EXECUTIVE SUMMARY

Results of FY 2010-11 Operations

As of August 1, General Fund Revenues are $3,431,401 versus Expenditures of $3,638,113, a net deficit of $206,712.

The year end close process must be completed before the final results are complete. Although adjustment of both revenues and expenses will produce a different final result, no major changes are expected.

With the FY 2010-11 Mid Year Budget, the General Fund was adjusted to $3,533,579.

		Actual	Budget	Budget
	GENERAL FUND	*FY 2010-11*	*FY 2011-12*	*FY 2012-13*
NOTE	BEGINNING CASH RESERVES	765,610	558,898	558,898
	REVENUES	3,431,401	3,393,452	3,527,760
1	INCREASE TO SALES TAX REVENUE		36,355	38,233
	OPERATING TRANSFERS IN		113,712	76,833
2	TRANSFER IN FROM LANDFILL RESERVES		150,000	
	EXPENDITURES	(3,638,113)	(3,693,519)	(3,793,393)
	OTHER ITEMS			
	INCREASE (DECREASE) TO RESERVES	(206,712)	0	(150,567)
	ENDING CASH RESERVES	558,898	558,898	408,331

Note 1, a revision of Sales Tax Revenue to the Recommended Budget document, and
Note 2, transfer in from Landfill reserves, already incorporated in the Recommended Budget document.

The FY 2010-11 Revenues are under the Budget forecast by 2.9%, while expenses exceed the Budget projections by 3%.

FY 2011-12 & 2012-13 City of Rio Vista Biennial Operating Budget

General Fund

The FY 2011-12 & 2012-13 City of Rio Vista Biennial Operating Budget includes the best estimates of revenues and expenditures of all the City's funds. The City accounts for approximately 50 funds for the various services for which the City provides to the residents of the City of Rio Vista. Each of the funds has a separate set of accounts which are individually accounted for and individually presented. The budget document also contains summaries where funds are grouped by type. Furthermore, several summaries are provided herein so that a general overview of the overall Budget can be achieved.

The financial outlook for the City of Rio Vista for the next two (2) years is challenging as are the economic problems of public agencies throughout California and the nation. There are mixed signals that the economic downturn has leveled off and even that some areas of the economy are improving. However, the next two (2) years promise to be very challenging for the City of Rio Vista. The direct effect of the economic downturn to the City's General Fund is that a very precarious, fragile, and weakened operational result is facing the City for the two year period budgeted herein.

The Budget document indicates a General Fund shortfall of $36,355 for FY 2011-12. However, an upward revision in the Sales Tax Revenue is recommended as more recent information supports an increase that eliminates the deficit, and reducing the deficit forecast in FY 2012-13 to $150,567. See Sales Tax Revision shown below:

SALES TAX REVISION	FY 2011-12	FY 2012-13
Revised Sales Tax Revenue	661,355	725,733
Proposed Budget	625,000	687,500
Potential Increase to Sales Tax	36,355	38,233

Property Tax Revenues

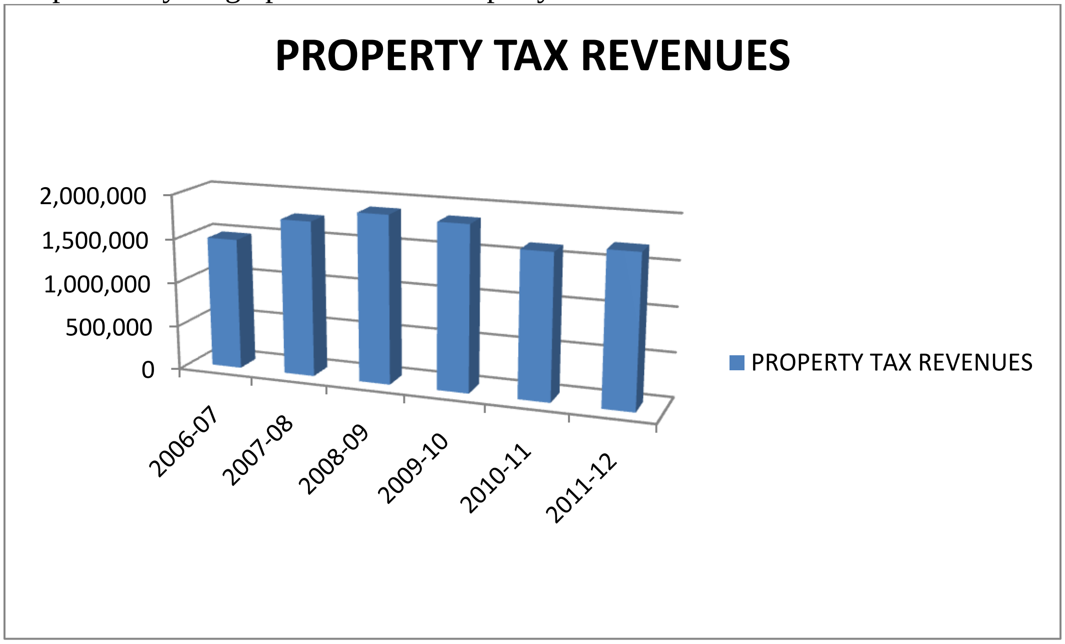
Property Tax Revenues account for 49% of FY 2011-12 General Fund Revenues. The average for the previous 5 years is 31%. There are two main reasons for the drastic change in ratio, 1) other non-tax revenues have dropped considerably during that time period, and 2) a concerted effort to remove capital grants from General Fund so that grants and capital projects do not impact net operating results. The latter is desired to improve budget monitoring of expenses in General Fund.

Property Tax Revenue peaked in FY 2007-08 but then dropped the next two years. In FY 2011-12, a forecast increase in Property Taxes Revenues will continue the downward trend of the previous three years. The FY 2011-12 forecast is $1,680,012, a 1.4% decrease from FY 2010-11, the smallest decrease of the last two declining years, and down 11.4% from the peak year FY 2007-08.

Table 3. Property Tax Revenues, a 5 year history.

FISCAL YEAR	2006-07	2007-08	2008-09	2009-10	2010-11
PROPERTY TAXES	1,757,230	1,895,501	1,859,089	1,703,248	1,680,012

Graph B. 6 year graph of Annual Property Taxes.



Sales Tax Revision

Sales Tax Revenues are the second largest revenue sources in General Fund. In FY 2011-12, the revised Sales Tax revenue accounts for 19% of the General Fund Revenues. The five year average of Sales Tax to General Fund Revenues is 18%. The most recent sales tax data from Muniservices, our reporting subscription service, confirms that a turnaround of local sales occurred in FY 2010-11. It further indicates that the turnaround trended up at an average 16.1% increase from the same period in the previous year for four quarters. Below is a graph and table showing our quarterly sales tax revenues since the 1st quarter of 2009. Note that the 4th quarter of 2009 is the lowest point of decline, after which a gradual upward trend is sustained until the 1st quarter of 2011. The forecast for local retail sales is an increase of 3.5% to 4.5% per year through the year 2015.

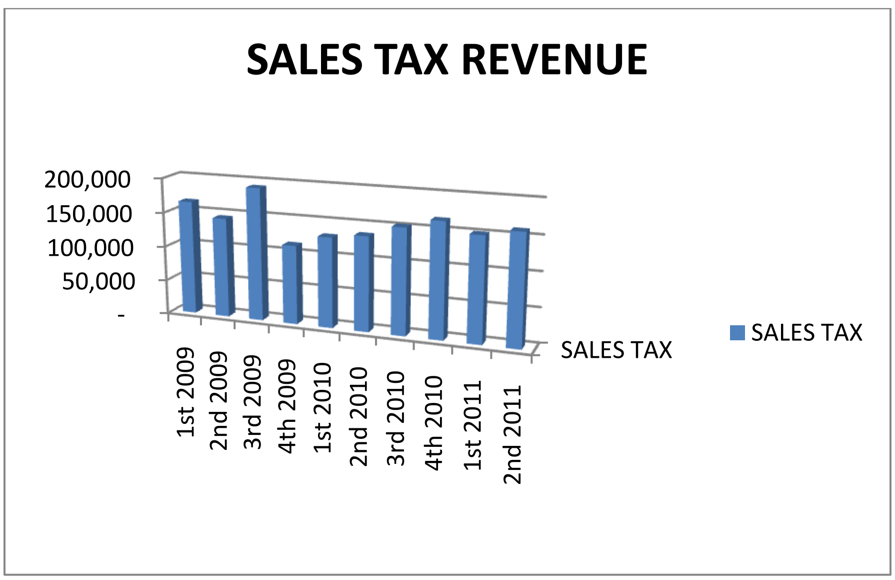
Table 1 below shows the quarterly "SALES TAX" payments received by City of Rio Vista.

Table 1. Quarterly Sales Tax.

QUARTER	SALES TAX
1st 2009	165,031
2nd 2009	144,494
3rd 2009	192,257
4th 2009	114,041
1st 2010	130,481
2nd 2010	136,589
3rd 2010	153,050
4th 2010	166,074
1st 2011	151,207
2nd 2011	160,190

Based on the revised forecast of FY 2011-12 Sales Tax revenues, the increase is expected to be $72,821 above the proposed Budget estimate. The data upon which the trend is based covers 8 quarters, 5 of actual history and 3 forecasts. To allow for the possibility that another downturn may occur during FY 2011-12, the revised forecast was reduced by approximately half, or the amount required to cover the deficit, $36,355.

Graph A. Quarterly sales tax revenues, 1ST Quarter 2009-2nd Quarter 2011 .



<u>Effect of Taxes on General Fund</u>

In FY 2011-12, Property Taxes and Sales Tax Revenues makeup 68% of the General Fund Revenues. Again, the result of the decrease in other revenues over the last few years, and trimming the capital projects from General Fund.

The remainder of General Fund Revenues are Franchise Fees,

<u>Transfer in from Landfill Reserves</u>

The General Fund Budget includes a $150,000 transfer in from Landfill Reserves in Fund 065. Since 1999, franchise fees for sanitation were deposited in Fund 065 rather than General Fund, to fund and track the landfill closure costs. The accumulation of reserves reached $300,000 in FY 2010-11; the required amount required to be reserved by State of California is under $150,000. Annual transfers can be made to General Fund for any excess buildup of reserve above the annually adjusted requirement.

<u>CDBG</u>

In Fund 036 CDBG, the Revenue item of $842,588 is expected to be received from HCD. Although, there is a proposed disallowance of grant expenditures, of approximately $85,000, the City does not agree with HCD findings and will put forth a challenge to the HCD findings. City expects to receive no less than $750,000.

<u>Cost Allocation Plan</u>

Introduction of Cost Allocation Plan

During the FY 2010-11Mid-Year Budget Review process it became evident that administration overhead charges to the General Fund were excessive and that a revision to the cost allocation process was necessary to determine a more equitable approach of allocating the cost of administrative support services. A re-allocation of certain General Fund expenditures was incorporated into the City's Mid-Year Budget at the time. The net of effect was a cost savings of $327,661 to General Fund.

Staff's review at the time focused on re-allocating administrative overhead expenditures charged to General Fund rather than evaluating the full cost of the City's administration overhead. The approach undertaken at Mid-year 2010-11 was necessary because of the limited time available to fully evaluate the data as entered into the City's accounting system. Secondly, the accounting information historically recorded in the City's general ledger system was entered in such a way that the detail needed for evaluation was not readily attainable. There is no basis for the percentage allocations previously utilized.

Continued tracking of operational costs in the same historical methods of the past produce higher than equitable administration overhead charges to the General Fund. In the past, General Fund afforded supporting other funds. However, in this lean times, the City must identify the "true" costs of all funds, and charge an equitable share throughout its array of funds and departments, and avoid charging General Fund more than is necessary.

For FY 2011-12, a full cost, comprehensive approach was undertaken to fully identify indirect, administrative charges. The full cost of administrative expenses subject to the cost allocation is $1,141,294. The net effect of applying the cost allocation plan is a net savings of $394,421 to General Fund.

During that Review, staff assessed only the administration overhead charged to the General Fund and determined that a re-allocation was necessary; at the time, the remainder of overhead charges were direct charged to other funds.

In the Budget document, there are various account with object code "6001" named "Admin OH Allocation" that show the effect in each affected department. Also, in the Attachment herein, a Cost Allocation Plan Summary will show the expenses subject to the Plan, the Basis for each allocation and the Rate applied.

Budgeting for Indirect Costs

Cost Allocation Plan

A Cost Allocation Plan will allow an Agency to fairly and completely allocate its administrative costs. This will allow the General fund to recover costs from all of the other funds and can also determine the overhead cost rates of staff providing fee services. General guidance on cost allocation for federal grant funded programs is provided from the Office of Management and Budget (OMB) through various circulars. For state, local and Indian tribal governments, OMB Circular A-87 applies.

A full cost plan, which uses the costs that the A-87 Plan disallows, is able to allocate all indirect costs like the private sector routinely does, including costs disallowed by an A-87 plan. This plan is recommended whenever the goal is to fully allocate indirect costs for interfund transfers and fee calculations which is routinely the case in public agencies.

Indirect costs are the costs for services shared by many programs within an entity. Frequently the terms "overhead" and "indirect" are used interchangeably. In OMB Circular A-87, indirect costs are defined as costs that are: "(a) incurred for a common or joint purpose benefiting more than one cost objective, and (b) not readily assignable to the cost objectives specifically benefitted, without effort disproportionate to the results achieved." Essentially, indirect costs are all of the remaining costs after the direct costs have been charged. It is possible to recover all cost without an indirect cost allocation plan, however, for most entities this is not be feasible.

Some activities such as facilities maintenance, payroll, and information technology do not lend themselves to direct charging. The additional burden of separately tracking and directly charging these costs to the various programs would far outweigh the benefit. At the other end of the spectrum would be to completely ignore indirect costs. Aside from the obvious inability to recover overhead on grant funded programs, by failing to recognize the cost of overhead the entity does not know the true cost of delivering services. Policy makers to make decisions as to what services will be provided without knowing the true cost.

Many entities underestimate the impact of indirect costs. In a climate of shrinking budgets and government continually being asked to do more with less, failing to recognize indirect costs can be a very costly mistake. Knowing the full cost of service is essential not only for requesting grant reimbursements but also for setting fees for services. A recent survey[1] of county cost allocation plans found an average indirect overhead rate of 24%.

The decision to implement a cost allocation plan is usually a question of whether or not the entity will recover more in overhead than it costs to develop and maintain the plan. Most organizations assume cost allocation plan development and maintenance will require significant resources. This may not necessarily be the case. Cost allocation models can range in complexity from a simple Excel spreadsheet to something more complex such as a full cost accounting module. Several vendors offer software specifically designed for calculating indirect overhead rates for federal grant reimbursements.

How complex does an allocation model need to be? The answer to this question depends on the complexity of the organization. A small city with annual expenditures of $10 million would not need anything more complex than a simple spreadsheet. In fact the OMB allows organizations receiving a small number of federal grants to use a simplified allocation methodology. The following excerpt from OMB circular A-87 describes the simplified allocation methodology:

“Where a grantee agency's major functions benefit from its indirect costs to approximately the same degree, the allocation of indirect costs may be accomplished by (1) classifying the grantee agency's total costs for the base period as either direct or indirect, and (2) dividing the total allowable indirect costs (net of applicable credits) by an equitable distribution base.
The result of this process is an indirect cost rate which is used to distribute indirect costs to individual Federal awards. The rate should be expressed as the percentage which the total amount of allowable indirect costs bears to the base selected. This method should also be used where a governmental unit's department or agency has only one major function encompassing a number of individual projects or activities, and may be used where the level of Federal awards to that department or agency is relatively small.”

The simplified method, much like other allocation methods, allocates costs proportional to an allocation base. Because the simplified methodology uses a single allocation base such as total direct costs or total direct salaries and wages, the rate calculation is very simple. The simplified method also has the advantage of not requiring the entity to track a great deal of additional data. For the most part the rate can be calculated using existing financial reports.

More complex organizations, or organizations having indirect functions disproportionally benefiting various programs, may need to adopt a multiple allocation base methodology. The overall approach is similar to the simplified method in that costs are allocated proportional to a base. The difference is that costs are divided into multiple pools with a separate base assigned for each. Ideally the base selected correlates to the relative benefit received. For example, facilities costs could be allocated using square footage as a base. When appropriate allocation bases are selected, the multiple allocation base methodology does lead to more rational and reasonable allocations. However, the methodology does create an additional burden in tracking metrics used as allocation bases and increases the overall complexity of the allocation model.

Regardless of the allocation methodology utilized, certain costs cannot be charged to federal grants. Through the applicable circulars the OMB lists these unallowable costs. For example, while it is possible to recover the cost of capital assets through usage allowances or depreciation, the actual capital expenditure is not an allowable cost. Compliance with these restrictions requires the entity to track these disallowed costs to ensure they are not charged to federal grants. It should be noted that even if a cost is disallowed under the OMB circular, it can be charged if specifically addressed in the grant agreement.

Indirect costs are charged to the various programs through an overhead rate. These rates are generally expressed as either a percentage of direct salaries and wages or as a percentage of total direct expenditures. The organization has several different types of rates to choose from.

Provisional Rate – A temporary rate that applies for a specified period of time. This rate is used until the final rate is determined.
Final Rate – The final rate is calculated once the actual expenditures are known.
Fixed Rate – This rate also applies for a specified period of time but is not adjusted when the actual expenditures are known. Instead, any differences between the actual expenditures and the fixed rate are carried forward to the following period.
Predetermined Rate – This rate applies for a specified period of time and is not adjusted when the actual expenditures are known. There is no carry forward with a predetermined rate. These rates are negotiated with the cognizant agency.

While an indirect cost allocation plan does create additional responsibilities for an organization, for most the benefits outweigh the costs. With an average indirect overhead rate of 24% even organizations receiving a small amount of federal support would benefit. In addition to cost recovery from federal grants, organizations benefit from better decision making by knowing the true cost of service. For all but the smallest organizations, developing an indirect cost allocation plan makes good financial sense.

Allocated Cost Base

Determined personnel costs of support staff, City Manager, Confidential Administrative Assistant, City Clerk, Finance Manager, Accountant I (2), Senior Account Clerk and Account Clerk II. Also, General Fund non-personnel related to functions of above staff, IT costs, attorney costs, etc.

Allocation Basis

Developed four methods of allocation to capture skewing for intensive functions or more practical allocation considerations. The methods are designated CAPS 1 through 4.

CAP-1 Time estimate of Finance and Administrative staff in Utility billing processing and collections x Personnel Cost x utility revenue by fund to total utility revenues.

CAP-2 Time estimate of Finance and Administrative staff in HR, Payroll and other Personnel matters x Personnel Cost x FTE’s by fund to total

CAP- 3 Time estimate of Finance and Administrative staff all other functions x Personnel Cost x avg of Rev & Exp by fund to total

CAP-4 Non-personnel administration overhead costs x CAP-3 factor

Allocated Costs

Determined total allocated costs. Reduced costs allocated under prior methodology. Determined allocated costs pending allocation. Identified where allocated cost was supported without producing a deficit within a particular fund.

The net effects of the Cost Allocation Plan are below. General Fund costs based on historical costing methods are under "Without Cost Allocation Plan".

Transitional Period

During the period where a Cost Allocation Plan is not fully implemented, the difference between non-CAP and CAP allocations are competing. This is where formalization of a CAP plan is important. Maintenance of a CAP plan is an issue that needs to be addressed periodically. The ideal situation is that a methodology described herein is fully incorporated as the legitimate system of allocating costs.

	City of Rio Vista Summary Effect of CAP General Fund with and without CAP			
		Administrative Exp - FY 2011-12		
	Support Functions	**OTHER FUNDS**	**GENERAL FUND**	**TOTAL ADMIN OVERHEAD**
	Cost Allocation Function			
100	City Council	19,789	10,413	30,202
105	City Manager	202,365	46,121	248,486
107	City Administration	101,537	53,428	154,965
110	City Attorney	8,518	4,482	13,000
115	City Clerk	98,399	20,444	118,843
135	Finance	436,157	47,472	483,629
136	Infor. Tech	59,139	33,030	92,169
	Administration Overhead with CAP	$ 925,904	$ 215,390	1,141,294
	Without Cost Allocation Plan			
100	City Council	(0)	30,202	30,202
105	City Manager	156,383	73,694	230,077
107	City Administration	-	154,965	154,965
110	City Attorney	-	13,000	13,000
115	City Clerk	50,399	68,444	118,843
135	Finance	324,701	158,928	483,629
136	Infor. Tech	-	110,578	110,578
	Administration Overhead without CAP	$ 531,483	$ 609,811	1,141,294
	CAP Difference between General & Other Funds	(394,421)	394,421	-

Redevelopment

Under the new California budget legislation, Redevelopment Agencies will be dissolved on October 1, 2011 unless participation in the Voluntary Program is initiated. The FY 2011-12 cost to RDA is estimated at $166,928.

The RDA Tax Increments are $569,310 and $146,324 for RDA affordable housing fund, a total $715,634. The net difference be available to cover administrative expenses and project costs. If dissolution is selected, the Assessed Values which are the basis for tax increments will become additional assessments for the City. In FY 2010-11, Assessed values for RDA were $106,659,296 compared with City values of $953,329,465, or 11.1% of City values. A rough estimate of the City's tax increase in case of dissolution is $150,000.

A lawsuit was filed against State of California to reverse the decisions of the Legislature regarding the RDA Dissolution Act. If the lawsuit is not successful, the cost to the RDA will be $332,679 to buy into the voluntary Program for FY 2011-12.

Other Budget Considerations

City will no longer receive $24,000 from State of California for Vehicle License Fees.

General Fund has substantial, currently unavailable Reserves because of loans made to other funds over the past few years. Upon repayment of this Reserve funds occur, a healthier General Fund will emerge.

Conclusion

The next two fiscal years, FY 2011-12 and FY 2012-13, promise to be very challenging. The mixed economic signals, property values are still flat, retail sales are starting to pick up, labor market weak, corporate profits up, present continued lean times for governments. Although the General Fund is in a fragile situation after the substantial reduction of its revenue base due to the economic downturn of the last few years, the City has made necessary adjustments, to poise the City of Rio Vista to weather the storm until a better climate comes along.