



## **SAN MATEO COUNTY FINANCIAL REPORTING: TOWARD CLARITY AND TRANSPARENCY**

### **SUMMARY**

As a result of the recent financial crisis, San Mateo County government has faced serious financial challenges over the past few years and will continue to do so in the years ahead. In order to assess how County officials are addressing these challenges, residents need to understand the County's finances. The financial information now produced by the County is so voluminous and complicated that the public cannot easily understand it. The County and the County Controller need to issue easily understood financial reports that focus on major elements of the County's finances.

The Grand Jury finds that the public benefits from thorough yet understandable financial reporting. It further finds that highlighting certain major financial elements in the County's budget (Budget) and Popular Annual Financial Report (PAFR) would make the County's finances more understandable.

The Grand Jury recommends that the Budget and PAFR report certain major financial elements in one location in a simple, straightforward manner. Examples of these elements include the total County resources (revenues), total employee payroll, and the total cost of benefits received by employees, each of which is currently not reported or is very difficult to discern.

### **GLOSSARY**

Board of Supervisors – The governing body of San Mateo County that approves and adopts the Budget. Supervisors are officials elected independently from the Controller.

Controller – San Mateo County Controller. The Controller is elected independently from the Board of Supervisors.

County – The geographic area of San Mateo County, California, or the government of the County, appropriate to the context in which it is used.

Budget – *County Adopted Budget*.

CAFR – *County Comprehensive Annual Financial Report*.

PAFR – *County Financial Highlights*, also known as the *County Popular Annual Financial Report*.

Excess ERAF – Excess Educational Revenue Augmentation Funds. Excess ERAF is generated when ERAF funds exceed school funding requirements. The County began receiving excess

ERAF in FY 2004.<sup>1</sup>

Fiscal year or FY – The period July 1 through June 30. For this report, a fiscal year will be referred to by the year in which it ends, e.g. FY 2012-2013 is FY 2013.

SamCERA - The San Mateo County Employees Retirement Association, the County's retirement system, established in 1944. SamCERA is a defined benefit pension plan for substantially all permanent County employees, the County Mosquito and Vector Control District, and the Superior Courts of the County. SamCERA is an independent legal entity separate from the County.

## BACKGROUND

The Board of Supervisors approves the Budget and is the spending “roadmap” for the upcoming fiscal year. The Budget for FY 2013 is 336 pages long, appropriates \$1.9 billion, and has approximately 1200 separate financial accounts.

Unlike the Budget, the Controller prepares the CAFR and PAFR. The primary purpose of the CAFR is to report how the County has performed financially in the past. The CAFR for FY 2012 is 183 pages long. The PAFR is “the ‘Reader's Digest’ version of [the] Comprehensive Annual Financial Report, summarized for readability and perspective.”<sup>2</sup> Yet because less than three out of ten pages of the PAFR for FY 2012 address the County's finances, information that is important to understanding those finances is missing.

Given the sheer volume and complexity of financial information contained in the Budget, CAFR, and PAFR, it is difficult for the public to grasp the “big picture” regarding the County's finances. Without such a grasp, the ability to evaluate the County's financial performance and the possible need for service cuts or additional revenues is diminished. The Grand Jury reviewed these materials in the course of other investigations and found them difficult to understand. As a result, the Grand Jury recommends changes that would make the County's financial reporting more understandable by the public.

## METHODOLOGY

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<sup>1</sup> “In 1992, the State of California found itself in a serious deficit position. To meet its obligations to fund education at specified levels under Proposition 98, the state enacted legislation that shifted partial financial responsibility for funding education to local government (cities, counties and special districts). The state did this by instructing county auditors to shift the allocation of local property tax revenues from local government to “educational revenue augmentation funds” (ERAFs), directing that specified amounts of city, county and other local agency property taxes be deposited into these funds to support schools.” League of California Cities, *Fact Sheet: The ERAF Property Tax Shift*, <http://www.californiacityfinance.com/ERAFfacts.pdf> (April 11, 2013).

<sup>2</sup> <http://www.co.sanmateo.ca.us/portal/site/controller/menuitem.1f860392596ef25b74452b31d17332a0/?vgnextoid=8f590f68ed180210VgnVCM1000001d37230aRCRD&vgnnextfmt=DivisionsLanding> (April 2, 2013)

## Documents

- Budget for FY 2013
- CAFR for FY 2012
- PAFR for FY 2012

## Interviews

- The Grand Jury interviewed appropriate officials from the County administration and the Controller's office.

## Online Sources

- The Grand Jury consulted various online sources relating to financial reporting.

## DISCUSSION

### Awards For County Financial Reporting

The Government Finance Officers Association of the United States and Canada (GFOA) has awarded the County its "Distinguished Budget Award" for FYs 2005 - 2011. The County did not apply for FY 2012 due to significant budget changes but did apply for FY 2013. Recipients of the award for FY 2013 have not been announced as of the approval of this report. Only persons with "experience in governmental budgeting" are invited to apply as reviewers, however.<sup>3</sup> Members of the general public do not participate in the award process.

Separately, the GFOA has awarded the Controller's Office for 13 consecutive years the "Certificate of Achievement for Excellence in Financial Reporting." Understandability of the CAFR by the general public is not a criterion for the award. Reviewers of CAFRs are experts in government finance.<sup>4</sup> Members of the general public do not participate in the award process.

The GFOA has awarded the Controller's Office for ten consecutive years the "Outstanding Achievement in Popular Annual Financial Reporting" for its PAFR. Reviewers of PAFRs "should possess a solid understanding of governmental accounting and financial reporting...."<sup>5</sup> Members of the general public do not participate in the award process.

The judging of financial reports is inherently subjective and is determined, in part, by the criteria utilized and the background of the reviewer. For example, the state of California and the cities of Los Angeles and Sacramento each received the GFOA's Certificate of Achievement for Excellence in Financial Reporting for 2010.<sup>6</sup> Yet CALPIRG, an "independent voice that works

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<sup>3</sup> <http://www.gfoa.org/downloads/GFOADistinguishedBudgetDetails2013.pdf> (April 20, 2013).

<sup>4</sup> <http://www.gfoa.org/downloads/CAFREligibilityReviewer.pdf> (April 20, 2013).

<sup>5</sup> <http://www.gfoa.org/downloads/PAFREligibilityReviewer.pdf> (April 20, 2013).

<sup>6</sup> [http://www.gfoa.org/index.php?option=com\\_wrapper&Itemid=786](http://www.gfoa.org/index.php?option=com_wrapper&Itemid=786) (April 20, 2013).

on behalf of the public interest”<sup>7</sup> gives the following grades to these governments for transparency in spending:<sup>8</sup>

- California – F
- Los Angeles – C-
- Sacramento – F

The County’s financial reporting has not been evaluated by CALPIRG.

The point is, while the GFOA’s recognition of the Budget, CAFR, and PAFR is laudable, it does not mean they cannot be improved.

### Improving County Financial Reporting

What is the County’s total annual payroll? What does the County spend each year to pay down SamCERA’s unfunded liability? What is the County’s total annual cost to provide benefits such as health coverage to its employees and retirees? What are the trends for these expenses over the past few years? The answers to these and many other important financial questions cannot be found easily or at all in the Budget, CAFR, or the PAFR.

This report makes a number of recommendations regarding financial reporting form and substance that would make County finances more understandable. Below is a brief explanation of the information the Grand Jury recommends the County and the Controller report in the Budget and PAFR, respectively. The reference numbers, e.g. R1a and R2a, refer to the reference numbers in the Recommendations section at the end of this report. In most instances, the Grand Jury has recommended that five years of information be provided so that trends can be observed.

#### **Requested Financial Information**

<b>RECOMMENDATION NUMBER</b>	<b>EXPLANATION</b>
R1a and R2a	Requests reporting of all sources of revenue. The Grand Jury has learned that the Budget does not report all revenue that the County anticipates receiving during a given fiscal year. For example, for FY 2013, the County anticipated receiving approximately \$40 million in Excess ERAF revenue that was not shown in the Budget. In fact, this additional,

<sup>7</sup> <http://www.calpirgedfund.org/page/caf/about-calpirg-education-fund> (April 20, 2013).

<sup>8</sup> [http://www.calpirg.org/news/cap/new-report-california-receives-%E2%80%9Cf%E2%80%9D-annual-report-transparency-government-spending?\\_utma=1.775119842.1366460629.1366460629.1366460629.1&\\_utmb=1.12.10.1366460629&utmci=1&\\_utmx=&\\_utmz=1.1366460629.1.1.utmcsr=google|utmccn=%28organic%29|utmcmd=organic|utmctr=%28not pr](http://www.calpirg.org/news/cap/new-report-california-receives-%E2%80%9Cf%E2%80%9D-annual-report-transparency-government-spending?_utma=1.775119842.1366460629.1366460629.1366460629.1&_utmb=1.12.10.1366460629&utmci=1&_utmx=&_utmz=1.1366460629.1.1.utmcsr=google|utmccn=%28organic%29|utmcmd=organic|utmctr=%28not pr) (April 20, 2013).

RECOMMENDATION NUMBER	EXPLANATION
	unreported Excess ERAF revenue is now \$53 million. An accurate report of all anticipated revenues is imperative to an understanding of the County's true financial picture.
R1b and R2b	Requests that all "requirements" (expenditures) be reported. This is already done, but it would be useful to report this amount adjacent to the report of all revenues.
R1c and R2c	Requests reporting of increases or decreases in the County's "rainy day fund" reserves, i.e., unrestricted monies that may be used by the County for any purpose. This information is useful in determining the County's financial health. This information is currently reported in the CAFR but is not easily accessed.
R1d and R2d	Requests reporting of significant non-recurring revenues and expenditures. This information is useful in understanding increases or decreases in the County's reserves.
R1e and R2e	Requests <i>per capita</i> calculations that would help County residents put into perspective the cost of County government. This information is not currently reported.
R1f and R2f	Requests the ten largest County expenses by category, e.g., employee payroll, employee benefits, amortization of unfunded liabilities, debt service, etc. This tells the reader where the County spends the bulk of its dollars by category. This information is not currently reported in this format.
R1g and R2g	Requests the ten largest County expenses by department, e.g., Sheriff's Office, Behavioral Health and Recovery Services, Human Services Agency, etc. This tells the reader where the County spends the bulk of its dollars by department. This information is not currently reported in this format.
R1h and R2h	Requests the number of County workers in each of four categories. This will help the reader understand the County's employment trends. This information is not currently reported or is difficult to discern.
R1i and R2i	Requests the total County payroll. The County payroll for FY 2013 is over \$400 million and is one of, if not the, largest County expenses. This information is not currently reported.
R1j and R2j	Requests the total cost to the County of benefits paid to County employees. The total cost of benefits comprises another large County expense and is not currently reported.
R1k and R2k	Requests the total payments to contractors providing services to the County, excluding contractors making capital improvements. This information would be one measure of the extent to which the County outsources services. As

RECOMMENDATION NUMBER	EXPLANATION
	reported by the 2011-2012 Grand Jury, outsourcing is one means by which to rein in retirement costs. <sup>9</sup> This information is not currently reported.
R1l and R2l	Requests the amounts of the County's unfunded liabilities such as that owing to SamCERA. This information is currently reported, but should be included in the information sought here because of the next request for information.
R1m and R2m	Requests the amount paid solely to amortize each of the reported unfunded liabilities. These payments, especially to SamCERA (\$92.5 million in FY 2013), are a large part of the budget. Knowing these amounts helps in understanding the present cost of past commitments. This information is not currently reported.
R2n -	Requests from the Controller the combined total of the end of year amounts of the unrestricted reserves. These reserves are an indicator of the County's financial health. This information is not currently reported in this format.
R2o	Requests from the Controller the increase or decrease in net assets, another measure of the County's financial health.

This list of important financial information is not exclusive. There may be, and probably is, additional financial information that would be beneficial. That said, there is a balance between providing so much information that the public cannot understand it and providing so little as to be uninformative. The Budget and CAFR fall into the first category, the PAFR into the second.

It should be noted that representatives of the County and the Controller's office were cooperative and forthcoming during the Grand Jury's investigation. They acknowledged that the County's financial reporting is complicated and not easily understood by the general public and welcomed the Grand Jury's effort to bring clarity to the County's financial picture.

## FINDINGS

- F1. The public benefits from financial reporting that is thorough, yet understandable.
- F2. Highlighting certain major financial elements in the Budget would make the County's financial reporting more understandable.
- F3. Highlighting certain major financial elements in the PAFR would make the County's financial reporting more understandable.

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<sup>9</sup> Ibid.

## RECOMMENDATIONS

The Grand Jury recommends that the *County's Board of Supervisors* do the following:

- R1. Direct staff to prominently disclose in table and/or graph form in one location in the proposed and adopted Budget the following information for the budget year and the actual amounts for the previous four fiscal years:
- a. Total sources of funds, including, without limitation, Excess ERAF and any other so-called "one time" revenues
  - b. Total requirements (expenditures)
  - c. Total increase or decrease in General Fund Reserves
  - d. Identify non-recurring revenues or expenditures in excess of \$3 million (individually or in the aggregate) from one source or for one project
  - e. Budget amount per San Mateo resident, i.e. total requirements divided by the most current official estimate of County population
  - f. Ten largest County expenses by category (expenditure object) e.g., employee payroll, employee benefits, amortization of unfunded liabilities, debt service, etc.
  - g. Ten largest County expenses by department, e.g., Sheriff's Office, Behavioral Health and Recovery Services, Human Services Agency, etc.
  - h. Total number of workers providing services to the County in each of the following categories
    1. Classified
    2. Unclassified
    3. Temporary/Extra Help/Intern
    4. Volunteers
  - i. The total payroll for all County employees
  - j. The total cost to the County of all benefits to all County employees
  - k. Total payments to contractors providing services to the County, excluding contractors making capital improvements
  - l. The following unfunded liabilities:
    - i. SamCERA, both as calculated by SamCERA's actuary and calculated using a "risk free" rate of return
    - ii. Other Post Employment Benefits (OPEB)
    - iii. Any other unfunded liabilities not associated with bonded indebtedness
  - m. The amount paid solely to amortize each of the unfunded liabilities listed in the preceding subparagraph

The Grand Jury recommends that the *County Controller* do the following:

- R2. Prominently disclose in table and/or graph form in one location in the PAFR the following information, on an accrual basis, for the current and previous four fiscal years:
- a. Total sources of funds, including, without limitation, Excess ERAF and any other so-called “one time” revenues
  - b. Total requirements (expenditures)
  - c. Total increase or decrease in the combined total of the following General Fund accounts: Committed, Assigned, and Unassigned
  - d. Identify non-recurring material (as defined by the Controller and individually or in the aggregate) revenues or expenditures from one source or for one project (expenditure object)
  - e. Total “general revenues, extraordinary item, and transfers” per San Mateo resident, i.e. the sum of these items divided by the most current official estimate of County population
  - f. Ten largest County expenses by category (expenditure object), e.g., employee payroll, employee benefits, amortization of unfunded liabilities, debt service, etc.
  - g. Ten largest County expenses by department, e.g., Sheriff’s Office, Behavioral Health and Recovery Services, Human Services Agency, etc.
  - h. Total number of workers providing services to the County in each of the following categories
    1. Classified
    2. Unclassified
    3. Temporary/Extra Help/Intern
  - i. The total payroll for all County employees
  - j. The total cost to the County of all benefits to all County employees
  - k. Total payments to contractors providing services to the County, excluding contractors making capital improvements
  - l. The following unfunded liabilities:
    - i. SamCERA, both as calculated by SamCERA’s actuary and calculated using a “risk free” rate of return
    - ii. Other Post-Employment Benefits (OPEB)
    - iii. Any other unfunded liabilities not associated with bonded indebtedness
  - m. The amount paid solely to amortize each of the unfunded liabilities listed in the preceding subparagraph
  - n. The combined total of the end of year amounts of the following General Fund accounts: Committed, Assigned, and Unassigned.
  - o. Total increase or decrease in net assets



## REQUEST FOR RESPONSES

Pursuant to Penal Code Section 933.05, the Grand Jury requests the following to respond to the foregoing Findings and Recommendations, referring in each instance to the number thereof:

- County Board of Supervisors
- County Controller

The County Board of Supervisors should be aware that its comment or response must be conducted subject to the notice, agenda, and open meeting requirements of the Brown Act.

Reports issued by the Civil Grand Jury do not identify individuals interviewed. Penal Code Section 929 requires that reports of the Grand Jury not contain the name of any person or facts leading to the identity of any person who provides information to the Civil Grand Jury.
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