

September 28, 2015

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

Dear Judge Sanders:

The City of Seal Beach (the “City”) has reviewed the Orange County 2014-15 Civil Grand Jury Report Regarding Unfunded Retiree Healthcare Obligations (“Grand Jury Report”). Below are the City’s comments to the applicable findings and recommendations set forth in the Grand Jury Report pursuant to Penal Code Sections 933(c) and 933.05. The City appreciates the opportunity to provide its response to the Grand Jury Report.

Findings

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

The City disagrees wholly with the finding that it is not in compliance with the requirement to contribute a full 100% or more of its Annual Required Contribution (“ARC”) in the FY 2012-13. As a preliminary matter, there is no requirement that the City contribute a full 100% or more of its ARC. Governmental Accounting Standards Board (“GASB”) Statement 45 governs accounting and financial reports by employers for Other Post Employee Benefits, other than pensions. According to a handout issued by GASB entitled “GASB Statement 45 on OPEB Accounting by Governments a Few Basic Questions and Answers”, a common misconception about Statement 45 is that it requires governments to fund OPEB. Statement 45 does not impose this requirement but rather “establishes standards for *accounting and financial reporting*. How a government actually finances benefits is a policy decision made by government officials. The objective of Statement 45 is to more accurately reflect the financial effects of OPEB transactions, including the amounts paid or contributed by the government, whatever those amounts may be.” See page 2 of the GASB handout, a copy of which is enclosed herein. Thus, under Statement 45, the City is only required to identify the OPEB debt on its financial statements; the City does not need to make the full 100% ARC contribution. Nonetheless, the City does contribute a full 100% or more of its ARC because it has determined that it is a fiscally sound practice to do so.

The City participates in the California Employers' Retiree Benefit Trust Fund ("CERBT"). The CERBT Fund is a trust fund dedicated to prefunding Other Post Employment Benefits OPEB for eligible California public agencies. The City pays current retirees¹ directly for their health care expenses to reimburse them for their contributions to CALPERS and other insurances. At the end of each fiscal year, the City pays CERBT the difference between (1) what the City paid directly to the current retirees and to CALPERS and (2) the City's ARC. The City's ARC is greater than the amount that the City pays directly to its current retirees because the ARC also includes the City's obligations to current employees who may retire from the City at some time in the future. The City's ARC is for the future benefit of already retired former employees as well as a set aside for the future retirement of current employees. Thus, the City does comply with the "requirement" to contribute 100% of its ARC. In FY 2012-13 the City's ARC was \$502,000. The City paid \$226,945.18 to current retirees directly, \$80,811 to CalPERS, and \$194,243.82 to CERBT for a total of \$502,000.

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

The City disagrees with the finding that it was required to disclose retiree health benefits as part of employee compensation pursuant to General Accepted Accounting Principals ("GAAP") standards. The Grand Jury Report states that according to GAAP, retiree health benefits earned by current employees for their future use should be recognized in the agency's compensation report in the period in which those benefits are earned. See page 15 of the Grand Jury report. The grand jury reviewed the City's financial documents for the period ending June 30, 2013.

Government Code Section 53892(l) provides that the report submitted to the State Controller's office shall contain "[t]he annual compensation of a local agency's elected officials, officers, and employees in accordance with reporting instructions developed by the Controller pursuant to Section 53891 in consultation with affected local agencies." Before it was amended in July 2015, Government Code section 53891 stated in part that:

“[t]he officer of each local agency who has charge of the financial records shall furnish to the Controller a report of all the financial transactions of the local agency during the next preceding fiscal year. The report shall be furnished within 90 days after the close of each fiscal year and shall be in the form required by the Controller.”

There was no requirement that the compensation report be GAAP compliant. The City submitted the state compensation report on the State Controller form. The form does not contain a line item to identify the entire amount of employee health care benefits (i.e. the difference

¹ Current retirees refers to City employees that have retired from the City.

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between the amount the City paid directly to the employee and the Annual Retiree Contribution). Enclosed is a copy of the compensation report that the City submitted to the State Controller's office in 2013.

In July 2015, Government Code Section 53891 was amended to state that:

“[t]he officer of each local agency who has charge of the financial records shall furnish to the Controller a report of all the financial transactions of the local agency during the preceding fiscal year. The report shall contain underlying data from audited financial statements prepared in accordance with generally accepted accounting principles, if this data is available. The report shall be furnished within seven months after the close of each fiscal year and shall be in the form required by the Controller. A local agency shall submit to the Controller information on annual compensation, as described in subdivision (l) of Section 53892, for the previous calendar year no later than April 30th.”

Government Code Section 53891 governs the reporting requirements for both the State Controller's report and the compensation report, which are two separate reports submitted by the City to the State Controller. The Government Code was recently amended to include a requirement that the State Controller's report contain data from financial statements that are prepared in accordance with GAAP, but only if the data is available. Notably, the Government Code was not similarly amended to require that the compensation report be prepared in accordance with GAAP.

Recommendations

The Grand Jury's report made two recommendations that it determined are applicable to the City. The City's responses to each of these recommendations are addressed below.

R.3 The 26 agencies that are not recognizing the full amount of their Annual Retired Contribution as expense in the current period [sic] should comply the requirement to do so.”

As discussed above, the City recognizes the full amount of its Annual Required Contribution as an expense in the current reporting period. The recommendation has already been implemented and no further action is needed by the City to comply with this recommendation.

R.4 The agencies surveyed should recognize their retiree health care benefits in employee compensation in conformity with GAAP.

This recommendation has not yet been implemented, but will be implemented in the future, if the State Controller updates its forms to include a line item for the City to identify the difference

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between the amount it pays its retirees directly and the Annual Required Contribution. As noted above, there is no requirement contained within the Government Code that the compensation report be prepared in conformity with GAAP.

The City hopes that this response is helpful and takes this opportunity to thank the Grand Jury for its services and efforts.

Respectfully submitted,



Jill Ingram
City Manager

GASB STATEMENT 45 ON OPEB ACCOUNTING BY GOVERNMENTS A FEW BASIC QUESTIONS AND ANSWERS

1. Why was Statement 45 on OPEB accounting by governments necessary?

Statement 45 was issued to provide more complete, reliable, and decision-useful financial reporting regarding the costs and financial obligations that governments incur when they provide postemployment benefits other than pensions (OPEB) as part of the compensation for services rendered by their employees. *Postemployment healthcare benefits*, the most common form of OPEB, are a very significant financial commitment for many governments.

2. How was OPEB accounting and financial reporting done prior to Statement 45?

Prior to Statement 45, governments typically followed a “pay-as-you-go” accounting approach in which the cost of benefits is not reported until after employees retire. However, this approach is not comprehensive—only revealing a limited amount of data and failing to account for costs and obligations incurred as governments receive employee services each year for which they have promised future benefit payments in exchange.

3. What does Statement 45 accomplish?

- When they implement Statement 45, many governments will report, for the first time, annual OPEB cost and their unfunded actuarial accrued liabilities for past service costs. This will foster improved accountability and a better foundation for informed policy decisions about, for example, the level and types of benefits provided and potential methods of financing those benefits.

The Standard also:

- Results in reporting the estimated cost of the benefits as expense each year *during the years that employees are providing services* to the government and its constituents in exchange for those benefits.
- Provides, to the diverse users of a government’s financial reports, more accurate information about the *total cost of the services* that a government provides to its constituents.
- Clarifies whether the amount a government has paid or contributed for OPEB during the report year has covered its annual OPEB cost. Generally, the more of its annual OPEB cost that a government chooses to defer, the higher will be (a) its unfunded actuarial accrued liability and (b) the cash flow demands on the government and its tax or rate payers in future years.
- Provides better information to report users about a government’s *unfunded actuarial accrued liabilities* (the difference between a government’s total obligation for OPEB and any assets it has set aside for financing the benefits) and changes in the *funded status of the benefits* over time.

4. What are the most common misconceptions about Statement 45?

- a. **That it requires governments to fund OPEB.** Statement 45 establishes standards for *accounting and financial reporting*. How a government actually finances benefits is a policy decision made by government officials. The objective of Statement 45 is to more accurately reflect the financial effects of OPEB transactions, including the amounts paid or contributed by the government, whatever those amounts may be.
- b. **That it requires immediate reporting of a financial-statement liability for the entire unfunded actuarial accrued liability.** Statement 45 does not require immediate recognition of the unfunded actuarial accrued liability (UAAL) as a financial-statement liability. The requirements regarding the reporting of an OPEB liability on the face of the financial statements work as follows:
- Governments may apply Statement 45 prospectively. At the beginning of the year of implementation, nearly all governments will start with zero financial-statement liability.
 - From that point forward, a government will accumulate a liability called the *net OPEB obligation*, if and to the extent its actual OPEB contributions are less than its annual OPEB cost, or expense.
 - The net OPEB obligation (not the same as the UAAL) will increase rapidly over time if, for example, a government's OPEB financing policy is pay-as-you-go, and the amounts paid for current premiums are much less than the annual OPEB cost.

Statement 45 does, however, also require the *disclosure* of information about the *funded status* of the plan, including the UAAL, in the notes to the financial statements—and the presentation of multi-year funding progress trend information as a required supplementary schedule.

- c. **That it requires governments to report “future costs” for OPEB.** It is misleading and incorrect to describe accrual accounting for OPEB as requiring the expensing of “future costs.” From an accrual accounting standpoint (the basis of accounting required for all transactions in the government-wide financial statements), the reported expenses relate entirely to transactions (exchanges of employee services for the promised future benefits) that *already have occurred*. Statement 45 requires governments to report costs and obligations incurred as a consequence of receiving employee services, for which benefits are owed in exchange. The *normal cost* component of annual expense is the portion of the present value of estimated total benefits that is attributed to services received in the current year. The annual expense also includes an amortization component representing a portion of the UAAL, which relates to past service costs. Estimated benefit costs associated with *projected future years of service* are *not reported*.