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AGENDA REPORT
Business | Discussion

March 4, 2019

TO: Commissioners

FROM: Keene Simonds, Executive Officer

SUBJECT: **First Reading | Proposed Update to the Fund Balance Policy**

SUMMARY

The San Diego Local Agency Formation Commission (LAFCO) will review a proposed update to the "Fund Balance Policy" as part of a first-reading. The proposed update adds discretionary standards and headlined by establishing a minimum reserve level of unassigned monies equal to four months of budgeted expenses. Other amendments include delegating authority to the Executive Officer to designate assigned monies for specific purposes up to $125,000 as well as establishing agency credit and restoration procedures. The proposed update is being presented to the Commission for feedback and ahead of initiating a public review before returning for action as early as May 2019.

BACKGROUND

Current Workplan

San Diego LAFCO's current workplan was adopted at a noticed hearing held on April 4, 2018 and outlines over two-dozen project goals for the fiscal year. The workplan is also organized to categorize projects into one of three priority levels: high; moderate; and low. The workplan includes preparing an update on the Fund Balance Policy as a high priority and timed in response to the Commission's review of the 2018-2019 operating budget and interest therein to formalize standards in managing agency reserves.

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Adoption | Fund Balance Policy

San Diego LAFCO's Fund Balance Policy was adopted in June 2013. Adoption responded to earlier guidelines issued by the Governmental Accounting Standards Board (GASB) under Statement No. 54 and its provisions to ensure uniformity in the reporting of fund balances among public agencies. The existing policy codifies the central components of GASB 54 and establishes fund balance classifications for spendable monies divided between restricted, committed, assigned, and unassigned as defined in short-form below.

- Restricted
  These monies are subject to external restrictions outside of the Commission – including legal and contractual obligations – with prescribed spending allowances.

- Committed
  These monies are subject to internal restrictions by the Commission for specific spending purposes; monies can be designated only with membership approval.

- Assigned
  These monies are subject to internal restrictions by the Commission or its delegate for specific spending purposes.

- Unassigned
  These remaining monies do not meet the definition of restricted, committed or assigned, and as such are not subject to any spending restrictions.

Current Fund Balance

San Diego LAFCO's current and lone governmental fund balance is classified as "general" and used to account for all financial resources.[1] The current fund balance as of the date of this report is $2,270,934 with the expectation the year-end amount will finish at approximately $1,530,000. The Commission maintains all fund balance monies between five active accounts divided between four with the County of San Diego and one with the San Diego County Credit Union. A breakdown of the current fund balance with respect to existing designations follows with additional details footnoted.[2]

San Diego LAFCO's Fund Balance Summary
(As of February 21, 2019)

Restricted	Committed	Assigned	Unassigned	TOTAL
-	175,000	75,000	2,020,934	$2,270,934

[1] Other governmental fund types available under GASB 54 are "special revenue," capital," "debt service," and "permanent."
[2] Committed funds are divided between (a) $125,000 to cover fee waivers and other costs for fire service reorganizations and (b) $75,000 specific to processing the "CSA No. 115 Reorganization." Assigned funds cover litigation costs. All allocations were last made and/or reviewed by the Commission March 2017.

DISCUSSION

This item is for San Diego LAFCO to review and provide feedback on a proposed update to the Fund Balance Policy. The item is drawn from the adopted workplan and interest therein by the Commission to consider formal standards in managing the fund balance to reflect current membership preferences. This includes – markedly – specific interest by the Commission to explore the merits of setting minimum fund balance thresholds in step with guiding the use of reserves as offsetting revenues. The item is being presented to the Commission as part of first-reading and ahead of staff initiating a 30-day public review and comment period before returning for action as early as May 2019.

Proposed Update

Staff's review of San Diego LAFCO's current Fund Balance Policy identifies six distinct amendments for Commission consideration. These distinct amendments are paired with editorial clarifications and establish discretionary standards in the Commission's management of the fund balance. A summary of the six amendments follows.

- Minimum Reserve Level
  The update proposes establishing a minimum designation of unassigned monies in the fund balance equal to 33.3% of budgeted operating expenses. This unassigned amount would provide four months of monies to cover expected operating costs and represents the time reasonably needed to collect all agency apportionments for the new fiscal year as further detailed in the accompanying footnote.[3] This policy provision would serve as the primary management tool of the fund balance.

- Committed Contingency
  The update proposes establishing a perennial designation of committed monies in the fund balance equal to 8.3% of budgeted operating expenses. This committed amount would provide one month of monies and specific to covering unexpected shortfalls incurred during the fiscal year. This policy provision would automatically apply each fiscal year unless waived by the Commission and serve as a substitute to the budgeting of an operating contingency.

- Executive Officer Authority to Assign Monies
  The update proposes delegating authority to the Executive Officer to assign monies in the fund balance for the specific purpose of legal expenses and costs associated with processing proposals with approved fee waivers/reductions. This delegation is limited to $125,000 per fiscal year to match the Executive Officer's procurement authority. Delegation also cannot result in unassigned monies in the fund balance falling below the minimum reserve level.

[3] State law provides all local agencies 60 days to voluntarily make payment to the Commission after the July 1st noticing requirement of the County Auditor. Should payment not be received within the 60 days, the Commission is authorized to direct the Auditor to collect from property taxes and/or other eligible revenues owed to the affected local agency. This latter procedure would take 30 to 60 days to complete given related noticing requirements and paired with the voluntary remittal period underlies the proposed four-month minimum unassigned fund balance standard.

- Crediting Excess Unassigned Monies
  The update proposes establishing procedures for the Commission to credit unassigned monies in the fund balance to the funding agencies (County, cities, and special districts) should the available amount exceed the minimum reserve level. The Commission would determine whether credits are authorized as part of the annual budget process with individual amounts to be equal to the agency's proportional share of the apportionment total in the most recent fiscal year.

- Restoration of the Minimum Reserve Level
  The update proposes procedures for the Executive Officer to present a restoration plan to the Commission for approval should unassigned monies in the fund balance fall below the minimum reserve level. The plan shall outline procedures to restore the unassigned fund balance to the minimum reserve level within three fiscal years.

- Regular Commission Review
  The update proposes the Commission conduct a regular review of the fund balance no less than once a fiscal year as part of the annual budget process. The regular review will inform the Commission whether actions are appropriate with respect to fund balance commitments, issuing agency credits, and – if needed – considering a restoration plan prepared by the Executive Officer.

The proposed update is attached.

ANALYSIS

The proposed update to San Diego LAFCO's Fund Balance Policy represents the first review of the document since it was established in 2013. While there are no new requirements to address, the amendments outlined in the preceding section are nonetheless merited and collectively expand the document from codifying GASB guidelines to include discretionary standards. This includes – most notably – establishing a minimum reserve level of unassigned monies equal to four months of operating costs, and in doing so help stabilize cash flow in the beginning of the fiscal year when agency apportionments remain pending. Establishing a separate and perennial contingency of committed monies equal to one month of operating costs similarly serves to protect the Commission and specifically against shortfalls towards the end of the fiscal year. Amendments to formalize procedures to provide credits to the funding agencies, requiring a restoration plan to replenish minimum reserve levels, and establishing an annual review further serve to prescribe standards in managing the Commission's public monies going forward.

ALTERNATIVES FOR ACTION

The proposed update on the Fund Balance Policy is being presented to San Diego LAFCO for discussion and feedback only.

RECOMMENDATION

It is recommended San Diego LAFCO provide feedback on the proposed update to the Fund Balance Policy – including direction on desired revisions – and ahead of staff circulating the item for public review and returning for action as early as May 2019.

PROCEDURES

This item has been placed on San Diego LAFCO's agenda for discussion as part of the business calendar. The following procedures, accordingly, are recommended in the consideration of this item:

1) Receive verbal report from staff unless waived;
2) Initial questions or clarifications from the Commission;
3) Invite comments from interested audience members (voluntary); and
4) Discuss item and provide feedback as requested.

Respectfully,

Keene Simonds

Keene Simonds
Executive Officer

Attachment:

1. Proposed Update to Fund Balance Policy (red-line)

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Subject

SAN DIEGO LAFCO FUND BALANCE

Purpose

This policy establishes 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*.

Background

The term, “fund balance” is used to describe the difference between assets and liabilities reported within a fund. In the past, fund balances have been classified into three separate components: reserved; designated; and undersigned. Limitations were associated with these classifications with respect to the purpose and usage of funds. The force of these limitations could vary significantly, depending on the funding source.

The Governmental Accounting Standards Board (GASB) issued Statement Number 54, *Fund Balance Reporting and Governmental Fund Type Definitions* for implementation in 2011. This new standard does not affect the calculation of fund balance; however, it altered various components used to report it. There are also new categories and terminology reflected in an approach that focuses on the constraints placed on the specific purposes of the funds. GASB Statement Number 54 applies to governmental funds, such as LAFCO’s General Fund.

With the shift of focus of GASB Statement Number 54, emphasis is now placed on the extent to which the government agency (LAFCO) is bound to honor constraints on the specific purposes for which amounts in the fund can be spent, rather than availability of fund resources. Under this new GASB, fund balances are classified as “non-spendable” and “spendable”. Spendable categories are further classified as *restricted, committed, assigned,* and *unassigned*. Definitions and LAFCO policies for non-spendable and spendable categories follow:

- *Non-Spendable*: 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.

- *Restricted*: Amounts that are externally imposed by creditors, grantors, contributors, or laws and regulations of other governments. They may also be internally imposed by enabling legislation. Examples are debt service reserves, gas tax funds and grants.

- *Committed*: Amounts committed for specific purposes by formal action of the governing body, such as enacted ordinances and resolutions, which prevent the amounts from being used for any other purpose without the governing body's formal action. These also include contractual obligations to the extent that existing resources have been specifically committed for us in satisfying those contractual requirements.

- *Assigned*: Amounts intended to be used for specific purposes without formal action by the governing body. This authority to determine the portions of a fund's balance that is to be assigned and reported as "assigned" in the agency's Comprehensive Annual Financial Report (CAFR) may be delegated to the Executive Officer or the Executive Officer's designee.

- *Unassigned*: Amounts in the General Fund in excess of non-spendable, restricted, committed, and assigned fund balances. For LAFCO, the General Fund Contingency Reserve and remaining spendable amounts which are not included in one of the other classifications would be classified as "unassigned" for presentation in the CAFR.

Policy

It is the policy of the San Diego Local Agency Formation Commission to:

1. Classify its fund balance in accordance with the Governmental Accounting Standards Board (GASB) Statement Number 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. Reporting of fund balance in LAFCO's CAFR will be based on the amounts and classifications ~~listed in the fund balance summary of LAFCO's annual budget~~made by the Commission or its delegate as provided in this policy. Classification of fund balance reflects the current plans of the Commission with respect to the use of fund balance. These plans represent current intention and are subject to change and assignment. Furthermore, the classification of funds (reflecting 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 ~~LAFCO~~the Commission.

2. Classify ~~Under GASB Statement Number 54,~~ monies in the fund balance~~s will be classified~~ as "non-spendable" and "spendable" consistent with GASB Statement Number 54. Spendable categories will be further classified as restricted, committed, assigned, and unassigned as described below.~~.~~

   a. Non-Spendable: The Commission shall designate fund balance monies 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. Restricted (Spendable): The Commission shall designate fund balance monies as "restricted" for amounts that are externally imposed by creditors, grantors, contributors, or laws and regulations of other governments. The Commission may also restrict fund balance if required by internally imposed enabling legislation or regulations.

   c. Committed (Spendable): The Commission shall designate fund balance monies as “committed” for amounts ~~committed~~ intended for specific purposes by formal action ~~of the San Diego LAFCO,~~ such as enacted ordinances, resolutions, actions items, or budgetary decisions~~, which 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. Additionally:

i. The Commission shall designate an amount equal to one-month or 8.3% of budgeted operating expenses as committed unless waived as part of the annual budget process. These monies are intended to cover unexpected shortfalls during the fiscal year, and serve as a substitute in budgeting an annual contingency.

d) Assigned (Spendable): The Commission delegates to the ~~or~~ Executive Officer ~~may~~ the authority to designate fund balance monies as “assigned” for ~~amounts intended to be used for~~ specific purposes ~~with or~~ without formal action. This delegation is limited to $125,000 per fiscal year and specific to legal expenses and costs associated with processing proposals with approved fee waivers. :~~This authority to determine the portions of a fund’s balance that is to be reported as “Assigned” in LAFCO’s CAFR may be delegated to the Executive Officer or the Executive Officer’s designee.~~ Additionally:

i. The designation of assigned monies in cumulative excess of $125,000 per fiscal year requires formal Commission approval.

ii. The designation of assigned monies cannot result in unassigned monies falling below the minimum reserve level as described in this policy.

e) Unassigned (Spendable): The Commission shall designate fund balance monies as "unassigned" for amounts ~~in the General Fund~~ that are in excess of non-spendable, restricted, committed, and assigned fund balances. ~~For LAFCO, the General Fund Contingency Reserve and remaining spendable amounts which are not included in one of the other classifications shall be classified as "Unassigned" for presentation in the CAFR~~. Additionally:

i. The Commission shall maintain a minimum reserve level of unassigned monies equal to four months or 33.3% of budgeted operating expenses. These monies are intended to protect against cash flow shortfalls related to the timing of the collection of agency apportionments in the fiscal year.

~~i.~~ii. If excess unassigned monies are available beyond the minimum reserve level described in this policy, the Commission may authorize credits to reduce new agency apportionments as part of the annual budget process. Individual credit amounts shall be equal to the affected agency's proportional share of overall invoiced apportionments in the current fiscal year.

~~ii.~~iii. Should unassigned monies equal less than the minimum reserve level described in this policy, the Executive Officer shall present a restoration plan to the Commission for approval. The restoration plan shall provide options with a recommendation to replenish unassigned monies to meet the minimum reserve level within three fiscal years.

3. Review the fund balance no less than once per fiscal year as part of the annual budget process and take action as appropriate under this policy.

Adopted: June 3, 2013

Amended: TBD

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