

Mendocino County  
Financial Management Roadmap Project:

# Reserve and Fund Balance Policy

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# The Financial Roadmap Project

**The County Financial Management Roadmap Project's goal** is to develop clear, actionable steps to improve the the County's financial management while addressing problems highlighted in external audits and reviews.

**These improvement recommendations will focus on:**

1. Systems improvements
2. Process improvements
3. Organizational considerations
4. Core financial policies and practices

# Financial Policies

**Review is underway of several core financial policies and practices:**

- Financial tracking and reporting
- Forecasting process and practices
- One-time revenue practices and policies
- **Fund balance and reserve policy (Today's Focus)**
- Others as determined through review process

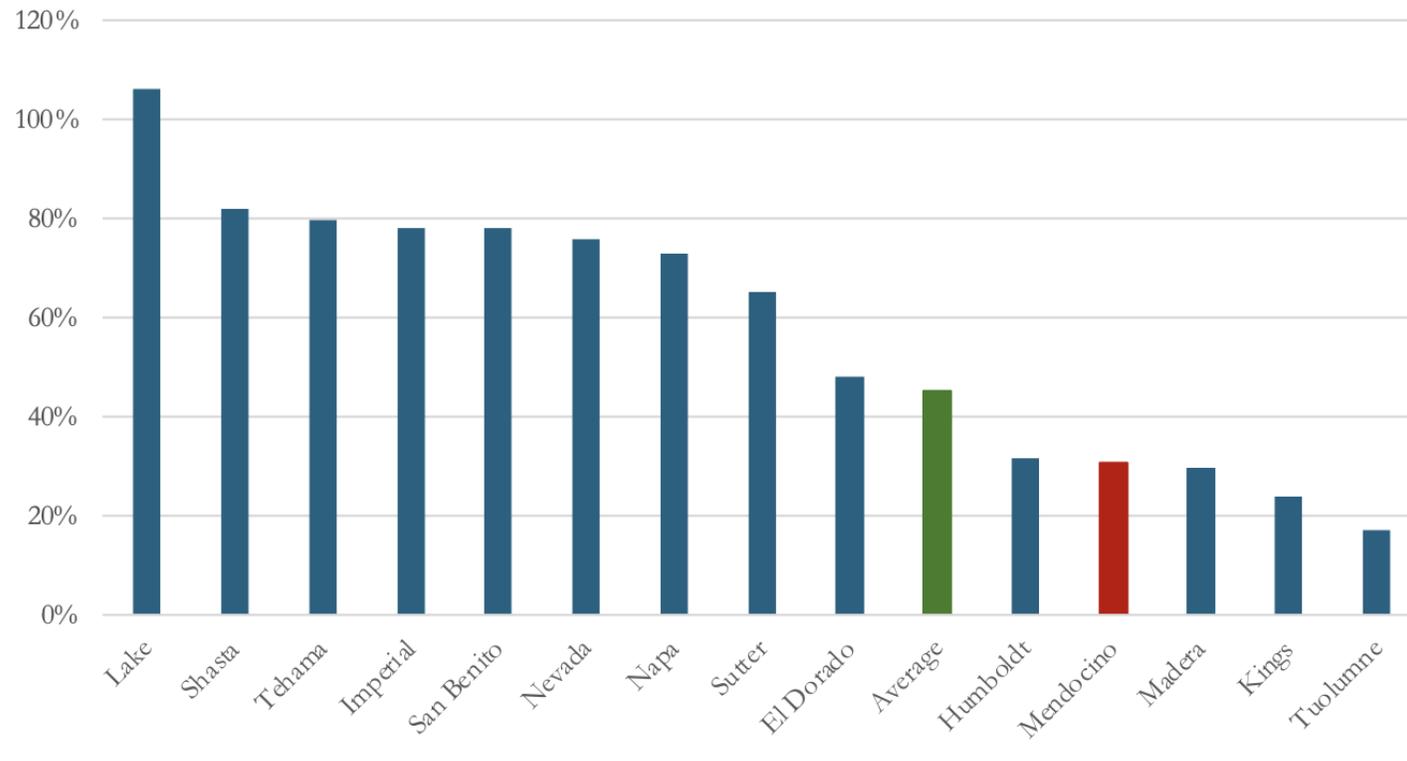
# Current Reserve Policy Problems

**The County's current reserve policy suffers from several critical weaknesses:**

- Targets are well below recommended industry standards and those of peer counties.
- This leaves the County severely exposed to impacts from recessions, emergencies, and other short- and long-term financial shocks.
- The current policy's complexity makes reserve administration challenging and hard for the public to understand.

# Fund Balance Significantly Lower Than Most Peers

**Total Fund Balance**  
(California Counties Between 50k-200k Population)



## A Key Indicator of Financial Health:

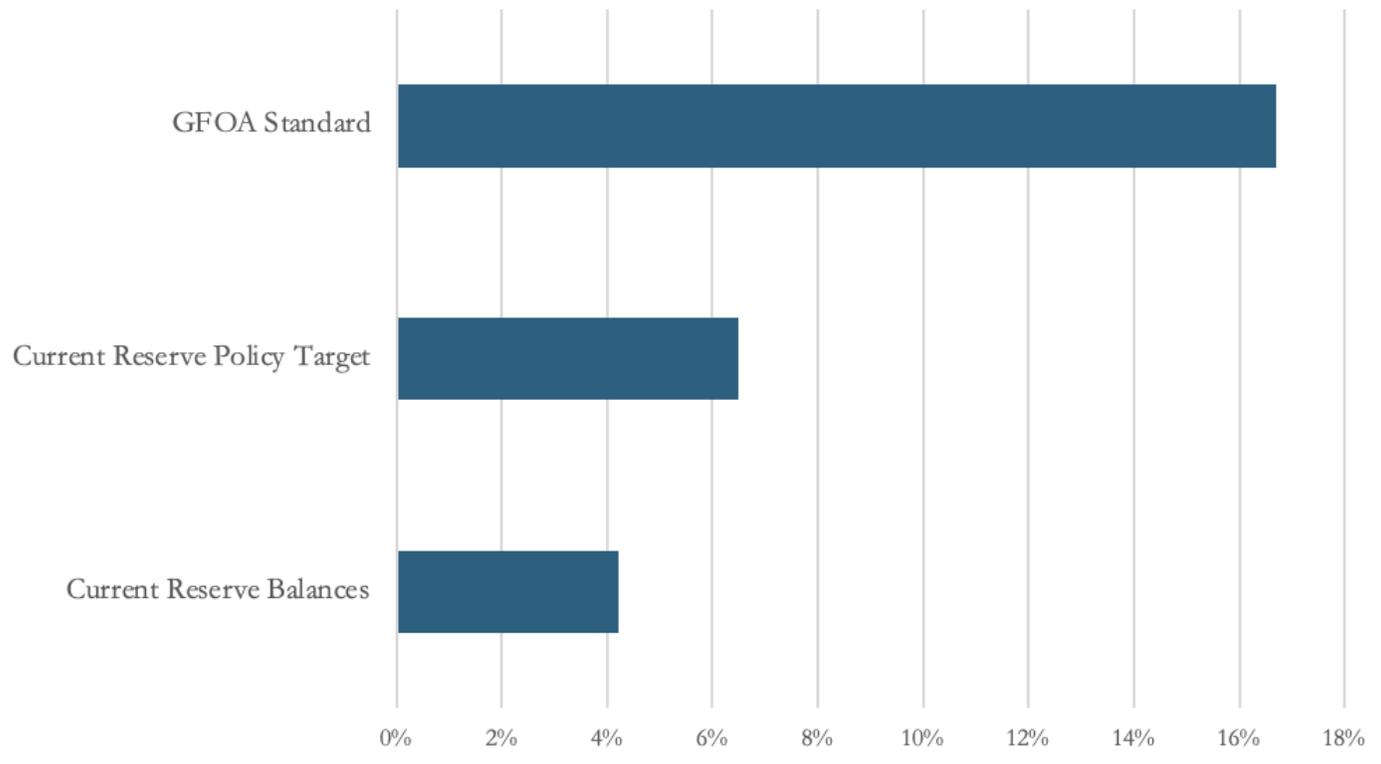
Fund balance in the General Fund reflects the year-end balance available for various future commitments - restricted grant balances, contract and capital project encumbrances, and reserves.

Mendocino's general fund fund balance is **30% lower** than peer county averages.

Reserve deficiencies account for most of this difference.

# General Reserves Lower than Standards

Mendocino General Reserves vs. GFOA Standards



(Sources: FY23-24 County Annual Comprehensive Financial Reports)

## Industry Standards:

Government Finance Officers Association (GFOA) recommends a general practice of maintaining reserves equivalent to two months of general operations (or 16.7%).

Mendocino's current target and actual reserve funding levels are **significantly below** this standard.

# Recommended Structure

**Simplify the reserve structure, establishing three reserves designed for different risks:**

- 1. Contingency Reserve** - Shocks to the annual adopted budget
- 2. Rainy Day Emergency Reserve** - Impacts from recessions and emergencies
- 3. Infrastructure & Systems Reserve** - Deferred maintenance of County assets & systems

# Contingency Reserve

## Contingency Reserve

- **Short-term focus:** Covers mid-year weaknesses without necessity of immediate cuts.
- Target of 5% of general fund expenditures.
- Draws from the reserve in one year replenished in following year's budget.
- Clear administration: Auditor-Controller maintains, with quarterly CEO balance reports.

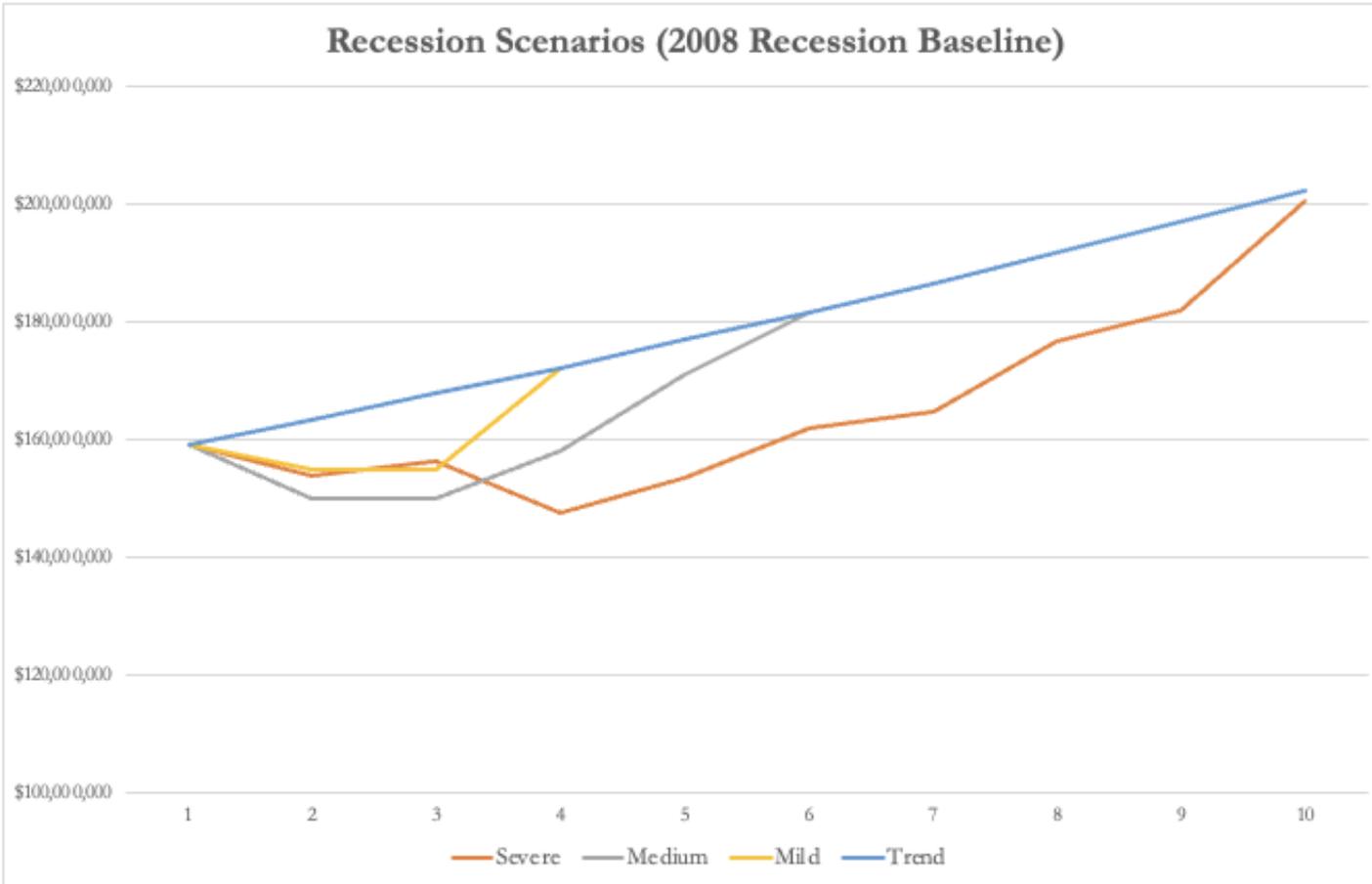
# Rainy Day Emergency Reserve

## Rainy Day Emergency Reserve

- **Long-term focus:** Minimizes budget cuts and services losses resulting from disasters, multi-year recessions, and other emergencies.
- Reserve grows gradually over time during stronger periods using 50% of better-than-expected year-end close balances. Drawn during recessions or Board-declared emergencies.
- Reserve minimum and target balance: 0% to 15% of annual expenditures.
- Clear administration: Auditor-Controller maintains and deposits to reserve, with quarterly CEO balance reports.

# Sizing the Rainy Day Emergency Reserve

**Recession Scenarios (2008 Recession Baseline)**



## Reducing Service Cuts During Recessions:

Each recession will be different, with varying impacts on the County's finances. Using the 2008 recession as a guide, different reserve balances would have been required to bridge 50% of losses:

<u>Scenario</u>	<u>Reserve Target</u>
Severe recession (2008)	44% target
Moderate recession	15% target
Mild recession	7% target

# Infrastructure & Systems Reserve

## Infrastructure & Systems Reserve

- **Address long-term liabilities:** Available for deferred maintenance and improvement of City facilities, infrastructure, systems, and other one-time uses.
- Reserve deposits from 50% of better-than-expected year-end close balances. Drawn during the subsequent budget (or any time) for capital and system priorities.
- Clear administration: Auditor-Controller manages deposits to reserve, with quarterly CEO balance reports.

# Phasing In the New Structure

**Current and future pressures need to be balance in adopting a new reserve policy.**

The recommended is to adopt a new structure that will phase in over time, with no new money required today:

- Current reserve balances would be used to establish the Contingency Reserve at target levels of \$8M, with \$3M transferred to both the Infrastructure & Systems Reserve and the Rainy Day Emergency Reserve.
- Pending Board action, transfer remaining FY24-25 Fund Balance to further fund Infrastructure & Systems Reserve
- Infrastructure & Systems Reserve appropriated in FY26-27 budget for priority projects.
- Rainy Day Emergency Reserve would grow more gradually over time, until needed.

# Closing Recap

Changes to the County's reserve policies are recommended to better meet industry/peer standards and address deficiencies noted in external and internal reviews.

Most critically, these changes would allow the County **to better safeguard future County services and staff by helping to stabilize its long-term financial management.**

The recommended policy would gradually phase in this new structure, requiring no new money today but growing over time to better position the County in the future.

Questions and comments?