



# CITY OF HUNTINGTON BEACH

Fred A. Wilson  
City Manager

September 28, 2015

The Honorable Glenda Sanders  
Presiding Judge of the Superior Court  
700 Civic Center Drive West  
Santa Ana, California 92701

## **RE: "Unfunded Retiree Healthcare Obligations-A Problem for Public Agencies?"**

Dear Judge Sanders:

This letter constitutes, in accordance with Section 933.05 of the California Penal Code, the response of the City of Huntington Beach to the Orange County Grand Jury 2014-15 Report, dated June 29, 2015, titled "Unfunded Retiree Healthcare Obligations-A Problem for Public Agencies?" (Grand Jury Report). The enumerated items in this response correspond to the Findings and Recommendations contained in the Grand Jury Report for the City of Huntington Beach.

### Grand Jury Findings and Recommendations

The City of Huntington Beach is providing the following response to each of the findings and recommendations, in accordance with California Penal Code Sections 933 and 933.05 (a) and (b).

### **Findings**

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

**Response: Disagree with Finding.** *The objective of GASB Statement No. 45, "Accounting and Financing Reporting by Employers for Postemployment Benefits Other Than Pensions," is stated as follows:*

*"... to improve the faithfulness of representations and usefulness of information included in the **financial reports** of state and local governmental employers...[emphasis added]"*  
(GASB Statement No. 45, paragraph 1, Introduction)

*The City's audited Comprehensive Annual Financial Report (CAFR) includes a detailed note disclosure on the City's Other Post Employment Benefit (OPEB) Plans in accordance with GASB 45 (see Attachment 1 for the OPEB note disclosure excerpted from the City's most recent CAFR).*

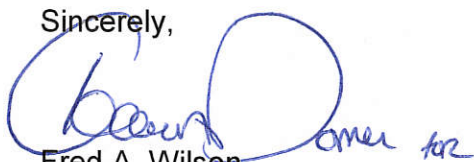
## Recommendations

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

**Response: Completed.** *The recommendation has been implemented. As noted in the above response to Finding F.4, the City complies with the requirements of GASB Statement No. 45 and includes all required disclosures in the City's CAFR.*

On behalf of the City of Huntington Beach, I want to thank you for the opportunity to provide this response to the Orange County Grand Jury.

Sincerely,

A handwritten signature in blue ink, appearing to read "Fred A. Wilson", with a large, stylized flourish extending to the right.

Fred A. Wilson  
City Manager

## Attachments

1. Note 7, "Other Post Employment Benefits," excerpted from the City's Comprehensive Annual Financial Report for the year ended September 30, 2014

C: City Council  
City Attorney  
Assistant City Manager  
Director of Finance  
Director of Human Resources



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**6. RETIREMENT PLAN – SUPPLEMENTAL (Continued)**

**Funded Status and Funding Progress**

Below is the funding progress as of September 30, 2013, the most recent actuarial valuation date (in thousands):

| Entry Age Normal Accrued Liability | Actuarial Value of Assets | Unfunded AAL (UAAL) | Funded Ratio | Covered Payroll | UAAL as a % of Covered Payroll |
|------------------------------------|---------------------------|---------------------|--------------|-----------------|--------------------------------|
| \$ 57,865                          | \$ 36,302                 | \$ (21,563)         | 62.7%        | \$ 27,173       | -79.4%                         |

The assumptions and actuarial methods for the September 30, 2013 actuarial valuation are disclosed in Note 6d and 6f. The schedule of funding progress presented as Required Supplementary Information following the notes to the basic financial statements presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

**7. OTHER POST EMPLOYMENT BENEFITS**

**a. Plan Description**

The City administers the following two other post employment benefits (OPEB) plans:

***Postemployment Medical Insurance***

The City agreed, via contract, with each employee association to provide postemployment medical insurance to retirees. These Other Postemployment Benefits (OPEB) are based on years of service and are available to all retirees who meet all three of the following criteria:

- At the time of retirement, the employee is employed by the City.
- At the time of retirement, the employee has a minimum of ten years of service credit or is granted a service connected disability retirement.
- Following official separation from the City, CalPERS grants a retirement allowance.



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**7. OTHER POST EMPLOYMENT BENEFITS (Continued)**

The City's obligation to provide the benefits to a retiree ceases when either of the following occurs:

- During any period the retiree is eligible to receive health insurance at the expense of another employer; and/or
- The retiree becomes eligible to enroll automatically or voluntarily in Medicare.

The subsidy a retiree is entitled to receive is based on the retiree's years of service credit and is limited to \$344 per month after 25 years of service. If a retiree dies, the benefits that would be payable for his or her insurance are provided to the spouse or family for 12 months. The retiree may use the subsidy for any of the medical insurance plans that the City's active employees may enroll in.

**PEMHCA**

The City provides an agent multiple-employer defined benefit healthcare plan to retirees through CalPERS under the California Public Employees Medical and Hospital Care Act (PEMHCA), commonly referred to as PERS Health. PEMHCA provides health insurance through a variety of Health Maintenance Organization (HMO) and Preferred Provider Organization (PPO) options. The PEMHCA benefits are applied to all safety employee groups, based on retirement plan election. The benefits continue to the surviving spouse for one year. The Huntington Beach Firefighters' Association (HBFA) joined PEMHCA in 2011. All other safety groups (Fire Management Association (FMA), Marine Safety Management Association (MSOA), Police Management Association (PMA), and Police Officers' Association POA) joined in 2004.

Safety employees are eligible for PEMHCA benefits if they retire from the City on or after age 50 with at least five years of service or disability, and are eligible for a PERS pension.

Below is the plan participant data as of June 30, 2013\*:

|   | Postemployment<br>Medical Insurance | PEMHCA |
|---|-------------------------------------|--------|
| Retirees and beneficiaries receiving benefits | 272                                 | 164    |
| Active Plan Members                           | 851                                 | 358    |
| Total Plan Participants                       | 1,123                               | 522    |

\* Actuarial valuation as of June 30, 2013 provides the most recent information available.

The City reports the financial activity of the two plans in its basic financial statements. No separate benefit plan report is issued.



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**7. OTHER POST EMPLOYMENT BENEFITS (Continued)**

**b. Accounting and Funding**

The City utilizes the California Employers' Retiree Benefit Trust (CERBT), an agent multiple-employer plan, for the postemployment medical insurance benefit. Benefits paid from the CERBT were \$725,000 for fiscal year 2013-14. The assets of the CERBT are excluded from the accompanying financial statements since they are in an irrevocable trust administered by CalPERS. Copies of CalPERS' annual financial report may be obtained from their executive office: 400 P Street, Sacramento, CA, 95814 or on their website: [www.calpers.ca.gov](http://www.calpers.ca.gov). The City's policy is to make 100% of each year's ARC, with an additional amount to prefund benefits as determined annually by City Council in order to improve the funded status of the plan.

For PEMHCA, the City selected the "unequal" method for the contribution. Under this method, the City offered a lesser contribution for retirees than for active employees. The City paid the PEMHCA minimum for actives (\$115 in 2013, \$119 in 2014). Beginning in 2008, Assembly Bill 2544 changed the computation for annual increases to annuitant health care under the unequal method. Under the new provisions, the City increases annuitant health care contributions equal to an amount not less than five percent of the active employee contributions, multiplied by the number of years in PEMHCA. The City's contribution for retirees is \$11.50 per employee for HBFA and \$51.75 for all other Safety groups in 2013. The annual increase in minimum PEMHCA contribution to CalPERS will continue until the time that the City contribution for retirees equals the City contribution paid for active employees.



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**7. OTHER POST EMPLOYMENT BENEFITS (Continued)**

The actuarial cost method used for determining the benefit obligations for the June 30, 2013 valuation were determined using the Entry Age Normal Actuarial Cost Method, which is a projected benefit full-cost method which takes into account those benefits that are expected to be earned in the future as well as those already accrued. The actuarial assumptions used were:

- Amortization of unfunded liability – 8 year amortization of initial unfunded liabilities from September 30, 2014 with assumption changes and gains/losses amortized over 15 years
- Discount rate – 6.25%
- Projected salary increases for covered employees due to inflation – aggregate increases of 3.25% per annum
- All other retirement assumptions equivalent to CalPERS' assumptions used for the City's normal retirement plans (refer to Note 5c)
- PEMCHA minimum increases for actives - \$119 in 2014, \$122 in 2015, with 4.5% annual increases beginning in 2016
- The medical trend rate represents the long-term expected growth of medical benefits paid by the plan, due to non-age-related factors such as general medical inflation, utilization, new technology, and the like. The following table sets for the inflation trend assumption used for the valuation:

| Year    | Annual Rate  |          | Year     | Annual Rate  |          |
|---------|--------------|----------|----------|--------------|----------|
|         | Non-Medicare | Medicare |          | Non-Medicare | Medicare |
| 2014/15 | 8.0%         | 8.3%     | 2018/19  | 6.0%         | 6.1%     |
| 2015/16 | 7.5%         | 7.8%     | 2019/20  | 5.5%         | 5.6%     |
| 2016/17 | 7.0%         | 7.2%     | 2020/21+ | 5.0%         | 5.0%     |
| 2017/18 | 6.5%         | 6.7%     |          |              |          |



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**7. OTHER POST EMPLOYMENT BENEFITS (Continued)**

The City's actual contributions, annually required contribution (ARC), Net OPEB asset (NOA), and Annual OPEB Cost (AOC) were computed as follows (in thousands):

**Employer Contribution**

|   |          |
|---|----------|
| Direct Contributions - City health plan contributions | \$ 4,939 |
| Implicit subsidy                                      | 263      |
| Total Employer Contributions                          | \$ 5,202 |

**Development of Annual OPEB Cost (AOC)**

|  |          |
|--|----------|
| Amortization of Actuarially Accrued Liability        | \$ 1,405 |
| Normal Cost  | 927      |
| Total Annual Required Contribution (ARC)             | 2,332    |
| Interest on Net OPEB Assets (NOA)                    | (599)    |
| Adjustment to the Annual Required Contribution (ARC) | 1,266    |
| Total Annual OPEB Cost (AOC)                         | \$ 2,999 |

**Development of Net OPEB Asset (NOA)**

|   |             |
|---|-------------|
| Net OPEB Asset (NOA), beginning of year | \$ (10,558) |
| Annual OPEB Cost (AOC)                  | 2,999       |
| Employer Contribution                   | (5,202)     |
| Net OPEB Asset (NOA), end of year       | \$ (12,761) |

The City's actual contributions of \$5,202,000 are greater than the annual required contribution. The Annual OPEB Cost is reported as expenses in the non-departmental governmental activities program.

**c. Other Disclosures**

Three-year trend information is disclosed below (in thousands):

| Fiscal Year | Annual OPEB Cost (AOC) | Actual Contribution | Percentage of AOC Contributed | Net OPEB Asset (NOA) |
|-------------|------------------------|---------------------|-------------------------------|----------------------|
| 9/30/2012   | \$1,438                | \$2,005             | 139.40%                       | (\$9,359)            |
| 9/30/2013   | \$1,484                | \$2,683             | 180.80%                       | (\$10,558)           |
| 9/30/2014   | \$2,999                | \$5,202             | 173.46%                       | (\$12,761)           |



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**7. OTHER POST EMPLOYMENT BENEFITS (Continued)**

**d. Funded Status and Funding Progress**

As of June 30, 2013, the most recent actuarial valuation date, the plan was 66.3% funded. The actuarial accrued liability for benefits was \$17.4 million, and the actuarial value of assets was \$11.5 million, resulting in an unfunded accrued liability (UAAL) of \$5.9 million. The City has contributed an additional \$2.7 million in the fiscal year ending September 30, 2014 to reduce the UAAL. The covered payroll (annual payroll of active employees covered by the plan) was \$81.7 million, and the ratio of the UAAL to the covered payroll was 7.2%.

The annual required contribution was determined as part of an independent actuarial valuation as of June 30, 2013 using the assumptions as noted in Note 7b.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the City are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as Required Supplementary Information following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the City and plan members) and include the types of benefits provided at the time of each valuation. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.