ORANGE COUNTY FIRE AUTHORITY

P.O. Box 57115, Irvine, CA 92619-7115 • 1 Fire Authority Road, Irvine, CA 92602

Jeff Bowman, Fire Chief **(714) 573-6000** **www.ocfa.org**

September 8, 2015

VIA CERTIFIED U.S. MAIL

The Honorable Glenda Sanders
Presiding Judge
O.C. Grand Jury
700 Civic Center Drive West
Santa Ana, CA 92701

Dear Judge Sanders,

Subject: OCFA Responses to 2014-15 Grand Jury Report "Joint Powers Authorities: Issues of Viability, Control, Transparency, and Solvency."

At its August 27, 2015, meeting, the Orange County Fire Authority's Board of Directors approved and authorized the attached responses to the Findings/Conclusions and the Recommendations to the 2014-15 Grand Jury Report entitled "Joint Powers Authorities: Issues of Viability, Control, Transparency, and Solvency." as requested.

Please feel free to let me know if you have any questions or need additional information.

Sincerely,

Sherry A.F. Wentz, CMC
Clerk of the Authority

cc: Grand Jury Foreman Paul S. Borzcik

Enclosure: OCFA Responses to the 2014-15 Grand Jury Report "Joint Powers Authorities: Issues of Viability, Control, Transparency, and Solvency."

September 3, 2015

The Honorable Glenda Sanders
Presiding Judge
Orange County Superior Court
700 Civic Center Drive West
Santa Ana, CA 92701

Your Honor,

The Orange County Fire Authority (OCFA) Board of Directors reviewed the 2014/15 Grand Jury report, "Joint Powers Authorities: Issues of Viability, Control, Transparency, and Solvency," during its public meeting held on August 27, 2015. The Board has reviewed and authorized this formal response from our agency.

We appreciate the time and effort the Grand Jury has dedicated to the citizens of Orange County in the pursuit of fair and transparent governance. The enclosed responses describe the OCFA's compliance with the Grand Jury's recommendations.

If I may be of service in the clarification of this response, please feel free to contact me at jeffbowman@ocfa.org or (714) 573-6010.

Sincerely,

Jeff Bowman
Fire Chief

Reserved for Board Recommendation/Action

MINUTES
ORANGE COUNTY FIRE AUTHORITY

Board of Directors Special Meeting

August 27, 2015
5:30 P.M.

3. CONSENT CALENDAR

C. Response to Grand Jury Report: "Joint Powers Authorities: Issues of Viability, Control, Transparency, and Solvency"

This item was pulled by a member of the public.

Stephen Wontrobski, Mission Viejo resident, spoke in opposition to OCFA's response to the Grand Jury Report.

On motion of Vice Chair Swift and second by Director Muller, the Board of Directors voted unanimously by those present to approve and authorize the Fire Chief to submit the proposed response to the recommendations contained in the Grand Jury Report entitled *"Joint Powers Authorities: Issues of Viability, Control, Transparency, and Solvency"* to the Presiding Judge of the Superior Court and to the Orange County Grand Jury.

Background and History of Compensation Cost Transparency at OCFA

The Orange County Grand Jury released a report entitled, *"Joint Powers Authorities: Issues of Viability, Control, Transparency, and Solvency"* on June 29, 2015. The report addresses concerns with (1) the viability of the JPAs with Redevelopment Agencies as members since RDAs were eliminated in 2012, (2) the use of JPAs by government organizations to be controlled by a single governmental entity, (3) the lack of true disclosure and transparency of their organization and financial information to taxpayers, and (4) the extreme debt to revenue ratio of some JPAs, which brings into questions their solvency.

Summary

Since becoming a Joint Powers Authority in 1995, the Orange County Fire Authority has evolved from a start-up organization to one that has continually received awards for excellence in financial reporting. A key to the current success and recognition has been the involvement and oversight by our Board of Directors in fiscal responsibility and strategic planning.

Some of the key documents that ensure continued transparency of our organization and financial information, and which are made available annually to our Board of Directors and the public include:

- Average annual firefighter earnings presented every November since 2008 including:
  - Annual overtime costs
  - Top earners and reasons for overtime
- Since 2009, the OCFA has regularly forwarded all compensation information on an annual basis to the State Controller's Office for posting on its website, and provides a web link on OCFA's website to this information
- The OCFA posts all employee's and director's compensation information on its website as recommended by the 2012 Grand Jury Report using the Grand Jury's model that was to be replicated by all Orange County local governments, since 2012
- Annual Budget Adoption (occurs annually each May or June)
  - While not required by law, the OCFA conducts a public hearing with each proposed budget adoption
  - Retirement and benefit costs are included in the publicly circulated budget documents, as well as retirement rate information
  - Future salary increases per labor agreements, if any, are disclosed within the budget documents
  - Five-year financial forecasts are provided in the budget documents, including a narrative which describes the detailed assumptions used within the forecast pertaining to salary and benefit costs
- Comprehensive Annual Financial Reports & Single Audit Reports
- The Orange County Retirement System (OCERS) posts retirement rate information on its website
- Since 2012, the OCFA has provided annual Liability Studies at public meetings of the Board of Directors, with the stated purpose "to ensure the long-term viability of the organization."

Response to Findings and Recommendations

Finding 4. Vertical Joint Powers Authorities with a single controlling entity, such as a city council, have the potential to use this organizational structure as a shell company to avoid other legal constraints on the controlling entity and to obfuscate taxpayer visibility.

The OCFA partially disagrees with this finding because the above finding is not applicable to the OCFA. Based upon the criteria provided in the Grand Jury report, the OCFA is a horizontal JPA, not a vertical JPA, since our members are composed of multiple similar entities that share a common problem or opportunity.

The OCFA membership is made up of 23 Orange County cities and the County of Orange for the purpose of providing public safety through shared fire prevention, suppression and emergency medical services. Each member agency has delegated these functions to the OCFA, reduced the cost of service through economies of scale, and has representation on its Board of Directors. The OCFA provides regional services, including specialty resources that would be difficult (financially) for many of our individual member agencies to provide on their own, such as air operations, hazardous materials response, hand crew and heavy equipment (bulldozer) services, etc. Each member agency also has the ability to withdraw from the OCFA JPA, if it so chooses. As a result, there are organizational checks and balances that allow for self-correction and accountability. As cited in the Grand Jury report as an example of horizontal JPAs, the OCFA JPA *does* provide a real service to the community.

Finding 5: Vertical Joint Powers Authorities in which the controlling entity transfers assets from itself to a Joint Powers Authority for the purpose of obtaining additional funding, or signs a long-term lease to a Joint Powers Authority to obtain assets, are avoiding transparency and are not acting in the best financial interest of the taxpayers.

The OCFA partially disagrees with this finding because the above finding is not applicable to the OCFA. As explained in Finding 4, the OCFA is not a vertical JPA structure, but a horizontal JPA structure.

Finding 9: The Orange County Fire Authority has an off-the-books unfunded debt liability of $577 million which the Grand Jury has determined to be of concern since it is a real liability on the County taxpayers.

The OCFA disagrees partially with this finding. The OCFA complies with all requirements issued by the Government Accounting Standards Board (GASB). GASB previously required governmental agencies to disclose pension contribution information in the footnotes of their financial statements; however, GASB did not require liabilities to be recognized for the local government's obligations in a pension plan. Under new GASB Statement 68 (*Accounting and Financial Reporting for Pensions*) effective fiscal year ended June 30, 2015, OCFA will begin reporting a liability in its financial statements for the unfunded portion of its pension liability. This action is described in greater detail in the response to Recommendation 7, below.

Separate from the financial statement reporting discussed above, the OCFA has routinely provided disclosure and transparency of its liabilities well-beyond GASB requirements by issuing an annual Liability Study at public meetings and making the Study available on its website.

http://www.ocfa.org/Transparency/Transparency.aspx#financial

Further, the OCFA has taken a proactive role in paying down this debt. See response to Recommendation 7.

Recommendation 3. All Joint Powers Authorities should take the following actions to insure transparency to the taxpayers: (1) have an annual outside audit, (2) post the complete audit on their city website as a separate Joint Powers Authority entity, (3) send the audit to the County Controller and the State Auditor, and (4) ensure the required reports are filed annually to the County and the State.

The OCFA has previously and routinely followed these recommended practices; therefore, the recommendation has been implemented.

Since its creation, the OCFA has regularly conducted annual financial audits performed by an outside Certified Public Accounting (CPA) firm, with the results presented to its Budget and Finance Committee and Board of Directors for approval. These audit reports are routinely included as attachments to the corresponding staff reports for the public meetings, and are made available on the OCFA's website. In addition, the audit reports are posted as independent documents on the OCFA's webpage dedicated to "transparency." OCFA staff routinely forwards these audit and financial reports to each member agency, which includes the County of Orange's CEO and the State Controller's Office. The Grand Jury report is recommending that audits be transmitted specifically to the County Controller and the State Auditor. While the OCFA already transmits its audits with the County CEO and the State Controller, we will also add the County Controller and State Auditor to future transmittals.

Recommendation 7. The Orange County Fire Authority should address their lack of transparency by providing public disclosure of their off-the-books unfunded public liability in their financial statements and address their solvency by an aggressive plan to reduce their unfunded liabilities.

The recommendation has not yet been fully implemented, but will be in the future.

Although we believe there has been no lack of transparency by OCFA concerning its long-term liabilities due to our reporting process through an annual Liability Study, we agree that OCFA's pension liability was not included in the financial statements, as discussed under Finding 9. Under new GASB Statement 68 (*Accounting and Financial Reporting for Pensions*) effective fiscal year ended June 30, 2015, OCFA will begin reporting a liability in its financial statements for the unfunded portion of its pension liability. The financial statements will be presented to the Budget and Finance Committee and Board of Directors for approval in November 2015, after the completion of the annual audit.

OCFA's Annual Liability Study

In July 2012, OCFA staff presented a comprehensive Liability Study to its Budget and Finance Committee specifically highlighting long term liabilities facing the OCFA. This Study was reviewed by the OCFA Board of Directors at its September 2012, meeting. The Liability Study not only included pension liabilities, but also included retiree medical liabilities, workers compensation liabilities, and compensated absences. This report exceeded the then current GASB reporting requirements and was intended to keep the Board of Directors and members of the public aware of significant financial challenges facing OCFA so that appropriate plans could be developed for addressing these liabilities. This report was updated and again presented to both the OCFA Budget and Finance Committee and Board of Directors in September 2013 and October 2014.

Actions taken based on these public reports included (1) directing staff to transmit a copy of the report to the County Board of Supervisors and the OCERS Board of Retirement, for its consideration of potential cost-containment actions relating to Pension Cost of Living Adjustments (COLAs) under the authority granted by the '37 Retirement Act, (2) directing staff to pursue a special actuarial study relating to the OCFA's Retiree Medical Defined Benefit Plan to evaluate options for potential plan amendments which could improve plan funding, subject to future negotiation with OCFA's labor groups, (3) directing staff to evaluate the financial feasibility of paying off the outstanding lease financing obligations associated with the OCFA's helicopters, as part of the 2014/15 budget development process, and (4) directing staff to evaluate options for mitigating the budget and liability impacts of payouts for accumulated sick and vacation balances, subject to future negotiation with OCFA's labor groups.

<u>*Governmental Accounting Standards Board Statement 68*</u>

The following information was presented to the OCFA Budget and Finance Committee at its May 14, 2015, meeting in connection with its regular communication with its independent financial auditor in accordance with Statements on Auditing Standards (SAS) No. 114 for the FY 2014/15 Financial Audit:

"On June 25, 2012, the Governmental Accounting Standards Board (GASB) issued new Statement No. 68, Accounting and Financial Reporting for Pensions, which affects the government-wide financial statements of governmental employers that sponsor or contribute to pension plans. OCFA is required to implement this new standard as part of the Fiscal Year 2014/15 financial audit for its full-time employee pension plan with the Orange County Employees' Retirement System (OCERS).

OCERS utilizes an actuary to annually calculate its Total Pension Liability (TPL) for the pension system. The TPL accounts for all future benefit payments that will be made, decades into the future, to current employees of all OCERS plan sponsors. The difference between the pension plan's assets and its TPL is the Net Pension Liability (NPL), also commonly referred to as the "unfunded liability." With GASB Statement No. 68, OCFA will now be required to report its proportionate share of the overall NPL as a long-term liability on its financial statements.

Previously, there had been a close relationship between how governments fund pensions and how they account and report pension information in their financial statements. A pension liability was only reported if there was a cumulative difference between the required and actual contributions made to the pension plan. For OCFA, the amount of any pension liability reported in its financial statements has always been $0, since all required contributions determined by the OCERS actuary have been contributed each year. Under GASB Statement No. 68, the funding of OCFA's pension liability is now completely disconnected from how the liability and related pension expense is reported in the financial statements. It is anticipated that OCFA will begin reporting a Net Pension Liability of approximately $450 million in its Fiscal Year 2014/15 financial statements.

It is important to note that the factual situation of OCFA's pension plan has not changed. Only the way the plan is accounted for and reported in the financial statements is changing. The new guidance provided in GASB Statement No. 68 is a definitive shift from a ***funding-based approach*** to an ***accounting-based approach***. This shift will improve the decision-usefulness of employer-level reported pension information and increase the transparency, consistency, and comparability of pension information across governments.

OCERS has worked with Segal Consulting to develop an actuarial valuation that includes all of the elements necessary for a successful implementation of GASB Statement No. 68 by both OCERS and the various plan sponsors. As part of OCERS' 2014 financial audit, its auditors Macias Gini & O'Connell, LLP, (MGO) completed additional audit tests that directly relate to the pension plan as a whole. In addition, OCFA's financial auditors Lance, Soll & Lunghard, LLP, (LSL) will also be increasing the scope of its audit testing that directly relates to OCFA's portion of the pension plan. The increase in audit test work by both firms (MGO and LSL) will likely include additional steps to test the census data provided to the actuary, as well as any new schedules and disclosures required to be included in the financial statements."

Accelerated Pay Down of OCFA's Unfunded Pension Liability

At its September 26, 2013 Board of Director's meeting, the following strategies for expedited payment of OCFA's unfunded pension liability were approved. These actions were originally estimated to reduce OCFA's amortization period significantly, with payoff anticipated in less than 16 years instead of the 29 year amortization period that was in place by OCERS when this plan was adopted. In 2014, updated actuarial reviews indicated that OCFA's accelerated pay down plan would result in full payment of OCFA's unfunded pension liability within 13 years.

The accelerated pay down strategies that have been operational for the past two years include:

1. Contribute additional amounts each year using the unencumbered fund balance available following the close of the prior fiscal year, estimated at approximately $3 million per year.

2. Contribute additional funds each year, using the savings that will be realized under PEPRA and savings from reductions to OCFA's retirement contribution rates, based on recent 15-year rate projections provided by Segal Consulting.

3. Beginning in FY 2016/17, contribute an additional $1 million per year building to $5 million in annual payments over 5 years; at year 5, pause to reassess whether the annual increases should continue to build, remain at $5 million, or be adjusted otherwise.

In addition, the Board of Directors took the following actions at its public meeting:

1. Directed staff to provide updates to the Board each year as part of the mid-year budget presentation, indicating the amount of Fund Balance Available (FBA) from the prior fiscal year, and directing those amounts to be paid to OCERS as annual lump-sum payments towards the OCFA's UAAL.

2. Directed staff to include additional payments towards the OCFA's UAAL in the annual budget, including the following factors:

   a. Savings that result from the new Public Employees' Pension Reform Act provisions and other reductions in OCFA's retirement contribution rates shall be used as a source for additional UAAL payments.

   b. Beginning in FY 2016/17, an additional $1 million should be added to the OCFA's annual budget each year for 5 years, for retirement contributions to OCERS as a base-building source for additional UAAL payments.

   c. Provide updates to the Board each year as part of the annual budget presentation, indicating the amount planned in each yearly budget as additional payments towards the OCFA's UAAL, resulting from the factors above.

The OCFA has been proactive in disclosing its pension liability to the Board of Directors, making the information transparent to the public, and developing creative plans to pay down the pension liability, thereby enhancing the organization's financial strength.