



SPECIAL FUND BALANCE RECONCILIATION

August 3, 2012

OVERVIEW

When special fund reporting discrepancies were discovered at the Department of Parks and Recreation (Parks), Governor Brown immediately directed the Department of Finance (Finance) to undertake a fund-by-fund review of the more than 500 special funds. Finance's review focused on two principal areas:

- The extent to which there were differences in special fund balances as of June 30, 2011, that were reported by departments to Finance and to the State Controller's Office (SCO)
- The reason or reasons for any variance in the two reported year-end balances.

The total amount of special fund balances reported by the SCO as of June 30, 2011—the end of the 2010-11 fiscal year—was \$12.5 billion. However, the total amount of special fund balances reported at that same point by Finance was \$8.8 billion. In order to get an accurate comparison of these totals, two adjustments have to be made:

- First is the treatment of encumbrances—goods that are ordered, but not received, by the end of a fiscal year (\$3.7 billion).
- Second is an adjustment for a 2010-11 budgetary solution that deferred the state payroll cost across two fiscal years, moving it from June 30, 2011 to July 1, 2011 (\$407 million).

These are the same adjustments that were used to calculate the true difference in fund balances for the Parks special funds.

With these adjustments, the comparable SCO total as of June 30, 2011 was \$8.4 billion—meaning that Finance's balances at that point were \$415 million higher. The \$415 million represents 4.7 percent of the fund balance total reflected by Finance.

Differences are primarily due to methodology and timing. Human error also contributed to the differences. Specifically:

- Methodology differences between the two offices account for \$164.3 million (1.9 percent of the total fund balance). This is the net of differences that are \$1.4 billion higher offset by differences that are \$1.3 billion lower. The largest differences are in transportation funds, the Fiscal Recovery Fund, and the Proposition 63 Mental Health Services Act Fund. For example, transportation funds are displayed in the SCO documents on a modified accrual basis—when the fiscal year revenue is earned, measurable and available and when the expenditure obligations are incurred. In budget documents, transportation funds are reported on a cash basis.
- Timing of transfers and other posting differences account for \$77.2 million (0.9 percent of the total fund balance). This is the net of differences that are \$218.4 million higher offset by \$141.2 million lower.

- Errors account for a minus \$196.7 million (2.2 percent of the total fund balance). This is the net of differences that are \$35.9 million higher offset by \$232.6 million lower. The largest errors are in the Beverage Container Recycling Fund (\$113.3 million) and the Restitution Fund (\$28.8 million).
- The Public Utilities Commission's funds vary by \$422.7 million (4.8 percent of the total fund balance).
- Parks and Recreation Funds vary by minus \$53.9 million (0.6 percent of the total fund balance).

Reporting of past year-end balances in special funds from departments to Finance is one of a number of steps that are used in the budget process to determine the funding level for the upcoming fiscal year. The primary budget control mechanism is the appropriation level from each fund contained in the annual Budget Act. To that end, proposed expenditures and revenues are reviewed against historical records—both prior budgets and prior expenditures.

To date, year-end special fund balances have been reported to Finance by departments' staff. Designated fund administrators of special funds are responsible for managing and administering these funds. Finance reconciles General Fund and fund administrators reconcile special funds.

Additional policies and procedures will be implemented to address differences in the fund balances reported to Finance and the SCO. Finance and the SCO will coordinate these efforts to maximize efficiency and effectiveness. Specifically, relevant data will be shared at the time the Budget is being developed and there will be new quality control efforts. Beginning with the 2013-14 January Budget, Finance and departments will reconcile special funds in collaboration with SCO. This reconciliation will be consistent with what already occurs with the General Fund.

ADDITIONAL SPECIAL FUND REFORMS ALREADY UNDERWAY

Last December, the Governor issued an Executive Order directing the Department of Finance to modify the state's traditional budget processes, and incorporate such measures as zero-based budgeting, strategic planning, and cost-benefit analyses. The Executive Order covered not only general fund departments but special fund departments as well. The Administration's efforts are well underway, and significant and substantial changes have already been made:

- State support for the Caltrans' Mass Transportation Program has been zero-based—meaning each of the program's expenditures must now be justified on an annual basis. As a result, 44 positions were identified as unnecessary.
- The Department of Toxic Substances Control has been zero-based. As a result, the program was refocused, the fund was brought into structural balance—increasing efficiency and providing funding for high-priority activities under the Safer Consumer Products Program.
- In the coming year, Finance has identified three large state agencies that oversee significant amounts of special funds—Caltrans, the Department of Consumer Affairs, and the Department of Public Health—and are reviewing their operations and identifying ways to make them more efficient as part of a zero-based budget effort. Additional agencies will be reviewed each year.
- Administrative cuts were made to special funds. Historically the focus has only been on reductions to the general fund.
- A number of departments with special funds were directed to reduce appropriations to a level where service would not be negatively impacted yet rates charged to other agencies would be reduced (Department of General Services and Office of Technology Services).