

**EXECUTIVE OFFICER'S AGENDA REPORT
JULY 22, 2015**

TO: LAFCO Commissioners

FROM: Marjorie Blom, Executive Officer ^{MB}

SUBJECT: **PUBLIC HEARING – CONSIDER ADOPTION OF COMMISSION RULE 46a –
FORMAL RESERVE FUND POLICY**

BACKGROUND

Currently, Stanislaus LAFCO does not have a formal reserve policy regarding designation of the Commission's fund balance, which is carried over from year-to-year. The Commission, during publicly noticed annual budget hearings, has set aside funds to: 1) allocate reserve monies to fund the hiring of outside legal and/or consultant services; 2) ensure that funds are available to cover liability costs associated with future employee cash-out benefits; and 3) maintain funds in reserve to stabilize LAFCO's operating revenues.

Reserve Fund Policy Purpose

The purpose of a formal LAFCO reserve policy is to ensure that the Commission maintains an appropriate designated reserve fund balance for personnel liability costs (e.g., employee cash out/termination), unexpected operational costs or unrealized revenues, general insurance deductibles, and/or unforeseen costs, such as litigation.

A formal reserve policy would also outline how the Commission intends to designate its net assets (reserves/fund balance/accrued annual interest), and once designated can be classified in a statement of financial position (e.g., annual audit).

Adoption of a reserve policy will also communicate to the Commission's funding agencies (the County and nine cities), interested agencies and the general public how the Commission intends to utilize its fund balance during the annual LAFCO budget process. Further, the policy would establish guidelines and requirements for the classification of fund balances consistent with the Governmental Accounting Standards Board (GASB) Statement Number 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, for local governmental agencies.

DISCUSSION

The Commission currently has two funds on the expense side of its budget, which are built-in for contingency purposes. These funds are considered "undesignated" based on general accounting standards, and are as follows:

1. Miscellaneous Fund (Account No. 62400)

This line item has been established to assist in reducing LAFCO's exposure to operating shortfalls such as unexpected expenses or unrealized revenues, if necessary. (The amount budgeted under this "contingency" fund is typically \$3,000 per year.)

2. Special Department Expense Fund (Account No. 65660)

The primary purpose of the Special Department Expense Fund is to: 1) allocate reserve monies to fund the hiring of outside legal and/or consultant services; 2) ensure that

funds are available to cover liability costs associated with future employee cash-out benefits; and 3) maintain funds in reserve to stabilize LAFCO's operating revenues. In the past, the Commission has typically set aside on average \$25,000 per year towards this fund.

Legal Authority

The Cortese-Knox-Hertzberg (CKH) Act or LAFCO law does not specifically spell out a recommended reserve fund, however, Government Code Section 56381 states:

"If, at the end of the fiscal year, the commission has funds in excess of what it needs, the commission may retain those funds and calculate them into the following fiscal year's budget. If, during the fiscal year, the commission is without adequate funds to operate, the board of supervisors may loan the commission funds. The commission shall appropriate sufficient funds in its budget for the subsequent fiscal year to repay the loan."

In essence, the only limit to the Commission's authority on setting its own budget relates to ensuring the adequate funding for the agency. The second paragraph in Government Code Section 56381(a) reads:

"At a minimum, the proposed and final budget shall be equal to the budget adopted for the previous fiscal year unless the commission finds that reduced staffing or program costs will nevertheless allow the commission to fulfill the purposes of this chapter."

Although there are no sections of the Cortese-Knox-Hertzberg (CKH) Act that place a statutory restriction on establishing or maintaining an individual LAFCO's reserves, it is however, helpful to establish a formal reserve policy.

PROPOSED POLICY

Attached as "Exhibit A" is a proposed Reserve Fund Policy, to be incorporated into the Commission's Policies and Procedures Manual as Rule 46a, pending Commission approval.

The Policy was developed utilizing the GASB Accounting standards, as well as benchmarking with other LAFCO's reserve fund policies throughout the State. As the attached Policy indicates, the following classifications for the designation of the Commission's fund balance reserves: Accrued Leave, Operating and General Fund.

These classifications are consistent with the Commission's current practice to set aside funds for costs associated with employee cash-out liabilities, legal defense in case of litigation, unrealized expenses or revenue, and reducing allocation costs for the Commission's funding agencies.

ENVIRONMENTAL REVIEW

Pursuant to the California Environmental Quality Act (CEQA) Guidelines Article 20, Regulation Section 15378(b)(2), the proposed Reserve Fund Policy is related to continuing administrative activities, and is not considered a project. Therefore, no further action is required under CEQA.

RECOMMENDATION FOR COMMISSION ACTION

Should the Commission determine the Reserve Fund Policy is sufficient in its current form, Staff recommends adoption of Resolution No. 2015-11, which:

1. Finds the proposed Reserve Fund Policy is not a project under Article 20, Regulation Section 15378(b)(2) of the California Environmental Quality (CEQA);
2. Finds that the proposed Reserve Fund Policy is consistent with the overall goals and polices of LAFCO; and
3. Adopts the Reserve Fund Policy, as recommended by Staff; or with modifications.

Attachments:

Exhibit A - Proposed Reserve Fund Policy
Draft LAFCO Resolution No. 2015-11
Summary of GASB Statement No. 54 – Fund Balance & Governmental Fund Type Definitions

EXHIBIT A
PROPOSED RESERVE FUND POLICY

RULE 46a: RESERVE FUND POLICY

A. PURPOSE

This policy establishes the guidelines and requirements for the classification of the Commission's reserve fund balances consistent with the Governmental Accounting Standards Board (GASB) Statement Number 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, for local governmental agencies.

B. BACKGROUND

The Commission has in the past designated "reserve" funds during publicly noticed annual budget hearings in order to: 1) allocate monies to fund the hiring of outside legal and/or consultant services; 2) ensure that funds are available to cover the liability costs associated with future employee cash-out benefits; and 3) maintain funds in reserve to stabilize LAFCO's operating revenues. Any funds remaining at the end of the fiscal year have been carried over as part of the fund balance to finance the following year's reserve account.

The Commission also utilized fee revenues collected from application fees as a way to "credit back" revenues to its funding agencies (county and nine cities) for the following year's operating expenses. With the establishment of a formal reserve policy, the Commission can formally utilize a designated "assigned" fund to offset its annual operational budget instead of utilizing its fee revenues, which have varied in amount from year-to-year.

C. FUND BALANCE CLASSIFICATION

1. The Commission's Fund Balances shall be classified consistent with the GASB Statement Number 54. Reporting of fund balance will be based on the amounts and classifications listed in the fund balance summary of LAFCO's Annual Budget. Classification of the fund balance shall reflect the current plans of the Commission with respect to the use of the fund balance. These plans represent current intention and are subject to change and assignment. Furthermore, the classification of funds (reflecting the current plans for asset use) does not in any way limit the ability of LAFCO to use those funds for other purposes, as deemed necessary by the Commission.
2. Under GASB Statement Number 54, fund balances will be classified as "Non-Spendable" and "Spendable". Spendable categories will be further classified as: Restricted, Committed, Assigned, and Unassigned.
 - a. Non-Spendable: The Commission may designate a portion of its fund balance as "Non-Spendable" for amounts that cannot be spent or are not in spendable form (i.e. prepaid items, land held for resale, long-term receivables), or are legally or contractually required to be maintained intact.

b. Spendable Category Definitions

1. Restricted: The Commission may designate a portion of its fund balance as “Restricted” for amounts that are externally imposed by creditors, grantors, contributions, or laws and regulations of other governments. The Commission may also designate fund balance as “restricted” if required by imposed enabling legislation or regulations.
2. Committed: The Commission may designate a portion of its fund balance as “Committed” by formal action for specific purposes, such as enacted ordinances, resolutions, or action items, which prevent the amounts from being used for any other purpose without formal action of LAFCO. Committed funds also include contractual obligations to the extent that existing resources have been specifically committed for use in satisfying those contractual requirements.
3. Assigned: The Commission may designate a portion of its fund balance as “Assigned” for amounts intended to be used for specific purposes. Examples of assigned funds may include: personnel expense liabilities, unexpected expenses related to potential litigation; or for special needs such as consultant studies.
4. Unassigned: The Commission may designate a portion of its fund balance as “Unassigned” for amounts that are in excess of Non-Spendable, Restricted, Committed, and Assigned fund balances. This category can include reserves for the purposes of the creation and/or maintenance of a General Fund.

D. ALLOCATION OF FUND BALANCE

As set forth in Government Code Section 56381, if at the end of the fiscal year, the Commission has funds in excess of what it needs; the Commission may retain those funds and calculate them into the following fiscal year’s budget.

Any funds remaining at the end of the fiscal year will be carried over as part of the fund balance to finance the following year’s reserve account. Allocation of LAFCO’s fund balance/reserves shall be determined by the Commission in the following manner:

- a. Assigned: An “Accrued Leave” fund set at a minimum of 15% of the total operating expenses, and allocated annually during the budget process.

Funds are to be expended for the sole purpose of compensating an employee who leaves the agency’s employment of the balance of his/her accrued leave time, in accordance with applicable Federal and State laws, and in conformance with County regulations and LAFCO policies.

- b. Assigned: An “Operating Reserve” fund set a minimum of 10% of the total operating expenses, and allocated annually during the budget process.

Funds may be expended to cover increases in operating expenses following adoption of the Final Budget; or for unexpected expenses (payment of potential litigation or other special needs such as consultant studies).

- c. Unassigned: The “General Fund” shall be set at a minimum of 10% of the total operating expenses, and allocated during the annual budget process.

The General Fund is for the remaining annual fund balance, which is not included in one of the above assigned classifications. The Commission may also utilize funds in this “unassigned” category for the purposes of reducing the annual allocation costs of the funding agencies, if necessary.

DRAFT
LAFCO RESOLUTION NO. 2015-11

**STANISLAUS LOCAL AGENCY
FORMATION COMMISSION**

RESOLUTION

DATE: July 22, 2015

No. 2015-11

SUBJECT: Adoption of Commission Rule 46a – Reserve Fund Policy

On the motion of Commissioner _____, seconded by Commissioner _____, and approved by the following:

Ayes: Commissioners:
Noes: Commissioners:
Ineligible: Commissioners:
Absent: Commissioners:

THE FOLLOWING RESOLUTION WAS ADOPTED:

WHEREAS, Stanislaus LAFCO has adopted Policies and Procedures in accordance with the Cortese-Knox-Hertzberg Local Government Reorganization Act and desires to adopt a policy to ensure that the Commission maintains an appropriate designated fund balance;

WHEREAS, the Reserve Fund Policy is consistent with the Governmental Accounting Standards Board (GASB) Statement Number 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, for local governmental agencies;

WHEREAS, adoption of the Reserve Fund Policy is not a project pursuant to Article 20, Regulation Section 15378(b)(2) of the California Environmental Quality Act (CEQA), as there is no substantial evidence that the proposed Policy will have a significant effect on the environment; and

WHEREAS, the Commission has considered the written report submitted by the Executive Officer as well as any testimony and evidence presented or heard at the public hearing held on July 22, 2015.

NOW, THEREFORE, BE IT RESOLVED that the Commission:

1. Finds that the proposed Policy is not a project, pursuant to Article 20, Regulation Section 15378(b)(2) of the California Environmental Quality Act (CEQA).
2. Finds that the proposed Policy is consistent with the overall goals and policies of Stanislaus LAFCO.
3. Adopts the attached Policy (Rule 46a) to be included in the Stanislaus LAFCO Policies and Procedures Manual.

ATTEST:

Marjorie Blom
Executive Officer

**SUMMARY OF
GASB STATEMENT NO. 54**

SUMMARY OF STATEMENT NO. 54
FUND BALANCE REPORTING AND GOVERNMENTAL FUND TYPE DEFINITIONS
(ISSUED 02/09)

The objective of this Statement is to enhance the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions.

This Statement establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds.

The initial distinction that is made in reporting fund balance information is identifying amounts that are considered *nonspendable*, such as fund balance associated with inventories.

This Statement also provides for additional classification as restricted, committed, assigned, and unassigned based on the relative strength of the constraints that control how specific amounts can be spent.

The *restricted* fund balance category includes amounts that can be spent only for the specific purposes stipulated by constitution, external resource providers, or through enabling legislation.

The *committed* fund balance classification includes amounts that can be used only for the specific purposes determined by a formal action of the government's highest level of decision-making authority.

Amounts in the *assigned* fund balance classification are intended to be used by the government for specific purposes but do not meet the criteria to be classified as restricted or committed. In governmental funds other than the general fund, assigned fund balance represents the remaining amount that is not restricted or committed.

Unassigned fund balance is the residual classification for the government's general fund and includes all spendable amounts not contained in the other classifications.

In other funds, the unassigned classification should be used only to report a deficit balance resulting from overspending for specific purposes for which amounts had been restricted, committed, or assigned.

Governments are required to disclose information about the processes through which constraints are imposed on amounts in the committed and assigned classifications.

Governments also are required to classify and report amounts in the appropriate fund balance classifications by applying their accounting policies that determine whether restricted, committed, assigned, and unassigned amounts are considered to have been spent. Disclosure of the policies in the notes to the financial statements is required.

This Statement also provides guidance for classifying stabilization amounts on the face of the balance sheet and requires disclosure of certain information about stabilization arrangements in the notes to the financial statements.

The definitions of the general fund, special revenue fund type, capital projects fund type, debt service fund type, and permanent fund type are clarified by the provisions in this Statement.

SUMMARY OF STATEMENT NO. 54- Continued

Interpretations of certain terms within the definition of the special revenue fund type have been provided and, for some governments, those interpretations may affect the activities they choose to report in those funds.

The capital projects fund type definition also was clarified for better alignment with the needs of preparers and users.

Definitions of other governmental fund types also have been modified for clarity and consistency.

The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2010. Early implementation is encouraged. Fund balance reclassifications made to conform to the provisions of this Statement should be applied retroactively by restating fund balance for all prior periods presented.

How the Changes in This Statement Will Improve Financial Reporting

The requirements in this Statement will improve financial reporting by providing fund balance categories and classifications that will be more easily understood.

Elimination of the *reserved* component of fund balance in favor of a *restricted* classification will enhance the consistency between information reported in the government-wide statements and information in the governmental fund financial statements and avoid confusion about the relationship between reserved fund balance and restricted net assets.

The fund balance classification approach in this Statement will require governments to classify amounts consistently, regardless of the fund type or column in which they are presented. As a result, an amount cannot be classified as restricted in one fund but unrestricted in another.

The fund balance disclosures will give users information necessary to understand the processes under which constraints are imposed upon the use of resources and how those constraints may be modified or eliminated.

The clarifications of the governmental fund type definitions will reduce uncertainty about which resources can or should be reported in the respective fund types.

Unless otherwise specified, pronouncements of the GASB apply to financial reports of all state and local governmental entities, including general purpose governments; public benefit corporations and authorities; public employee retirement systems; and public utilities, hospitals and other health care providers, and colleges and universities.