burdens on general purpose revenues. We estimate that salary and pension obligation costs funded by these revenues will increase by at least $319 million by 2000-01. Although this increase is partially offset by a $91 million reduction in costs related to trial court operations, we anticipate that other factors, such as the need for capital improvements, will make additional demands on these general purpose revenues. Considering both the loss of current revenues and net increased costs to the county, we estimate the county could face a budget shortfall exceeding $308 million by 2000-01, as shown in Figure 1.

Figure 1

Possible Budget Shortfall by 2000-01



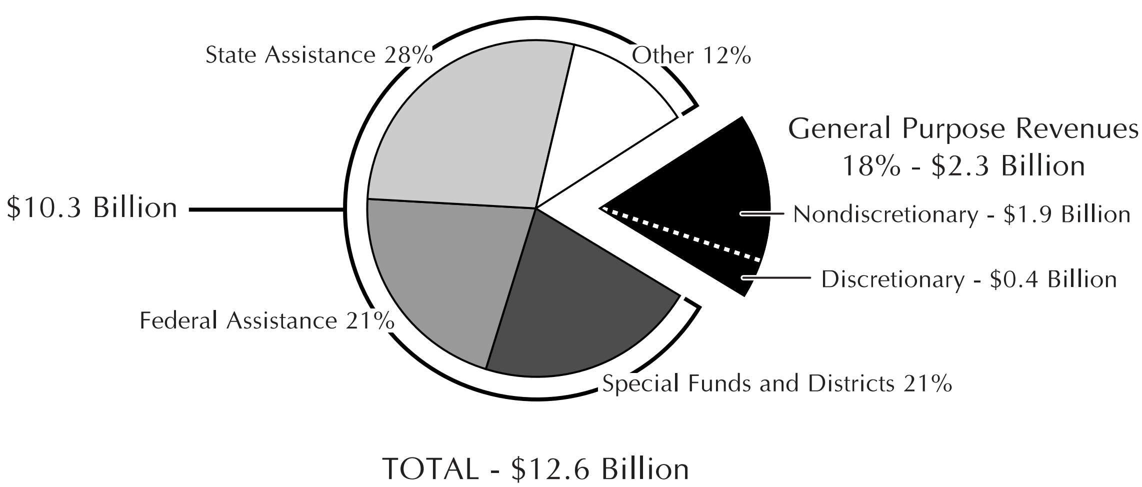
Beyond fiscal year 2000-01, this shortfall will be exacerbated because the county may face the loss of about $300 million per year in surplus retirement system earnings currently available to offset county contributions to the retirement system. Finally, the county has limited discretion over the use of general purpose revenues because of state and federal requirements. As a result of all the factors we have discussed, Los Angeles County will continue to face challenges in balancing future budgets.

The County Has Limited Discretion Over Its Annual Budget

The county adopted a $12.6 billion budget for 1997-98. As Figure 2 shows, revenues financing the budget include $10.3 billion in program-specific revenues, primarily from the state and federal governments, and $2.3 billion of general purpose revenues, such as property and sales taxes and motor vehicle license fees. Program-specific revenues are funds that the county must spend for specific purposes such as grants from the federal and state governments to provide cash payments to poor families with dependent children. General purpose revenues, on the other hand, are available to fund programs at the Board of Supervisors' (board) discretion. The board determines how to spend the county's general purpose revenues. However, about $1.9 billion, or 82 percent, of this discretionary revenue is essentially restricted to specific federal or state programs because the county must commit some of its own resources in accordance with state or federal law. As a result, the board's real discretionary power is limited to the remaining $400 million, which represents about 3.3 percent of the total budget. This limitation continues to make it difficult for the board to alter the county's budget structure and emphasizes the importance of controlling county operations supported by general purpose revenues, also referred to as net county cost (NCC).

Figure 2

1997-98 Budgeted Revenue

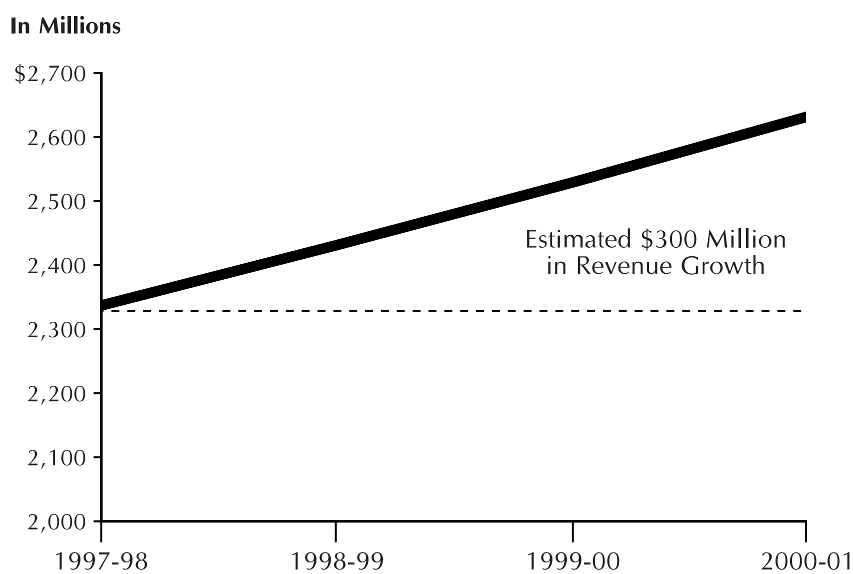


General Purpose Revenues Are on the Rise

Figure 3 provides our overall forecast through 2000-01 for all general purpose revenues excluding fund balance. Fund balance is the amount of funds remaining at year end, representing the excess of assets over liabilities. This figure indicates growth in these revenues of about $300 million from 1997-98 to 2000-01. Below, we discuss our projections for each of the revenues separately. As mentioned above, the board has discretion over the expenditure of general purpose revenues that support NCC. The principal components of general purpose revenues include property taxes, nondepartmental revenues, and, in some years, fund balance. Nondepartmental revenues include other taxes, such as sales and utility user taxes and motor vehicle license fees. In the analysis that follows, we do not include projections related to fund balance because it only represents a resource if revenues exceed expenditures for a particular period. In addition, our analysis does not include portions of fund balance that are reserved for specific purposes, such as reserves related to Propositions 62 and 218, which may require refunds of certain taxes previously collected. To the extent that circumstances require use of such resources for their designated purpose, the reserves do not represent a resource available for other purposes.

Figure 3

Anticipated Growth in General Purpose Revenues



Property Tax Revenues Should Increase

In 1998-99, the county estimates revenues will likely increase by:

- ☑ *2.3 percent for property tax*
- ☑ *4.5 percent for vehicle license fees*
- ☑ *4.0 percent for sales and use taxes*

The county estimates that property tax revenues will increase by about 2.3 percent in 1998-99 but has not prepared official forecasts for later years. Our projections for property tax revenues reflect an estimated 5 percent increase each year from 1997-98 to 2000-01. This increase is based largely on information provided in the Governor's Budget Summary for 1998-99 (summary). According to the summary, the State's economic recovery has begun to reverse the downward trend in the real estate market experienced in the early 1990s. The passage of Proposition 8 in 1979 provided for the reduction of property values to reflect real estate market conditions. As a result, since 1991, the statewide assessment roll was reduced by tens of billions of dollars due to Proposition 8 reassessments. However, these reassessments have slowed so far in 1997-98, and restoration of some Proposition 8 assessed values to the statewide assessment roll is expected for 1998-99. In addition, property values have begun to increase, as measured by home sales and new construction. Finally, a 2 percent California Consumer Price Index factor was applied to base values for 1997-98 and will again be applied in 1998-99. As a result, the assessed value of property statewide is expected to increase by 5 percent in 1998-99. In addition, the LAO reported that median home prices in Los Angeles County as of November 1997 are a little more than 5 percent higher than that of November 1996.

Motor Vehicle License Fees and Sales and Use Tax Revenues Are Expected to Increase

The county estimates that in 1998-99 motor vehicle license fees will increase by 4.5 percent, and sales and use tax revenues will increase by 4.0 percent. We also expect an increase in these fees and revenues. Specifically, our figures for motor vehicle license fees reflect an estimated increase between 4 percent and 5 percent each year from 1997-98 to 2000-01. This projected increase is based on our trend of activity from 1994-95 through the latest estimates for 1997-98, which indicate steady growth in the level of these fees. This is consistent with forecasts for 1998-99 by the Department of Finance and the LAO, which both project statewide growth of 5 percent.

In addition, our projections for growth in sales and use taxes are based on statewide forecasts of the University of California, Los Angeles, and the LAO, which both project annual growth averaging about 5.5 percent to 5.6 percent for 1998 through 2000. This rate of increase exceeds the 1 percent to 2 percent growth our trends indicated based on activity from 1994-95 through the latest estimates for 1997-98. However, we have chosen to use the more favorable forecast of 5.5 percent growth because it is more consistent with the growth rates expected for the other revenues discussed above.

Anticipated Revenue Losses Could Increase the Strain on Net County Costs

We anticipate that by 2000-01 the county will lose about $380 million in program-specific revenues on which it currently relies. These revenues include funds from the Medi-Cal Disproportionate Share Hospital program and the Medicaid Demonstration Project. As these revenues are lost, the county must either find new sources of revenue or face an increased demand against that small portion of revenue over which it has discretion. Table 1 shows that by 2000-01, the loss of these program-specific revenues is expected to exceed the growth in general purpose revenues by $80 million. After 2000-01, the county may face an additional loss of $300 million in surplus retirement system investment earnings.

Table 1

Program Revenue Reductions Create Possible Budget Shortfall By 2000-01 (In Millions)

Projected growth in general purpose revenues (1997-98 through 2000-01)	$300
Loss of program-specific revenues	
Disproportionate Share Hospital program	(180)
1115 Waiver	(200)
Projected Shortfall From Program Revenue Loss	**$(80)**

Disproportionate Share Hospital Funding Will Expire After 1998-99

Los Angeles County estimates it will receive $210 million in Disproportionate Share enhanced funding for 1997-98 and $180 million for 1998-99.

One strain on the county's discretionary revenue is the expiration of the Disproportionate Share Hospital enhanced funding after fiscal year 1998-99. In our February 1998 report, we noted that the federal Balanced Budget Act of 1997 provided additional funding for the 1997-98 and 1998-99 state fiscal years to hospitals in California that serve an exceptionally large number of Medi-Cal or other low-income patients. Specifically, the law allows hospitals in California with high disproportionate share status to receive payments up to 175 percent (instead of 100 percent) of their net Medicaid and uninsured patient costs for the two-year period. State legislation enacted in 1997 amended the Medi-Cal Plan to conform with the new federal provisions for fiscal year 1997-98 only. The county estimates that in fiscal year 1997-98, it will receive approximately $210 million as a result. If the State makes similar changes for fiscal year 1998-99, the county estimates it will receive about $180 million from this source. This estimate is down from the earlier estimate of $208 million we reported in our February 1998 report. Since federal law limited the funding to two years, the county will lose this source of revenue entirely in 1999-2000. We have reflected this loss at $180 million in Table 1.

Funding From the 1115 Waiver Will End After 1999-2000

As described in our previous audits, the county received $536 million in federal funds under the 1115 Waiver, also known as the Medicaid Demonstration Project, in fiscal years 1995-96 and 1996-97. The project is designed to stabilize the county health care system and to eventually move it from expensive inpatient hospital services to less expensive community-based primary and preventive care. In our February 1998 report, we noted that the county expects to receive about $200 million per year under the project for 1997-98 through 1999-2000. As part of the project, the Department of Health Services (DHS) has been reengineering the county's health care delivery system. Although the DHS had targeted an annual savings of $294 million as its goal, it now projects annual savings of only $205 million by 2000-01 after it has fully implemented the reengineering plans. In addition, even if it successfully realizes all the estimated savings, the DHS projects it would still depend on the full amount of 1115 Waiver funding to avoid a significant budget shortfall in 2000-01, the first year after the 1115 Waiver expires. Table 1 therefore reflects a loss in funding of $200 million for 2000-01.

Surplus Retirement System Investment Earnings Will Be Available Past 2000-01

The county continues to use about $300 million each year in surplus retirement system investment earnings to pay for pension-related costs. These surplus earnings arise when earnings on retirement system investments exceed current funding obligations. Under the terms of agreements negotiated with the retirement association, the county has been using surplus retirement system investment earnings to pay for current pension obligations and retired employee health insurance premiums. As noted in our February 1998 report, the unused surplus earned through June 30, 1997, will be about $900 million, presuming the county uses $300 million in 1997-98 as planned. This amount will grow by any additional surplus earned through June 30, 1998, which data on actual costs through March 1998 suggest is likely.

Although surplus investment earnings will likely be available past 2000-01, this source of funding will not be available indefinitely.

In 1996-97, the county used about $300 million of the surplus and expects to use the same amount in 1997-98. In addition, a recent correction of errors in the method used to value retirement system assets and liabilities may increase the employer's share of contributions by as much as $40 million annually. This could place an additional burden on the use of the accumulated surplus earnings. Because the surplus earnings will likely be available past 2000-01, we did not reflect the loss of them in Table 1. However, it is important to note that this source of funding will not be available indefinitely.

Increases in Net Costs Add to the Burden on General Purpose Revenues

In addition to the loss of program-specific revenues, the county faces net cost increases that will add to the burden on general purpose revenues. Specifically, employee salaries and debt service on pension obligations will rise an estimated $319 million based on approved agreements with employee unions and debt service schedules. These rising costs will be partially offest by a reduction of $91 million in the amount of general purpose revenues required to fund trial court operations. In addition to employee salary and debt service costs, overtime costs exceeding budgeted amounts continue to burden general purpose revenues. Finally, the county will probably have to use some general purpose revenues to pay for the costs of needed capital improvements. As a result, net cost increases will add $228 million to the burden on general purpose revenues by 2000-01, and other pressures, such as the cost of needed capital improvements, could add even more. Table 2 combines the effect of these cost changes with the impact of revenue losses shown earlier in Table 1. The combined result indicates that the county could face a budget shortfall exceeding $308 million by 2000-01.

Table 2

Increases in Net Costs Add to Possible Budget Shortfall By 2000-01 (In Millions)

Projected shortfall from program revenue loss (Table 1)	$ (80)
Impact of changes in net county costs	
Increased salaries	(298)
Increased pension debt service	(21)
Reduced trial court requirements	91
Net additional shortfall	(228)
Total Projected Shortfall By 2000-01	**$(308)**

Approved Salary Increases Will Incrementally Add to Costs Through 1999-2000

We estimate that recently approved salary and benefit increases will cumulatively increase net county costs covered by general purpose revenues by approximately $298 million by 2000-01. In February 1998, we reported that the Board of Supervisors began to approve salary increases for employee bargaining units. At that time, the county projected $50 million in increased salary costs for fiscal year 1997-98. Since our February 1998 report, the board has continued to approve salary increases, resulting in approved salary increases for 44 of the 54 total bargaining units. In addition, the county reached tentative agreements with nine units and is in negotiation with the remaining unit. The board also approved salary increases for the employees not represented by bargaining units, which make up approximately 8 percent of the county's total workforce. The terms of the salary increases vary by bargaining unit. The salary increase for nonrepresented employees is generally representative of the approved increases for the 44 bargaining units. These terms provide for semiannual increases, totaling 12 percent, to occur starting January 1, 1998, and ending January 1, 2000.

Salary increases will add about $298 million to net county costs by 2000-01.

Since salaries and employee benefits account for a large portion of the county's total expenditures, the cumulative impact of the salary increases on the county's fiscal outlook is significant. Specifically, salary increases not offset by reductions in other expenditures or increases in funding increase net county costs (NCC), and must be funded by general purpose revenues. The county has not yet estimated the impact of the salary increases on NCC for all of the fiscal years affected. Because of the potential significance of these increases, we developed estimates of the cumulative NCC of the salary increases. To calculate our estimate, we used the salary increase schedule approved for the non-represented employees since it is representative of the increases approved for all of the bargaining units. We also based our estimate on percentages the county's Chief Administrative Office (CAO) provided to us that represent the amount of increase to NCC for every 1 percent salary increase. In total, we expect the cumulative effect of the salary increases will be about $298 million by 2000-01, as shown in Table 2.

Debt Service on Existing Pension Obligations Will Rise Through 2000-01 and Beyond

The county continues to pay principal and interest on debt issued in 1986 and during 1994-95. Specifically, the county issued pension obligation certificates in 1986 to raise cash to pay pension benefits to a specific group of county retirees. In addition, the county sold pension obligation bonds during 1994-95 to pay its unfunded liability to the retirement system. According to the county's Comprehensive Annual Financial Report for fiscal year 1996-97, the county's funding requirements for all outstanding pension bonds and certificates will be about $221 million in 1997-98 and will increase every year thereafter through 2006-07. Based on county data used to calculate the burden of salary and benefits on general purpose revenues, we estimate that about 38 percent of the annual principal and interest payments needs to be covered by general purpose revenues. By 2000-01, we expect this increasing burden will exceed the 1997-98 amount by about $21 million, as shown in Table 2.

Change in Trial Court Funding Reduces Net County Costs

The county estimates that it will reduce its fiscal year 1998-99 net cost by $91 million because of changes in trial court funding enacted in 1997. Chapter 850, Statutes of 1997, transferred the responsibility for trial court operations from the counties to the State and established each county's required contribution to fund these operations. Since these costs are not expected to grow by fiscal year 2000-01, we reflect a savings of $91 million in Table 2.

Overtime Costs In Excess of Budgeted Amounts Add to the Strain on General Purpose Revenues

Countywide overtime expenditures have exceeded the budget by $56 million to $69 million a year for fiscal years 1994-95 through 1996-97.

The county continues to have difficulty in controlling overtime costs. In our February 1998 report, we noted that countywide overtime expenditures have exceeded the budget by $56 million to $69 million each year for fiscal years 1994-95 through 1996-97. We also estimated that if the current trends continued, the county would pay $240 million in these expenditures by the end of fiscal year 1997-98, $67 million over its budget. Based on its five-month budget status report, the CAO now estimates that the overtime budget will be overspent by about $62 million for fiscal year 1997-98. While this amount is slightly less than we previously estimated, these costs are still significant. Departments that exceed their overtime budgets must offset these excess costs with savings elsewhere in their budgets, such as salary savings from unfilled budgeted positions. However, to the extent that the county is unable to offset or cut costs or find additional sources of revenue, these excess costs become a burden on general purpose revenues. In our February 1998 report, we also noted that filling vacant positions in county departments for which funds have been budgeted could help reduce overtime expenditures. In the Appendix we provide an update on the status of vacancies for key departments.

General Purpose Revenues May Be Needed to Pay for Capital Improvements

Needed improvements to the county's buildings and facilities will likely contribute to some increase in net county costs to the extent that general purpose revenues are used to pay for projects, or for debt service on obligations incurred to finance these projects. According to the Capital

Because the county needs to replace its aging and inadequate office facilities, the possible solutions will likely strain general purpose revenues.

Projects/Refurbishments Addendum to the 1997-98 Proposed Budget, the county has a continuing unmet need to replace its aging and inadequate general office facilities. The addendum also points out that limitations on available capital projects financing and diminished levels of local funding have caused the county to focus its capital plans on projects of immediate need, projects that produce offsetting cost efficiencies, or projects mandated by the courts. For example, while the population of inmates in county detention facilities continues to grow, additional capacity is scarce and there is clearly a need for more jail space. The sheriff's inmate population is projected to grow from about 19,900 in 1996-97 to 23,800 in 1998-99. During the same period, however, recommended capacity for the facilities has remained flat at 13,900. In another example, as we reported in our February 1998 report, the board has approved a $903 million plan to replace facilities at the Los Angeles County/University of Southern California Medical Center that were damaged in the 1994 Northridge earthquake. Although it expects to receive about $463 million in state and federal funds for this project, the county will have to pay the remaining $440 million. To finance its share of the project, the county plans to issue debt that will likely require some use of general purpose revenues to retire. While we are not able to quantify all the costs related to needed capital improvements, the possible solutions will likely add a burden on general purpose revenues.

Conclusion

General purpose revenues in Los Angeles County are expected to grow by $300 million through 2000-01. However, we do not expect this growth to keep pace with potential losses of other funding totaling $380 million and net increasing costs that may exceed $228 million. The county will therefore likely face a budget shortfall exceeding $308 million by 2000-01. In addition, after 2000-01, the county must deal with the loss of about $300 million in surplus retirement system earnings. These conditions are exacerbated because of the county's limited discretion over the use of general purpose revenues. As a result, it will continue to be a challenge for the county to achieve balanced budgets.

Recommendations

The county should continue to closely monitor each department's budget to help ensure that each department does not exceed its budgeted net county costs and that the county continues to meet its overall budget. In addition, the county should continue to seek long-term solutions to its budget difficulties, paying particular attention to ways it can enhance its discretionary revenues while limiting increased burdens on these revenues.

We conducted this review under the authority vested in the California 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

KURT R. SJOBERG
State Auditor

Date: April 30, 1998

Staff: Steven Hendrickson, Audit Principal
John F. Collins II, CPA
Sylvia See

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Appendix

Status of Issues Noted in Our Four Previous Audits of Los Angeles County's Budget

We issued four previous reports, one each in March and November 1996, one in March 1997, and another in February 1998 addressing the Los Angeles County (county) budget. In this appendix, we review the status of key issues from these reports.

The County Obtained Time Extensions From the Federal Emergency Management Agency to Secure Additional Funding

In February 1998, we reported that $422 million of state and federal disaster aid was in jeopardy pending approval of time extensions from the Federal Emergency Management Agency (FEMA). This funding, expected to offset costs to replace critical care structures damaged in the January 1994 Northridge earthquake, was in jeopardy because the county was not meeting the construction deadlines set by FEMA. We reported that the county submitted a request in January 1998 for a deadline extension to the year 2007. Although FEMA did not grant this request, it did extend the deadline to January 2003 and indicated that further extensions should not be a concern as long as the county makes progress. It therefore appears likely that the county will receive the entire $422 million in federal funding.

Vacancies Continue to Contribute to Overtime Expenditures

As noted earlier, the county expects to exceed its overtime budget by $62 million in fiscal year 1997-98. In February 1998, we reported that unfilled vacancies contribute to excessive overtime expenditures. Specifically, we cited a county study acknowledging that the Probation Department could save at least $2.5 million a year in overtime costs by filling existing vacancies.

At the Probation Department, the Sheriff's Department, and the Department of Children and Family Services (DCFS), we reviewed the county's efforts in filling vacancies. These three departments combined represent over 90 percent of the $62 million by which the county expects to exceed its fiscal year 1997-98 overtime budget. We found that both the Sheriff's Department and the DCFS have successfully reduced vacant positions in fiscal year 1997-98. While the Probation Department has not been successful in reducing its vacancies, it has developed a detailed hiring plan and is in the early stages of implementing it. We expect that as the county continues to fill its vacancies, it will reduce its overtime expenditures.

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David E. Janssen
Chief Administrative Officer

April 21, 1998

Kurt R. Sjoberg, State Auditor
Bureau of State Audits
660 J Street, Suite 300
Sacramento, California 95814

Dear Mr. Sjoberg:

RESPONSE TO PHASE V COUNTY AUDIT

Thank you for the opportunity to comment on the draft version of the Phase V audit that you have conducted of the County of Los Angeles, pursuant to Chapter 518, Statutes of 1995. This is the fifth and final audit required consistent with legislative authorization transferring $50 million in Metropolitan Transportation Authority funds to the County General Fund for fiscal year 1995-96 budget. The audit also notes the status of two fiscal issues addressed in previous audit reports.

This last audit takes a forward look at the County through 2000-01. It includes a revenue forecast showing a $300 million increase in general purpose revenues. It cites changes in program specific revenues and changes in costs resulting in a projected budget shortfall of $308 million by 2000-01. The audit further notes that the County has faced projected shortfalls in past years and has always produced a balanced budget.

We concur with the audit recommendations which reflect the County's ongoing practices. These include closely monitoring each department's overall budget to ensure the County continues to meet its overall budget, and seeking long term solutions to budget difficulties. In this regard, the 1998-99 Proposed Budget, adopted by the Board of Supervisors on April 21, 1998, includes a plan to begin eliminating the County's reliance on excess pension funds to finance its ongoing programs. We are additionally continuing to finalize our multi-year budget planning/forecasting effort which will include projections for revenues and costs for two years beyond the "Proposed Budget" year, and refined projections for the impact of negotiated salary increases. Further, the Department of Health Services is developing a post 1115 Waiver plan to address this potential revenue loss, and we continue to support Federal and State legislative solutions to maximize revenues and/or prevent revenue losses. Regarding the loss of some Disproportionate Share Hospital (DSH) funding identified in the audit report, the County is supporting AB 2087 (Gallegos) to maximize DSH revenues and has also testified in support of elimination or further reduction of the State's administrative fee for this program.

The 1998-99 Proposed Budget also begins to address capital improvements and refurbishment needs that County has been unable to address for the past several years, as noted in the audit report.

Once again, we appreciate this opportunity to comment on your draft audit report.

Sincerely,

DAVID E. JANSSEN	ALAN SASAKI
Chief Administrative Officer	Auditor-Controller

DEJ:AS
bjs

c: Each Supervisor

cc: Members of the Legislature
Office of the Lieutenant Governor
Attorney General
State Controller
Legislative Analyst
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
Capitol Press Corps