

## Policy: Sonoma LAFCO Fiscal Reserves

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### **Policy**

In preparing and adopting annual budgets, the Commission will retain reserve funds as follows:

1. An employee severance reserve, comprising an estimated level of funding that would be needed to pay for accrued employee benefits (primarily accrued vacation) that would become due at the end of staff employment.
2. An insurance deductible reserve, equal to the deductible listed in insurance coverage provided through the Memorandum of Understanding between LAFCO and the County for the provision of support services. LAFCO is listed as insured under the County's General Liability Policy, which covers potential operational liabilities (accidents and injuries) as well as Errors and Omissions coverage which provides limited coverage for management errors. It should be noted that this coverage does not extend to lawsuits regarding commission actions.
3. A general reserve, intended to cover unforeseen operating costs of the Commission, including but not limited to costs for legal proceedings, and to allow for adjustments to apportionments as directed by the Commission.

The Commission will target total reserves at approximately 50% of the annual budget.

### **Legal Authority**

The California Government Code is largely silent with regard to the establishment of fiscal reserves and appropriate reserve funding levels. The code does state:

*§ 56381. (a) The Commission shall adopt annually, following noticed public hearings, a proposed budget by May 1 and final budget by June 15. 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 and programs of this chapter. The commission shall transmit its proposed and final budgets to the board of supervisors, to each city, and to each independent special district.*

In addition, a portion of § 56381 (a) (F) (4) (c) reads:

*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*

That section then goes on to read:

*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 (emphasis added).*

### **Background and Discussion**

The Commission has followed a budget preparation and adoption process consistent with the California Government Code, and has regularly collected funding from the County, cities, and independent special districts to meet the Commission's proposed expenditures. For several years, the amount of funding collected, together with the unbudgeted revenue from application fees, has been somewhat in excess of actual budget expenditures.

The Commission considered these "excess" funds as a "Fund Balance". The Fund Balance was factored into subsequent fiscal year budgets; however it was also generally considered a "reserve" that could be used for unseen expenses (such as litigation) or to manage budget increases ("smoothing" budget increases over time so that there were not large increases in any given year).

In the 2000s the Fund Balance was quite low, both in actual terms and as a percentage of the Commission's budget. Actual Fund Balances were as low as \$25,000 and represented less than 10% of the adopted budgets in those years.

In recent years the Fund Balance has increased dramatically, and now represents as much as half of the annual adopted budget.

The availability of the Fund Balance for use for unforeseen expenses has been of particular interest to the Commission. LAFCOs in other counties have occasionally faced significant litigation expenses, in some cases costing several hundreds of thousands of dollars in legal fees and judgements.

In 2017 the Commission's Policy Committee considered development of a Fiscal Reserve policy but came to no conclusions with regard to categories of reserves or amounts. In 2022 the Budget Committee took up the subject and made recommendations that are reflected in this Policy.

Adopted: