

# SHASTA LAFCO

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## **Report to the Shasta Local Agency Formation Commission**

**From: Jan Lopez, Executive Officer**

**Meeting Date: April 2, 2015**  
**Agenda Item #: 5. b. 1) Financial Status Reports**  
**Subject: Chief Financial Officer Report**

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### **Background:**

The Commission has before it some very difficult fiscal decisions to consider, with most resulting from a number of prior decisions and their unintended consequences. The issues before us are complex, not simple. One or two actions did not bring us to this point. A quick summary of those events will help guide the Commission and the public reader.

On March 7, 2013 Shasta LAFCO approved a draft budget for fiscal year 2013/2014, directing the Executive Officer to circulate it for comments to all cost-share agencies and the public. The first draft budget proposed a 3% increase of \$6,000 to be spread between the cost-share agencies. This would have raised agency revenues from \$186,000 to \$192,000 for funding the operations of Shasta LAFCO.

The adoption of a final budget for fiscal year 2013/2014 was set for June 13, 2013, just two days prior to the June 15<sup>th</sup> mandatory date. (This annual process is fully outlined in Section 56381 of the California Government Code.) The Budget Committee was also directed to revisit the draft budget.

During the intervening comment period, LAFCO received a number of comments from their cost-share agencies and the public. Discussion about the need to conduct sphere of influence (SOI) and municipal service reviews (MSR) for all of these agencies ensued at public meetings from March to the June hearing date. On April 4<sup>th</sup>, after receiving testimony, the Commission reversed its earlier decision to only provide SOIs and MSRs for certain cost-share agencies, not all of them. It would be important to plan ahead for that work.

Once that decision was made, a number of agencies and members of the public stated that LAFCO staff should conduct those studies within no increase to the cost-share agencies. Among the comments was a proposal to add four line items to the proposed budget to dedicate funds to conduct the remaining SOI and MSR studies. These would have covered producing the studies in-house and within the existing budget: (a) \$17,280 for Round #1 SOIs; (b) \$19,200 for Round #1 MSRs; (c) \$23,040 for related legal costs; and (d) \$10,000+ for CA Department of Fish & Wildlife fees for projects that would not qualify for a No Effect Determination exemption.

On June 13, 2013, after receiving additional comments, the Commission approved the 2013/2014 budget with no increase in revenues, and no additional budget line items or funds dedicated for the SOI/MSR work.

In July 2013, the executive officer position was vacated, with LAFCO Counsel directed to solicit candidates to fill the position. Two months later the remaining LAFCO staff became unavailable to work. After a late October approval by the Commission, a new executive officer and new LAFCO staff commenced work.

The executive officer and staff proceeded to restructure the administrative and fiscal systems, and to prepare a plan for conducting the mandated SOI/MSR studies. During that work, a number of critical and important fiscal matters surfaced and were presented to the Commission for direction.

The SOI/MSR studies were designated as high-priority work due to a class-action lawsuit filed against Shasta LAFCO, for which the court approved a settlement agreement setting the end of November 2014 as a completion date. In January 2014, work on the remaining SOI/MSR studies began in earnest.

SOI/MSR hearings were held monthly until November and December 2014 when they were held twice in each month. Two agency studies were continued to February 19, 2015 when the Buckeye Fire Protection District SOI/MSR was approved. The remaining study to be completed, the Fall River Valley Coordinated Service Area SOI/MSR, was rescheduled to March 5<sup>th</sup> and then again to April 2, 2015, where the Commission is expected to make a decision and conclude the work identified in the lawsuit.

The original contract for the current executive officer was scheduled to conclude in January of this year; it was subsequently extended through February and March. A new proposal was presented to the Commission on February 19<sup>th</sup>, and continued for consideration on April 2<sup>nd</sup>. This proposal is to provide executive officer services over the next 16 months to address and resolve myriad outstanding fiscal and administrative issues.

**Discussion:**

A brief examination of the Draft Budget Worksheet FY 2014/2015, included with the financial documents for this meeting, clearly identifies a serious shortfall.

The current LAFCO staff worked under the restrictions of the adopted FY 2013/2014 budget, and, in response to a request from the Commission, developed the FY 2014/2015 budget using a static revenue base of \$186,000. From FY 1999/2000 the annual budget increased every year, reaching a ceiling of \$210,000 in 2007/2008. By 2011/2012, however, it had dropped significantly to \$186,500, remaining at \$186,000 for the past two years.

A 2013 audit presented a serious lack of internal controls and the discovery of an unexpected \$60,000 discrepancy in fund balance that had been missed in earlier monthly financial reports. Although the comments were useful, the auditor was unable to conduct a proper audit due to the lack of internal controls and inconclusive recordkeeping practices.

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An audit of 2006/2007 identified a similar discrepancy of \$12,000. The Shasta County Auditor handled LAFCO finances at this time, however LAFCO indicated they kept a “second set of books” and that the discrepancy occurred had accumulated over time. Fortunately, both discrepancies were to the positive for LAFCO. On March 6, 2008, LAFCO cancelled their fiscal management contract with the Shasta County Auditor, opting to utilize a combination of local bank accounts and the Local Agency Investment Fund managed by the California State Treasury Office. The next audit occurred in 2013.

With the decision that the outstanding SOI/MSR studies must be accomplished by the end of November 2014 (a total of 51 agencies remaining out of a total of 61), the Commission identified this work as the most-critical. The second most-critical tasks were upgrading of administrative and fiscal issues.

In addition, determining to hire an Independent Contractor as their executive officer, the Commission concurred with utilizing an employment agency for their part-time support staff. The need for quick placement of personnel who were already prescreened and ready to work changed the previous practice of hiring and managing employee payroll from within. These changes permitted the reallocation of some budget funds and payroll tasks to accommodate several large unbudgeted expenses incurred between July and November 2013.

Internal reviews and updates of Shasta LAFCO operating systems during the first few months resulted in the:

- Establishment of internal controls and new chart of accounts with CPA assistance
- Established new accounting software to reduce potential errors and to produce integrated system-generated financial reports
- Split fiscal duties among staff to establish distinct degrees of separation for management of all fiscal transactions
- Manual reconstruction of three years’ worth of agency financial records into new accounting system
- Reorganization of agency application and project files
- Development of improved electronic and manual fiscal recordkeeping methods, procedures, and records which accurately reflect management of LAFCO financial records.
- Production of accurate, system-generated fiscal reports, reducing the potential for errors that result from manually developing fiscal reports on spreadsheets.
- Initiation of an intense internal review of LAFCO’s historical fiscal records to permit an accurate reconstruction of the agency’s financial operations.
- Implementation of previously absent internal fiscal controls that significantly reduce the opportunity for misuse or abuse due to lack of oversight systems.
- Update of all computer programs and increased security of LAFCO’s electronic and hard copy records.

- Move to contract for employee services for the provision of part-time support staff during the 2014 transition period, resulting in a significant reduction of employee-related costs for this fiscal year.
- Accommodated \$67,804 in extraordinary unanticipated budgetary expenses during the first seven months of this contract through cost-saving measures and adjustments, yet remaining within the approved budget through the end of the fiscal year without having to request additional funds from LAFCO’s supporting agencies.

Additionally, during those seven months LAFCO staff and the Commission focused on resolving or improving these important issues and situations with positive results. A partial snapshot of those results are:

- Development and implementation of a Master Plan for completion of municipal service reviews and sphere of influence updates for the remaining 41 local agencies.
- Implemented an open-door policy for the visiting public and local agencies by staffing the office from 9 a.m. through 4 p.m. Monday thru Thursday, and often being open on Friday for drop in meetings.
- Increased transparency of LAFCO operations by making information and records on all levels more user-friendly and accessible to the public and supporting agencies.
- Improved noticing and documentation availability on proposals and proposed actions, reaching out to affected and interested agencies for comments in a timely and responsible manner, and incorporation of comments received in the analysis for individual proposals.

Unfortunately, although some results were positive and available funds helped early in the project, these actions did not provide a corrective force sufficient to overcome, in just 17 months, the previous five years of minimal oversight and inconsistent business practices, much less to cure the difficulties in the agency’s current operations.

<i>Fiscal Year</i>	<i>Budgeted</i>	<i>Actual</i>	<i>Overage Unbudgeted</i>	<i>Average % of Overages</i>
FY 2013/2014:				
Legal	5000	51316	46316	926%
Special Studies	0	11156	11156	100%
Transition Costs	0	14277	14277	100%
*Termination	0	19729	19729	100%
FY 2013/2014 Totals	5000	95478	91478	
FY 2014/2015				
Legal	18000	32766	14766	82%
Special Studies	10785	25433	15141	140%
Transition Costs	0	0	0	0
*Termination	0	0	0	0
FY 2014/2015 Totals	28785	58199	29907	
TOTALS	33785	153677	121385	359%

*Unfunded PERS liability of \$14000/year, past employee				
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The above chart demonstrates four areas where either nothing was budgeted for the services, or the service was severely under budgeted; all expenses were approved by the Commission.

During the 2013/2014 budget hearings it was suggested to add these categories to the proposed budget. Here is a simple comparison of what was suggested as compared with what actually happened in the budgets over the past 17 months:

<i>Special Studies Categories</i>	<i>Budgeted for 2013/2014</i>	<i>Recommended for 2013/2014 Budget</i>	<i>Actual Expense 2013-2015</i>	<i>Notes</i>
SOI/MSR 1 <sup>st</sup> Round	0	36589	36480	19% of budget
Round #1 Legal Expense	0	23040	10142	10% of budget
SOI CDFW fees (or exemptions from fees)	0	unknown	0	\$2200 per filing; Unknown total
Total		59629	46622	Final cost as proposed

Our most current estimate of Shasta LAFCO’s finances as of March 27<sup>th</sup> (see Item 5. b. 2) on this agenda) indicates our total expenses will be \$230,363. As of March 27<sup>th</sup> we had an estimated \$9,263 in cash funds. The last quarter of the Draft Budget Worksheet for this fiscal year demonstrates we have insufficient cash to operate the agency through the end of this budget cycle.

Government Code 56381(c) states,

*“If, at the end of 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.”*

This indicates that, should the board of supervisors agree to provide these funds, Shasta LAFCO will need to add the total amount of the funds requested ( yet to be determined) to the amount of its current revenues (\$186,000) to its 2015/2016 draft budget. This is a common practice used especially by smaller special districts and other agencies, when their revenues are unexpectedly low or absent at an untimely point in their fiscal year.

To demonstrate:

<i>Annual Revenues (actual)</i>	<i>Borrowed Revenues (example)</i>	<i>Increase to Budget to repay loan</i>	<i>% of Increase</i>
186,000	60,000	246,000	32%
186,000	75,000	256,000	40%

The Fiscal Committee has been meeting on these issues for several months now, and will have met three times in this month alone. Commissioner Fyten presented a comprehensive analysis of the impending budget shortfall at the February 19, 2015, meeting. By the time the Commission meets to consider the proposed Draft Annual Budget on April 30, 2015, the Committee will likely hold at least two more meetings on the matter.

Critical to addressing this issue is the need to publish the Draft Proposed Budget for 2015/2016 by the first full week in April. Both the Commission, its Fiscal Committee, its cost-share agencies, and the public will have until the June 4<sup>th</sup> meeting to submit comments and suggestions. The Commission, on the other hand, will need to seek alternative methods of financing the final three months, the 4<sup>th</sup> Quarter, of this fiscal year before what revenues remain are gone. The Commission cannot afford to wait until June or July to make that decision.

**Conclusions:**

Shasta LAFCO has currently overspent its budgeted revenues by approximately \$50,000. There are additional obligations that will come in during April, May, and June of this year which may increase that amount, even with the very austere practices that have been in place for many months.

- Legal costs are \$46,316 over budget for FY 2013/2014, and \$14,766 (as of February this year) for FY 2014/2015.
- Special Studies expenses were over budget by \$11,156 for FY 2013/2014, and \$15,141 for FY 2014/2015.
- Restricting the annual cost-share total to \$186,000 for the past two years was an unwise approach to cutting costs, since the unintended consequence of those decisions did not permit adjustments to the 2014/2015 revenues to accommodate the significant increase in legal fees (two lawsuits, increased meetings, additional work, etc.)
- Regardless of maintaining close watch on staff costs, LAFCO staff was required to work extremely hard to accomplish the goals set by the Commission (conclusion of studies, increase in number of hearings from six a year to fourteen for the studies alone, etc.). And staff met each of those assigned goals.

Budget planning for 2015/2016 was estimating a 7% or 13% increase to accommodate current operation needs.

**Recommendations:**

It is recommended that the Commission instruct its Fiscal Committee and staff to

- Immediately seek a solution to the current deficit so as to permit Shasta LAFCO to cover its obligations until the new fiscal year begins.
- Complete the reconstruction of the agency's finances from 2008.
- Budget for a new audit during FY 2015/2016 to cover the past four years.

**Attachments:**

- A. Explanation of 2014/2015 Budget Overrun (Fyten)
- B. 2013 Proposed Changes to add SOI/MSR Funding Categories
- C. 2013/2014 Adopted Budget
- D. 2013/2014 Budget Update (Issued for 1<sup>st</sup> and 2<sup>nd</sup> Quarters)
- E. 2014/2015 Adopted Budget Worksheet
- F. SOI/MSR Master Plan Process – Final for December 2014