



Steven S. Choi, Ph.D., Mayor

cityofirvine.org

City of Irvine, One Civic Center Plaza, P.O. Box 19575, Irvine, California 92623-9575

949-724-6233

September 14, 2015

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

RE: City of Irvine Response to Orange County Grand Jury Report
"Unfunded Retiree Healthcare Obligations – A Problem for Public Agencies?"

Dear Honorable Judge Sanders:

The City of Irvine has reviewed the Orange County Grand Jury Report, "Unfunded Retiree Healthcare Obligations – A Problem for Public Agencies?" released on June 29, 2015. The City of Irvine appreciates the role of the volunteer members of the Grand Jury and thanks them for their time and effort analyzing this important topic. As requested by the Grand Jury, and under California Penal Code Section 933, this letter constitutes the City of Irvine's response to the Grand Jury's findings and recommendations.

The City of Irvine agrees with the importance of addressing the funding of retiree healthcare and all other post-employment obligations. Unlike many cities, Irvine does not pay for health care coverage for retired employees. Instead, the City offers employees at the time of retirement the option to purchase the medical insurance plan in effect at premium group rates for the employee and their eligible dependents. This benefit increases the City's overall pooled health insurance premiums, since retired employees are more expensive to insure than active employees, but the cost impact is minimal compared to directly paying the cost of retiree health insurance premiums. In addition, providing our insurance plans at the group rate to retirees as a benefit of employment provides an additional incentive for the retention of valuable and experienced employees.

The City commissions an actuarial report every two years to estimate the cost of the implicit subsidy associated with this benefit. The cost, which is reported on the City's financial statements, includes the price of coverage for retirees participating in the program and also a projection of the cost for existing employees who may elect the

option to participate in the future. The City's estimated accrued liability per capita is the seventh lowest of the 32 entities in the Grand Jury's report. According to the Grand Jury report, the City of Irvine's actuarial liability is \$25 per resident. This compares to an average of \$120 and as much as \$694 for other Orange County entities. Beyond Orange County, a report from California Common Sense indicates the average per-capita unfunded retiree health liability is \$625 among California cities and \$1,737 for the State of California.¹ In comparison, the City's per capita unfunded liability is 4% of the average city's liability in the State of California.

The results of such liability estimates are sensitive to their underlying assumptions, including the number of future retirees anticipated to participate in the program, the time they will participate and projections of future health care costs. The City of Irvine's most recent actuarial analysis, which is more contemporary than the data in the Grand Jury report, indicates Irvine's unfunded liability has since decreased from \$25 per resident to \$22. Several recent changes in the operating environment may cause additional future cost reductions. Changes in California public retirement plan law now incentivize a later retirement age. This will likely reduce the time retirees pay for coverage from the City before eligibility for Medicare coverage commences. In addition, the Affordable Care Act provides an additional insurance option not previously available to retirees as an alternative to the City's own health insurance program.

While the City has not yet established an irrevocable trust fund to finance its projected retiree health obligations as recommended in the Grand Jury's report, this liability has not been forgotten. In recent years the City has been prioritizing the pay-down of a considerably larger liability, its unfunded pension liability. For purposes of comparison, this liability is 73% of its annual General Fund expenditures, while the actuarially projected retiree health benefit liability is only 3%. To date, the City has paid an additional \$18 million towards the unfunded pension liability and is on course to meet the objective of paying it down within 10 years. This effort will result in estimated savings of \$142.9 million over 29 years, with present value savings of \$33.1 million. The unfunded retiree health benefit liability will be presented to City Council in the future for prioritization as additional funds are made available from the aggressive pay-down of the pension debt.

The City of Irvine carefully manages its operations and is proud of its conservative management of its fiscal resources, which includes the City Council's plan to accelerate payment of its unfunded pension liability. The City has noted the findings and recommendations in the Grand Jury report and will continue to closely monitor its pension, retiree health and other obligations.

¹Adam Tatum, Surveying California's Unfunded Retiree Healthcare Obligations (California Common Sense, April 2014)

FINDINGS

F.2. Twenty one out of the 32 agencies that provided June 30, 2013, data to the Grand Jury had not put aside funds in an irrevocable trust to help pay for the accrued actuarial liability of retiree healthcare costs. This is an imprudent level of contribution.

The City of Irvine agrees with the finding that it has not put aside funds in an irrevocable trust to pay for accrued actuarial liabilities; however, the City disagrees with the characterization this is an imprudent level of contribution as it pertains to Irvine. Unlike agencies that provide a defined retiree health care benefit, Irvine offers retirees the opportunity to self-pay for health insurance at current employee group rates. Therefore its retiree health obligations are not direct payments to a retiree or on behalf of a retiree. Because retirees, who generally cost more to insure, are allowed to pay the full premium in the City's health insurance program, the premium per participant is higher than it would otherwise be. This increased cost, as an implicit subsidy, becomes the basis of the actuarially calculated unfunded liability.

The implicit benefit incurred is not considerable, especially as it compares to Irvine's resources. The calculated accrued liability represents 3% of the City's expenditures and Irvine's estimated per capita liability is the seventh lowest of the 32 entities in the Grand Jury's report. Irvine has concentrated its resources on reducing its larger unfunded pension liability and believes that working to realize the financial gains expected from this endeavor are the highest priority. The smaller retiree health care liability is not forgotten, however, and setting aside additional funding to offset this actuarial liability will be brought to City Council for consideration in the future as the City realizes savings from the reduction in its pension liability.

F.3. Anaheim, Buena Park, County of Orange, Huntington Beach, Lake Forest, and Stanton complied with the requirement to contribute a full 100% or more of their Annual Required Contribution in the FY 2012-13. The remaining 26 agencies did not comply.

The City of Irvine disagrees partially with this finding. The Grand Jury report indicates that the Grand Jury believes that, "... it is in the best interest of cities with high Annual Required Contribution (ARC)/Annual Covered Payroll (ACP) values to take steps to reduce their Accrued Actuarial Liability, either by putting away funds (sinking fund) to meet these future expenses, or by renegotiating their future benefit payments with their employees/unions." The City agrees it is not setting aside monies in a sinking fund for this purpose for reasons described above, but the City's ARC/ACP value, or ratio, of less than 1% is the third lowest of the 31 entities for which data was available in the Grand Jury's report. The City of Irvine is prioritizing the accelerated payment of its larger unfunded pension liability at this time. The City is not aware of any requirement to establish a sinking fund as the finding implies, though the City will prioritize doing so

when additional funds are made available from the pay-down of its larger pension liability.

Government Accounting Standards Board (GASB) Statement No. 45, establishes standards for an employer's accounting and financial reporting of Other Postemployment Benefits (OPEB). An employer's method of financing the benefits is outside the scope of this GASB Statement and there is no requirement to contribute a full 100% or more of the ARC.

***F.4.** All agencies surveyed (except Anaheim) do not disclose retiree health benefits as part of employee compensation per GAAP standards.*

The City of Irvine wholly disagrees with this finding. The City of Irvine complies with GASB Statement No. 45, which governs the reporting of retiree health benefit costs in the City's financial statements. GASB Statement No. 45 represents Generally Accepted Accounting Principles, or GAAP, for the City's treatment of these costs. We are unaware of any more detailed accounting requirements applicable to the City than this.

GASB Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, has identified GASB statements and interpretations as the authoritative guidance on state and local government GAAP. Thus, GASB Statement 45 is the highest level of authoritative guidance for state and local governments on this issue and the City of Irvine is in compliance with this as a GAAP standard.

RECOMMENDATIONS

***R.2.** The 21 agencies that have not contributed into an irrevocable trust fund to finance their retiree health obligations should put aside monies to fund this obligation and reduce their unfunded public liabilities. (F.2)*

This recommendation will not be implemented since it is not warranted at this time. The City of Irvine has prioritized paying-down its unfunded pension liability, a much larger obligation. In June 2013, the Irvine City Council adopted a ten-year plan to accomplish this goal and, to-date, has paid \$18 million to accelerate the pay-down of this unfunded public liability. The City Council's plan is expected to realize savings of \$142.9 million over 29 years, representing a present value savings of \$33.1 million. While the retiree health benefit liability is significantly smaller, it is also important and has not been forgotten. It will be brought back to the City Council for consideration as additional savings are made available from the aggressive reduction in its pension liability. Meanwhile, the City of Irvine complies with all reporting requirements related to the cost of its retiree health benefits as discussed in **F.3** above.

R.3. *The 26 agencies not recognizing their full Annual Required Contribution as expense in the current period and should comply with the requirement to do so. (F.3)*

This recommendation will not be implemented since it is not warranted. The City of Irvine reports the full cost of its retiree health benefit in its financial statements in accordance with applicable government accounting standards. The City's pay as you go approach is identified within those standards as an acceptable funding option. Unlike other agencies, the City of Irvine does not directly pay for retiree health care expenses. The City instead indirectly subsidizes retiree health insurance costs by allowing retirees at the time of retirement the option to continue to self-pay for health insurance at the City's group rates. At this time the City is prioritizing the pay-down of its larger unfunded pension liability. Setting-aside additional funding in a fund to offset the actuarially projected unfunded retiree health benefit liability will be presented to the City Council for consideration as savings are realized from the reduction in this pension liability.

R.4. *All agencies surveyed should recognize retiree health care benefits in employee compensation in conformity with GAAP. (F.4)*

The recommendation has been implemented as the City of Irvine complies with GASB Statement No. 45 governing the reporting of retiree health benefit costs in the City's financial statements. GASB Statement No. 45 represents GAAP for the City's treatment of these costs. We are unaware of any more detailed accounting requirements applicable to the City than this.

As stated in **F.4**, GASB Statement No. 55 has identified the authoritative guidance for state and local government GAAP. Thus, GASB Statements and Interpretations, including GASB Statement No. 45, are the highest level of authoritative guidance for state and local governments.

Please contact myself or City Manager Sean Joyce at (949)724-6249 if you have questions or if we can provide additional information.

Sincerely,



Steven S. Choi, Ph.D.
Mayor

cc: Irvine City Council
Paul S. Borzcik, Foreman, 2013-14 Orange County Grand Jury