EL DORADO LAFCO

LOCAL AGENCY FORMATION COMMISSION

AGENDA OF SEPTEMBER 28, 2016

REGULAR MEETING

TO:	**Ken Humphreys, Chair, and Members of the El Dorado County Local Agency Formation Commission**
FROM:	**José C. Henríquez, Executive Officer**
AGENDA ITEM #8:	**APPROVE CHANGES TO THE BUDGETARY CREATION PROCESS**

RECOMMENDATION

Staff recommends that the Commission approve the manner in which the fund balance, possibly applicant fees, are calculated in the budget. Specifically, the new process calls for utilizing carryover funds, and possibly applicant fees, in the budget a year after calculation/collection.

REASON FOR RECOMMENDED ACTION

Staff's proposal would ensure that real, known numbers are used in the revenues for fund balance and applicant fees, eliminating forecast errors.

BACKGROUND

This agency's budget relies on four main sources of revenue: applicant fees, fund balance, agency contributions and interest revenues. The assumption behind these revenue streams is that LAFCO will collect these funds throughout the fiscal year to arrive at the numbers forecast on the budget. The emphasis here is *forecast*, since three out of the four numbers are unknown at the time the Commission adopts the budget. The only revenue source the Commission can control is agency contributions, mainly because agencies are compelled to send their payment to LAFCO by law.

While staff does its best to use hard numbers on these forecasts, these are projections subject to factors that are beyond LAFCO's control. For example, the Commission cannot compel applicants to submit petitions. Staff can only estimate the applicant fee amount based on the level of activity at the planning departments and at EID with an eye towards past performance. The Commission cannot compel the Federal Reserve to adjust interest rates so that LAFCO can meet its target in the budget. There is limited control on the fund balance, but that is because staff looks for savings and tries to minimize spending. Despite all best efforts, the fund balance is still subject to unforeseen expenses as well.

Current Forecasting Model

It should be noted that fund balances (forecast or calculated) are *not* amounts LAFCO *plans* to have left over. That would make fund balances like any other expenditure in the budget. Instead, fund balances are monies left over after all expenses have been incurred and paid for at the end of a fiscal year. This is why fund balances are treated as a revenue source. The current forecasting model of the fund balance can be summarized as follows:

- Forecast all operating and employee expenses starting from a specific date; and
- Subtract those forecasted expenses from the actual funds in LAFCO's bank accounts as of that same specific date.

The reason why the forecasted expenses are deducted from the actual funds in LAFCO's bank accounts is because LAFCO essentially has one large infusion of revenues during the first quarter of the fiscal year and has to live off of that for the remainder of the year. Applicant fees can be a source of ongoing revenue; however:

1) The total amount is small relative to the budget (approximately 6% of the budget;

2) These funds are dependent on the whether LAFCO has an application and on the level of application activity;

3) These funds are intermittent at best; and

4) These funds cannot be counted as revenue until they are "earned" (meaning that they are reimbursements for labor expenses as opposed to deposits where no work has been conducted).

Fund Balance Calculation

Once the books are closed a request is sent to Terrie Prod'hon's Accounting Office (LAFCO's accounting consultant) for the calculation of the actual fund balance amount at the end of the fiscal year. The calculated fund balance amount is entered into QuickBooks where it appears on the Commission's "Profit and Loss Statement" that is submitted with every packet.

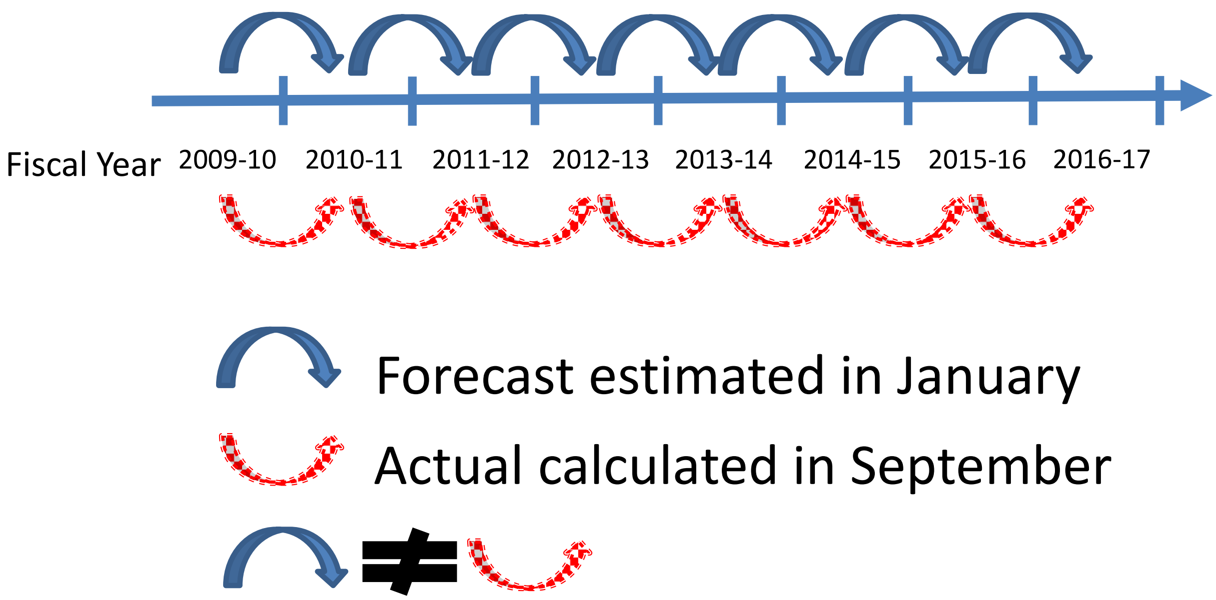
It should be noted that the actual fund balance calculated after the close of LAFCO's books at the end of a fiscal year has never matched the forecasted fund balance calculated at the time the budget is created. In January 2016, staff calculated that the fund balance at the end of FY2015-16 would be $8,370. The fund balance was calculated at $ 147,625 in September 2016, a difference of over $139,000. At the end of FY2014-15, the difference between the forecast and actual was over $108,000.

Because the forecast model has been really off the last two fiscal years, staff was concerned that the model is not utilizing all realistic assumptions and/or it may be time to use a different forecasting model. After speaking with Michael Ocenosak from Terrie Prod'hon's Office, the forecasting model was deemed sufficiently robust to yield a reliable forecast. However, LAFCO staff has made several incorrect assumptions in calculating the forecast fund balance. Using the calculation for the Fiscal Year 2015-16 as an example:

- The “accrued leave” funds were used exclusively as an expense (as opposed to a sort of reserve account, which is a more accurate description of this item);
- An extra pay period was deducted (it should have been counted in FY 2016-17 because that is when that pay period would be processed);
- Several expenses were forecast to have been bigger than what they ultimately were (meaning that staff spent less than expected on these items); and
- The reserve amount was deducted entirely when the proper method to account for it would have been to have added it to the revenue side as well (since, like “accrued leave,” it is not a true expense).

Had these errors not been made, the forecasted fund balance would have been approximately $24,000 off.

The image below graphically illustrates how the fund balance is used:



In summary, the fund balance amount (the amount of money carried over from the current fiscal year into the next) is estimated in January and entered into the budget for the following fiscal year. In September of the following fiscal year, the fund balance is calculated and treated as cash on hand to use in the same fiscal year. For the past 10 years, the estimated fund balance has not matched the actual amount.

Proposal for the use of the Fund Balance

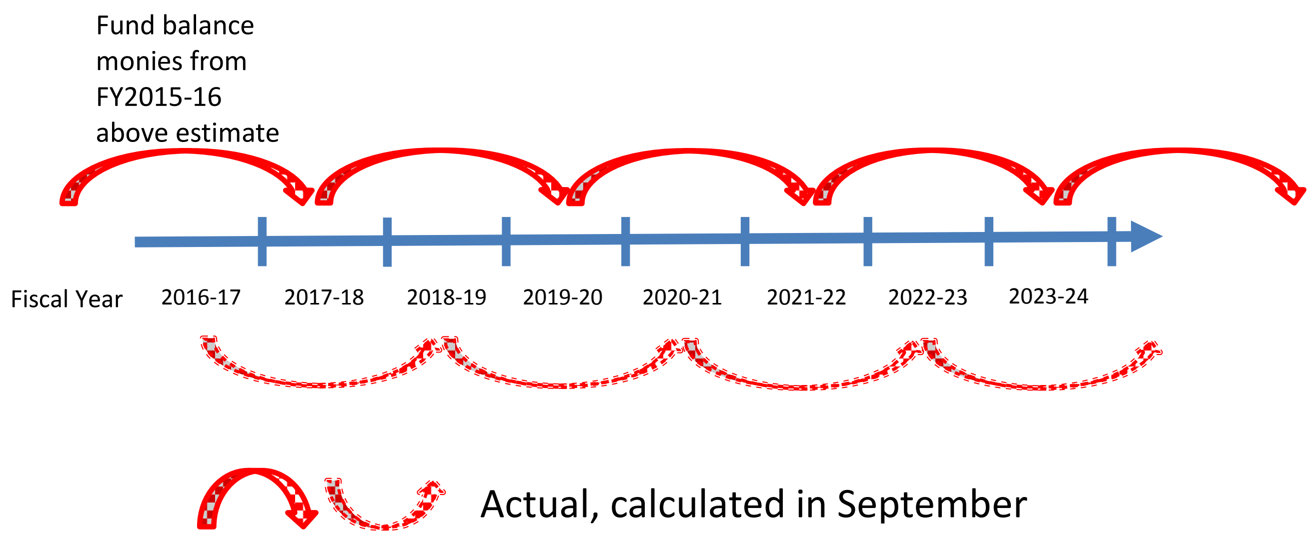
With Mr. Ocenosak’s feedback, the calculations for next year’s forecast will be better. However, there is an opportunity to get away from estimating revenues and using actual numbers in crafting LAFCO’s budget. Staff proposes that the Commission approve of the following:

- Use $8,370 of the FY2015-16 fund balance in this fiscal year since that was the amount assumed as the fund balance in the FY2016-17 budget;

- The LAFCO computers are now as old as the machines they replaced. Originally staff was going to propose allocating funds in next year's budget (FY2017-18) to purchase new IT infrastructure. The inclusion of this allocation may increase the size of LAFCO's budget next year. Since the FY2015-16 fund balance amount is higher than anticipated, part of these monies can be used for this purpose on this fiscal year. This would eliminate any potential budget increases. Staff estimates that the total cost will be $12-17,000;
- The remainder of the FY2015-16 fund balance monies are set aside and put away. These will not be used at all in this fiscal year. When it comes to crafting the budget for FY2017-18, these funds are plugged into the fund balance line item in that budget;
- Next September when the carryover funds from this fiscal year (FY2016-17) are calculated, which under the current practices would be used in the FY2017-18 budget as cash on hand, are instead set aside and put away. These funds will then be used as the fund balance line item for the FY2018-19 budget.

  To ensure transparency, staff will report the calculated fund balance amount to the Commission and its auditors next September. Staff will also present the deposit slip so that the Commission is confident that the monies are not used for any other purpose. The use of fund balance monies every other year becomes the new practice from here on out, starting with this fiscal year.

It should be emphasized that the fund balance monies, once calculated, will not be saved away forever. They will be used. The intent is to use the actual fund balance from any fiscal year in crafting a budget instead of a forecast amount. The only difference between this proposal and current practice is that the actual fund balance is used one year later than current practice. Graphically, this proposal can be explained like this:



There are no accounting rules that could bar the use of this proposal. In addition, this practice is not unprecedented in that two other LAFCOs use their fund balance amounts in this fashion. If this budgetary proposal is approved by the Commission, it will ensure that one additional revenue source in the budget becomes certain. In addition, it will give the Commission a better idea of what the impact will give to the funding agencies because the fund balance amount on any given year is a known amount and not an estimate.

Fees

Given the recent uptick in interest among potential applicants, the Commission should consider creating a similar process for applicant fees. While the process for fund balance could be instituted right away, for fees it will have to wait. This is because the fee proposal is dependent upon whether the collected and earned fees in FY2016-17 exceed the forecasted amount. The total amount will not be known until the end of FY 2016-17; however, all earned fee amounts could start to be saved and set aside as soon as the forecast fee amount of $6,777 is reached.