

**PENSION ENHANCEMENTS:  
A QUESTION OF GOVERNMENT CODE COMPLIANCE**



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## **SUMMARY**

The unfunded pension liability of the Orange County Employees Retirement System (OCERS) has grown exponentially since 2000. Between 2000 and 2005, county officials contributed to this unsustainable trajectory by awarding generous retirement benefit increases to several groups of employees participating in OCERS. These benefit improvements increased OCERS' unfunded actuarial accrued liability (UAAL) by \$574.6 million (Delaney, 2015) and may threaten the county's ability to provide public services. See Appendix A for glossary of financial terms.

The County Employment Retirement Law (CERL) of 1937, as codified in the State of California Government Code (Appendix C), contains specific requirements that county and local governments must follow when considering pension enhancements, giving the public ample opportunity to review and comment (State of California, 1937). The 2016-2017 Orange County Grand Jury (OCGJ) found that the Orange County Board of Supervisors (BOS) complied with these CERL codes when granting pension enhancements. However, Orange County Fire Authority (OCFA) documentation indicated one week's notice of the hearing was provided rather than the two weeks' notice required, and the Orange County Sanitation District did not provide documentation showing compliance with any of the specific transparency code requirements.

Pension reforms put in place in recent years have mitigated the effect of such past code violations and addressed the burgeoning pension debt, fundamentally changing retirement systems. Orange County's Measure J, passed in 2008, strengthened the public's oversight of pension enhancements. Still, adherence to transparency requirements by county officials remains important to pension reform.

## **REASON FOR THE STUDY**

Precipitated by public concern about the ballooning UAAL, five grand jury reports have addressed the subject in Orange County (Appendix B). These reports focused on the financial impact of the UAAL on Orange County cities, the county, and taxpayer interests. The 2013-2014 OCGJ and 2015-2016 OCGJ reported on the history and status of the UAAL for Orange County cities and the County of Orange, respectively. They did not, however, report on transparency.

The 2016-2017 OCGJ, also concerned about the UAAL, was alerted by a citizen complaint letter, as well as activism and lawsuits in Northern California (Citizens for Sustainable Pension Plans, 2016), that noncompliance with CERL fiscal and notification requirements may have occurred when the 2000-2005 pension enhancements were approved. Recently, other California grand juries (2014/2015 Marin County Grand Jury, 2015) (2015-2016 Sutter County Grand Jury, 2016) found a number of government code violations occurred in their counties during the approval of pension enhancements between 2000 and 2005.

Given the generous retirement enhancements that occurred and the seriousness of the resulting Orange County pension debt, the 2016-2017 OCGJ sought to determine if county pension enhancement awards in 2001, 2002, and 2004 complied with the fiscal and disclosure requirements of CERL as specified in California Government Code sections §7507, §23026, §31515.5, and §31516. Although benefit increases occurred in Orange County cities during this time that also added to the county's UAAL, the scope of this investigation did not extend to the cities.

## **METHOD OF STUDY**

The 2016-2017 OCGJ interviewed Orange County financial executives and representatives of OCERS and the Sanitation District, studied reports about the OCERS Trust Fund, read news articles on pension debt, and reviewed relevant county government internal audits and financial documents. The 2016-2017 OCGJ also solicited all relevant documents related to the approval of pension enhancements for the years in question. This included meeting agendas, minutes, and resolutions of the respective boards governing pension approvals; actuarial reports, financial statements, and audit reports; and memorandums of understanding as a result of pension-related negotiations between unions and Orange County officials representing employees anticipating retirement changes.

The 2016-2017 OCGJ also reviewed previous OCGJ reports on pensions (Appendix B), as well as other California grand jury reports addressing transparency in pension enhancements. We examined the provisions of California CERL government code sections §7507, §23026, §31515.5, and §31516 in effect during the period under review (Appendix C).

## **BACKGROUND AND FACTS**

### **Transparency Requirements**

CERL governs state employee pensions, detailing fiscal and transparency requirements when pension changes are being considered. These government codes contain specific requirements in California Government Code sections §7507, §23026, §31515.5 and §31516 that county and local governments must meet before awarding pension enhancements to public employees (Appendix C). These code sections require governing boards to do the following:

- Give notice to the public of the proposed pension increase on a board meeting agenda;
- Obtain an actuarial valuation of the future cost; and
- Present the proposed increase with the actuarial report and explain the impact of the increase on the pension plans' financial health and funding.

(State of California, 1937)

### **Pension Enhancements 2000 - 2005**

By 2000, Orange County employees had begun lobbying for better pensions. In 2001, the BOS approved a change in the retirement benefits of Orange County deputy sheriffs. This increased

the UAAL by \$119.5 million (Delaney, 2015). Pension benefit improvements approved in 2002 for probation and OCFA employees increased the UAAL by \$89.7 million. In 2004, the BOS and the Sanitation District Board of Directors approved changes in retirement benefits for County of Orange general members, probation and sanitation employees, collectively increasing the UAAL by \$365.4 million (Delaney, 2015). Although other influences made a greater contribution to the growth in the UAAL, these enhancements were significant contributors, adding a total of \$574.6 million to the UAAL. See Appendix D for details of the 2000-2005 pension enhancements.

### **Compliance with Transparency Regulations**

Based on a review of documentation, the 2016-2017 OCGJ determined that the BOS, in approving pension enhancements for the Orange County deputy sheriffs, probation, and general Orange County employees, complied fully with the requirements of government code sections §7507, §23026, §31515.5, and §31516. The boards of directors for the Sanitation District and OCFA approved pension enhancements, but the approval process did not comply with all aspects of the government transparency codes.

The Sanitation District Board of Directors approved a pension benefit enhancement but the 2016-2017 OCGJ found no evidence from the documentation provided that they complied with the requirements of the transparency regulations (CERL sections §7507, §23026, §31515.5 and §31516). That is, they did not show evidence that they provided notice to the public of the proposed pension increase on a board agenda or present the actuarial valuation of the future cost at a public meeting at least two weeks before approval of the increase, nor did they publicly explain the impact of the proposed increase on the pension plan's financial health and funding within the appropriate timeframe.

The 2016-2017 OCGJ reviewed documents from the OCFA and found the agency deviated from the requirement in CERL code sections §7507 and §31516 (State of California, 1937) that "*the future costs of changes in retirement benefits or other postemployment benefits, as determined by the actuary, shall be made public at a public meeting at least two weeks prior to the adoption of any increases in public retirement plan benefits.*" The public notice of changes in the pension plan was posted only one week prior to the meeting.

### **Subsequent Events**

Subsequent to the 2000-2005 pension enhancements, the County of Orange supported pension reforms that mitigate concerns about past government code noncompliance, and some have served to lower pension costs.

Measure J, approved on November 4, 2008, by 75.2% of Orange County voters, amended the County's charter to require a vote of the people on any pension enhancement, ensuring transparency and public awareness of the associated financial impact (County of Orange, 2009).

The 2012 California Public Employees' Pension Reform Act (AB 340) addressed pension debt. In accordance with AB 340, the BOS adopted resolutions that lowered pension costs by changing

pension benefit formulas and requiring employees to share in the cost. These changes included, among other things:

- Setting a new maximum benefit with a lower cost pension formula for safety and non-safety employees with requirements to work longer in order to reach full retirement age.
- Placing a cap on the amount used to calculate a pension.
- Reforming pension spiking for new and existing employees.
- Requiring three-year averaging of final compensation for new employees.
- Providing counties with new authority to negotiate cost-sharing agreements with current employees.

(State of California, 2012)

Pension reform measures changed the landscape of pension awards, strengthened the opportunity for public scrutiny of retirement changes, and mitigated the impact of code violations.

## CONCLUSION

This investigation highlights the importance of transparency and public engagement in civic government. The 2016-2017 OCGJ determined that the statutory pension-related procedural requirements fostering public transparency were met by Orange County governing officials representing law enforcement, probation, and the county for general members. OCFA officials apparently gave only one week public notice of impending pension enhancements, rather than the two weeks required by code sections §7507 and §31516. There was no evidence of public notice or other compliance with CERL transparency codes for sanitation district employees' pension enhancements.

Since 2005, concern about the UAAL has galvanized Orange County officials to support pension reforms. Measure J ensured public awareness of future pension enhancements, mitigating the effects of code violations in the past. Notwithstanding the positive effect of Measure J, Orange County governing boards should comply with all fiscal and transparency requirements of CERL before awarding pension enhancements to public employees.

## FINDINGS

In accordance with California Penal Code Sections §933 and §933.05, the 2016-2017 OCGJ requires (or, as noted, requests) responses from each agency affected by the findings presented in this section. The responses are to be submitted to the Presiding Judge of the Superior Court.

Based on its investigation titled "Pension Enhancements: A Question of Government Code Compliance," the 2016-2017 OCGJ has arrived at two principal findings, as follows:

- F. 1. When the OCFA Board of Directors approved 3% at 50 for firefighters in 2002, only one week notice was given to the public.

F.2. The Sanitation District did not provide documentary evidence that the operative code requirements were met by the Sanitation District Board of Directors when they approved 2.5% at 55 pension formula for sanitation workers in 2004.

Penal Code §933 and §933.05 require governing bodies and elected officials to which a report is directed to respond to findings and recommendations. Responses are requested, from departments of local agencies and their non-elected department heads.

## **RECOMMENDATIONS**

In accordance with California Penal Code Sections §933 and §933.05, the 2016-2017 OCGJ requires (or, as noted, requests) responses from each agency affected by the recommendations presented in this section. The responses are to be submitted to the Presiding Judge of the Superior Court.

Based on its investigation titled “Pension Enhancements: A Question of Government Code Compliance,” the 2016-2017 the OCGJ has the following recommendations.

R.1 The OCFA should implement procedures that ensure compliance with all transparency requirements including those relating to the approval of pension enhancements.

R.2 The Sanitation District should implement procedures that ensure compliance with all transparency requirements including those relating to the approval of pension enhancements.

## **REQUIRED RESPONSES**

The *California Penal Code* §933 requires the governing body of any public agency which the Grand Jury has reviewed, and about which it has issued a final report, to comment to the Presiding Judge of the Superior Court on the findings and recommendations pertaining to matters under the control of the governing body. Such comment shall be made no later than 90 days after the Grand Jury publishes its report (filed with the Clerk of the Court). Additionally, in the case of a report containing findings and recommendations pertaining to a department or agency headed by an elected County official (e.g. District Attorney, Sheriff, etc.), such elected County official shall comment on the findings and recommendations pertaining to the matters under that elected official’s control within 60 days to the Presiding Judge with an information copy sent to the Board of Supervisors.

Furthermore, California Penal Code Section §933.05 (a), (b), (c), details, as follows, the manner in which such comment(s) are to be made:

(a) As to each Grand Jury finding, the responding person or entity shall indicate one of the following:

- (1) The respondent agrees with the finding;
- (2) The respondent disagrees wholly or partially with the finding, in which case the response shall specify the portion of the finding that is disputed and shall include an explanation of the reasons therefore.

(b) As to each Grand Jury recommendation, the responding person or entity shall report one of the following actions:

(1) The recommendation has been implemented, with a summary regarding the implemented action;

(2) The recommendation has not yet been implemented, but will be implemented in the future, with a time frame for implementation;

(3) The recommendation requires further analysis, with an explanation and the scope and parameters of an analysis or study, and a time frame for the matter to be prepared for discussion by the officer or head of the agency or department being investigated or reviewed, including the governing body of the public agency when applicable. This time frame shall not exceed six months from the date of publication of the Grand Jury report;

(4) The recommendation will not be implemented because it is not warranted or is not reasonable, with an explanation therefore.

(c) If a finding or recommendation of the Grand Jury addresses budgetary or personnel matters of a county agency or department headed by an elected officer, both the agency or department head and the Board of Supervisors shall respond if requested by the Grand Jury, but the response of the Board of Supervisors shall address only those budgetary /or personnel matters over which it has some decision making authority. The response of the elected agency or department head shall address all aspects of the findings or recommendations affecting his or her agency or department.

Comments to the Presiding Judge of the Superior Court in compliance with Penal Code section §933.05 are required or requested from:

Responses are required from the governing body of each of the following entities within 90 days of the date of publication of this report:

**Orange County Fire Authority (F. 1 and R.1)**  
**Orange County Sanitation District (F. 2 and R.2)**

Responses are requested from the following non-elected agency or department heads:

**None requested.**



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## APPENDICES

### APPENDIX A: Glossary

**Actuarial Report (Valuation)** - The valuation is an appraisal which requires making economic and demographic assumptions in order to estimate future liabilities. The assumptions are typically based on a mix of statistical studies and experienced judgment.

**Audit Report** - The auditor's report is issued by either an internal auditor or an independent external auditor as a result of an internal or external audit, giving assurance for the user to make decisions based on the results of the audit. Audits may be financial or operational in nature.

**Pension Benefit Formula** - A formula to calculate the amount of pension benefit an employee would receive in retirement. For example, the term 3% @ 50 means three percent of final compensation, multiplied by the number of service years, for an employee retiring at the age of fifty. A hypothetical employee with final annual compensation of \$100,000 at age fifty, with 30 years of service, would receive an annual pension of \$90,000, or 90% of final compensation.

**Liabilities** - Debts or obligations owed by one entity (debtor) to another entity (creditor) payable in money, goods, or services.

**Pension** - A regular payment made during a person's retirement from an investment fund to which that person or their employer or both have contributed during their working life.

**Pension Debt (Liabilities)** - Future payouts that a pension fund is obligated to make.

**Unfunded Actuarial Accrued Liability (UAAL)** - The excess of the actuarial accrued liability over the actuarial value of assets; also referred to as “unfunded pension liability.”

**Pension Plan Assets** - The term pension plan assets refers to the funds available to meet future compensation obligations to retired employees. Pension plan assets consist of cash as well as investments.

**Memorandum of Understanding (MOU)** - Describes a bilateral or multilateral agreement between two or more parties. It expresses a convergence of will between the parties, indicating an intended common line of action. As pertains to this report, an agreement is between a county agency and the members association (a union).

**Pension Spiking**- Sometimes referred to as “salary spiking,” this is the process whereby public sector employees grant themselves large raises, artificially inflating their compensation in the years immediately preceding retirement in order to receive larger pensions than they otherwise would be entitled to receive. This inflates the pension payments to the retirees and, upon retirement of the “employee,” transfers the burden of making payments from the employee’s employer to a public pension fund. This practice is considered a significant contributor to the high cost of public sector pensions.

**APPENDIX B: Past Orange County Grand Jury Reports on Pension Funding**

- 2002-2003 Who Represents Orange County Taxpayers?  
<http://www.ocgrandjury.org/pdfs/gjrepresent.pdf>
- 2004-2005 Another County Crisis: Pensions, Health Care, and Other Benefits  
<http://www.ocgrandjury.org/pdfs/pension.pdf>
- 2011-2012 Transparency Breaking Up Compensation Fog—But Why Hide Pension Costs?  
<http://www.ocgrandjury.org/pdfs/transparencybreakingupcompensationfog.pdf>
- 2013-2014 Orange County City Pension Liabilities: Budget Transparency Critically Needed  
[http://www.ocgrandjury.org/pdfs/2013\\_2014\\_GJreport/PensionReport.pdf](http://www.ocgrandjury.org/pdfs/2013_2014_GJreport/PensionReport.pdf)
- 2015-2016 Orange County's \$4.5 Billion Unfunded Pension Liability & Retirement Plans  
[http://www.ocgrandjury.org/pdfs/2015\\_2016\\_GJreport/2016-06-15\\_Website\\_Report.pdf](http://www.ocgrandjury.org/pdfs/2015_2016_GJreport/2016-06-15_Website_Report.pdf)

## APPENDIX C: California Codes Relevant to Pension Enhancement Requirements

Note: Emphases added.

### *California Government Code Section §7507*

CERL Code §7507 requires city and county governing boards when considering changes in retirement benefits to “...secure the services of an actuary to **provide a statement of the actuarial impact upon future annual costs**, including normal cost and any additional accrued liability, before authorizing changes in public retirement plan benefits. The future costs of changes in retirement benefits or other postemployment benefits, as determined by the actuary, **shall be made public at a public meeting at least two weeks prior to the adoption of any increases in public retirement plan benefits.**”

### *California Government Code Section §23026*

CERL Code §23026 specifies requirements that a board of supervisors must fulfill before enhancing pension benefits. The board shall:

“...**make public, at a regularly scheduled meeting of the board, all salary and benefit increases** that affect either or both represented employees and non-represented employees.”

“...**include notice of any salary or benefit increase...on the agenda for the meeting as an item of business.**”

“...provide notice prior to the adoption of the salary or benefit increase.”

“...**include an explanation of the financial impact that the proposed benefit change or salary increase will have on the funding status of the county employees’ retirement system.**”

### *California Government Code Section §31515.5*

CERL Code §31515.5 states that, “...**the board of supervisors**, in compliance with Section 23026, **shall make public at a regularly scheduled meeting of the board, all salary and benefit increases** that affect either or both represented employees and non-represented employees. Notice of any salary or benefit increase shall be included **on the agenda for the meeting as an item of business**. Notice shall occur **prior to the adoption of the salary or benefit increase, and shall include an explanation of the financial impact** that the proposed benefit change or salary increase will have on the funding status of the county employees’ retirement system.”

### *California Government Code Section §31516*

CERL Code §31516 states that “...**the board of supervisors**, in compliance with Section 7505, **shall secure the services of an enrolled actuary to provide a statement of the actuarial impact upon future annual costs before authorizing increases in benefits and that the future annual costs as determined by the actuary shall be made public at a public meeting at least two weeks prior to the adoption of any increase in benefits.**”

**APPENDIX D: Pension Enhancements 2000 – 2005**

A change in the retirement benefit for law enforcement (safety) was approved in 2001, effective June 28, 2002, for a benefit formula of 3% of the member's final compensation for all years of service (retroactive) rendered at age 50. This increased the future UAAL by \$119.5 million (Delaney, 2015).

In 2002, the retirement benefit formula for firefighters was approved by the OCFA Board of Directors, as was an increase for Probation Services Unit employees who became Safety members. These benefit improvements increased the future UAAL by \$89.7 million (Delaney, 2015).

In 2004, a number of benefit formulas were enhanced by the plan sponsor; probation members adopted the 3% @ 50 formula, Orange County Sanitation District adopted a 2.5% @ 55 formula, general members of the County of Orange adopted the 2.7% @ 55 formula, collectively increasing the UAAL by \$365.4 million (Delaney, 2015).

The benefit enhancements noted above, in the aggregate, increased the UAAL by \$574.6 million (Delaney, 2015).