
UNFUNDED RETIREE HEALTHCARE OBLIGATIONS- A PROBLEM FOR PUBLIC AGENCIES?



GRAND JURY 2014-2015

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EXECUTIVE SUMMARY

When local government employees retire from service in Orange County, their employment often allows them to continue purchasing health insurance through the agency (city or county) for which they had been employed. They may also receive a stipend from that agency to help pay for these health insurance premiums. These benefits are known as Other Post-Employment Benefits, or OPEB in governmental accounting terms. Until 2004, these costs were considered routine operating expenses that were paid from an agency's general fund. As a result, historically, local agencies did not make any provisions to estimate the amount of funds that would be required in the future and did not set money aside to make sure the employers were able to make these payments when they came due. In 2004, the Governmental Accounting Standards Board (GASB) issued Statement No.45 "Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions" in an effort to improve financial reporting by state and local government agencies. The objective of issuing this directive was to require governments to improve their accounting practices. These changes were required to meet certain financial reporting goals that were not being met. These goals were:

1. Recognize the cost of benefits in periods when the related services are received by the employer.
2. Provide information about the actuarial accrued liabilities for promised benefits associated with past services and whether and to what extent these benefits have been funded.
3. Provide information useful in assessing potential demands on the employers future cash flows.

The Orange County Grand Jury (OCGJ) reviewed the data provided in the investigated agencies' financial statements for the fiscal year ended June 30, 2013, to locate the information identified above. The inquiry determined that the combined Unfunded Retiree Health Obligation for the 36 (less four non-reporting cities) agencies was \$1.1 billion as of June 30, 2013, which were derived from the Comprehensive Annual Financial Reports (CAFRs). This is a significant amount, especially when combined with the Unfunded Pension Liability of \$5.7 billion. The OCGJ further determined that less than 30% of the agencies surveyed recognized the full annual cost of the OPEB expense, with most not recognizing the deferred benefit as earned compensation of current employees. The analysis of the potential demands on the employer's future cash flows revealed that certain agencies were at far greater risk of encountering issues with future cash flows than others due to the higher benefits promised to retirees in the past and lack of efforts to fund the liability at present.

BACKGROUND

(A Glossary of Terms is provided in the Appendix.)

Overview

In 1961 the State of California (State) began to offer State workers retiree healthcare benefits because workers were at risk of losing their health care coverage

upon retirement. This loss to the retiree may have resulted because the high premium cost was more than the retiree could afford, or the retiree had a health condition that resulted in insurers denying coverage. Local governments followed suit, and many cities and local agencies began offering health care benefits to retirees. This is true today even though conditions have changed; for example, today government workers are eligible for federal Medicare at age 65 or through the Affordable Care Act.

All 34 cities in Orange County, as well as the County of Orange (County) and the Orange County Fire Authority (OCFA), offer their employees some form of retiree health care benefits. In many agencies, if a retiree purchases health insurance through the agency that they retired from, that agency may choose to contribute a minimal amount. This amount is established by the Public Employees Medical and Hospital Care Act (PEMHCA) and helps to offset the retiree's health insurance premium. Some agencies provide generous benefits that may pay up to 90% of the premium cost for retirees. Until 2004, most local government agencies accounted for the costs of paying for retiree benefits as a cost of doing business and charged the costs to ongoing expenses.

In 2004, the Governmental Accounting Standards Board (GASB), an organization that oversees how governments account for their financial activities, examined this pay-as-you-go policy used to account for the health care benefits payables. The GASB concluded that this approach is not a sound accounting practice for three reasons. First, it did not allow the government entity or the public to know what the actuarial accrued liabilities for health benefits are which have been promised to retirees. Second, it did not provide information about whether the government entity had the funds to pay for these costs annually as well as in the future. Third, it did not match the expense of the benefit in the period that it was earned/incurred.

GASB Statement No. 45 Reporting Requirements

In order to correct the above accounting and information issues, the GASB, through GASB Statement No. 45, required government agencies to do the following:

1. Authorize an actuarial or alternate measurement study done which assesses how much the agency will have to pay for medical benefits in the future based on the life expectancy of current employees as well as retirees for whom benefits are being paid. This calculated amount is known as the Accrued Actuarial Liability (AAL).
2. Calculate the annual amount that the agency will have to pay every year to make sure that all future obligations are met. This amount is known as the Annual Required Contribution (ARC).
3. Disclose the cumulative amount owed to retirees for the health care benefits promised or Accrued Actuarial Liability (AAL) as well as the amount of monies the employer has put aside in an irrevocable trust to pay for the future liability (Contributed Amount).
4. Compare the ARC to the annual payroll cost of the employer to assess potential demands on the employers' future cash flow.
5. Recognize the cost of benefits in periods which the related services are received (including the benefit as compensation to the employee that has

earned it even though the employee does not collect the benefit until after retirement).

Orange County cities, the County, and the OCFA all provide retiree health benefits that are funded at varying levels. This report provides the citizens of the County a snapshot of the overall financial situation regarding retiree health benefits promised by local agencies.

REASON FOR THE STUDY

The main purpose of this study is to quantify the full extent of the financial liability for retiree health benefits facing the County's 34 cities, the County, and the OCFA. The goal is to determine how much is owed in total by these 36 agencies and how much each agency has to contribute each year to meet its obligation to pay for the benefit.

The State's Legislative Analyst Office (LAO) Report in 2015 stated that retiree healthcare is "the state's last major liability that needs a funding plan" (Legislative, 2015). According to the LAO, the "unfunded liability" for retiree healthcare promised to state workers over the next 30 years is \$72 billion, which is greater than the \$50 billion unfunded liability for state worker pensions reported by the California Public Employees Retirement System (CalPERS) in 2014. In light of the LAO report, the Orange County Grand Jury (OCGJ) decided it was advisable to determine the level of the liability for retiree healthcare costs facing the taxpayers of the County.

In addition to determining the magnitude of the liability, the OCGJ also considered it advisable to see how many public agencies were complying with the requirements and recommendations put forward by the GASB in Statement No. 45, as they play an important role in transparency by revealing the full extent of future costs and public liabilities of retiree health benefits. In addition, the analysis provided by the OCGJ provides quantitative information regarding each public entity's progress in addressing the important issue of unfunded liability.

METHODOLOGY

The method of investigation adopted by the OCGJ was mainly through document and literature reviews.

The historical origins of the retiree health benefit provisions by local agencies were studied and analyses were done on the subject of post-employment benefits and the issues involved in reporting and paying for these benefits.

The research included a review of the accounting literature as it pertains to the recognition of these expenses and the correct presentation of this data in the financial reports of local agencies.

The OCGJ decided to examine the financial statements of the 34 cities of Orange County, the County of Orange, and the Orange County Fire Authority to determine if these agencies were complying with the disclosure requirements imposed on them by GASB Statement No. 45. The OCGJ also obtained an understanding of the potential

demands on the agencies' future cash flows based on the annual cost, as well as the accumulated liability, for their Other Post Employment Benefit obligations.

The Comprehensive Annual Financial Reports (CAFR) for the year ending June 30, 2013, were obtained from the agencies' websites and analyzed by the OCGJ. The "Notes to the Financial Statements" were analyzed for the required information and data regarding balance sheet liabilities. General Fund annual expenditures were also obtained for analysis purposes. In cases where a disclosure was missing, the agencies were contacted by mail and were requested to provide the information to the OCGJ. The resulting data gathered was analyzed to provide insight into the level of liability for healthcare that the agencies are responsible for, as well as annual expenses incurred by each agency.

INVESTIGATION AND ANALYSIS

The investigation yielded a significant amount of data. The following tables lay out the nature of the data collected and support the conclusions drawn from the data. The OCGJ had access to information regarding the AAL calculated for each agency by an external actuary or, in a few cases, by using an alternate measurement method prescribed by the GASB; and was also able to determine the amount of funding that the agencies had put in an irrevocable trust. In addition to the data on the extent of the liability and the annual required contribution to be made by an agency, the OCGJ collected information on the amount of General Fund liabilities and expenditures for the FY 2012-13. The Grand Jury also analyzed the population of each jurisdiction to assess the impact of that agency's annual OPEB costs on its residents.

Table 1: List of Orange County Cities/Agencies Reviewed

1	Aliso Viejo	19	Lake Forest
2	Anaheim	20	Los Alamitos
3	Brea	21	Mission Viejo
4	Buena Park	22	Newport Beach
5	Costa Mesa	23	Orange
6	Cypress	24	Placentia
7	Dana Point	25	Rancho Santa Margarita
8	Fountain Valley	26	San Clemente
9	Fullerton	27	San Juan Capistrano
10	Garden Grove	28	Santa Ana
11	Huntington Beach	29	Seal Beach
12	Irvine	30	Stanton
13	La Habra	31	Tustin
14	La Palma	32	Villa Park
15	Laguna Beach	33	Westminster
16	Laguna Hills	34	Yorba Linda
17	Laguna Niguel	35	County of Orange
18	Laguna Woods	36	Orange County Fire Authority

The data collected were for the 34 cities in Orange County, the County, and the OCFA (see Table 1). The last two agencies (County and OCFA) were included because many County cities contract with the County Sheriff's Department and the OCFA for police and/or fire services, and do not have a local police and/or fire department. To fully estimate the liability for post-employment healthcare costs for County agencies (and ultimately residents), the information related to the County agencies needs to be included.

GASB 45 Requirement: Authorize Actuarial Study

A review of the data collected from the Comprehensive Annual Financial Reports (CAFRs) of the 36 entities revealed that four cities did not have the disclosures in their CAFR regarding retiree healthcare obligations. As a result, the OCGJ concluded that these cities did not comply with the GASB Statement No. 45 requiring them to conduct an actuarial or alternative measurement study, to estimate the annual required contribution and the amount of the actuarial obligation. These cities were Aliso Viejo, Dana Point, Laguna Hills, and Villa Park. The City of Laguna Woods also did not disclose GASB Statement No. 45 in the annual CAFR, but provided the information to the OCGJ when requested. The Grand Jury followed up with a questionnaire to each of the above four cities.

It is the opinion of the OCGJ that if a city or agency is subject to PEMHCA, the agency is providing post-employment healthcare benefits even if it is at a very low level. Since all California cities that allow their retirees to purchase health insurance are subject to PEMCHA and are required to provide a subsidy to retirees towards the payment for healthcare premiums, it is important that each of the four cities listed above review their policies to determine if they are, in fact, exempt from GASB Statement No. 45 reporting.

GASB 45 Requirement: Calculate & Disclose Annual ARC

The OCGJ reviewed the Comprehensive Annual Financial Reports for the year ended June 30, 2013, and was able to determine the level of ARC for the year by each agency (see Table 2). The total annual cost is almost \$100 million dollars for the 32 entities that provided this information.

To assess the how significant this cost was to the agencies, the OCGJ decided to compare the Annual OPEB Cost (which is the ARC less any payments already made in the current year) for each agency to its General Fund Expenditures for the same period.

The data in Table 3 indicates the annual OPEB cost (AOPEBC) on average was 2% of General Fund Expenses (GFEXP). However, in Westminster the OPEB cost was over 9% of annual expenditures, which is significantly higher than the survey average. Six cities had AOPEBC that were more than double the average. Cities with higher than average AOPEBC/GFEXP ratios may encounter difficulty in meeting their obligations in the case of an economic downturn when their revenues are reduced.

Table 2: Annual Required Contribution of Orange County Agencies

	Agency	Annual Required Contribution (ARC)
1	Anaheim	\$8,694,000
2	Brea	\$1,443,000
3	Buena Park	\$563,749
4	Costa Mesa	\$2,146,578
5	Cypress	\$519,000
6	Fountain Valley	\$2,533,000
7	Fullerton	\$3,860,848
8	Garden Grove	\$925,657
9	Huntington Beach	\$1,561,000
10	Irvine	\$679,000
11	La Habra	\$615,000
12	La Palma	\$159,370
13	Laguna Beach	\$153,301
14	Laguna Woods	\$14,924
15	Laguna Niguel	\$242,811
16	Lake Forest	\$50,024
17	Los Alamitos	\$243,447
18	Mission Viejo	\$736,000
19	Newport Beach	\$2,806,000
20	Orange	\$989,285
21	Placentia	\$2,198,487
22	Rancho Santa Margarita	\$45,299
23	San Clemente	\$139,542
24	San Juan Capistrano	\$114,894
25	Santa Ana	\$2,732,000
26	Seal Beach	\$502,000
27	Stanton	\$177,000
28	Tustin	\$1,195,094
29	Westminster	\$4,878,000
30	Yorba Linda	\$1,748,362
31	County of Orange	\$42,713,000
32	OCFA	\$14,307,307
	Total ARC	\$99,686,979

Source: Annual Comprehensive Financial Reports for FY 2012-13 obtained from agency websites

Table 3: Annual Cost as a Percentage of General Fund Expenditures

	Cities/Agencies	Annual OPEB Costs (AOPEBC)	Total General Fund Expenditures (GFEXP)	AOPEBC/GFEXP Percentage
1	Westminster	\$4,272,000	\$44,977,980	9.5%
2	Fountain Valley	\$2,533,000	\$38,207,193	6.6%
3	Yorba Linda	\$1,583,193	\$26,255,575	6.0%
4	Laguna Woods	\$226,947	\$4,095,104	5.5%
5	Placentia	\$1,375,364	\$25,061,558	5.5%
6	Fullerton	\$3,877,097	\$74,222,592	5.2%
7	OCFA	\$13,689,125	\$285,518,241	4.8%
8	Anaheim	\$8,574,000	\$238,154,000	3.6%
9	Brea	\$1,324,000	\$53,866,984	2.5%
10	Costa Mesa	\$2,153,804	\$90,115,525	2.4%
11	Los Alamitos	\$243,447	\$11,513,015	2.1%
12	Seal Beach	\$507,830	\$25,610,260	2.0%
13	Newport Beach	\$2,806,000	\$143,834,937	2.0%
14	Cypress	\$462,249	\$23,834,348	1.9%
15	Tustin	\$1,034,400	\$54,837,976	1.9%
16	La Palma	\$155,293	\$9,159,937	1.7%
17	La Habra	\$556,000	\$33,355,966	1.7%
18	County of Orange	\$42,497,000	\$2,654,002,000	1.6%
19	Mission Viejo	\$747,497	\$48,447,473	1.5%
20	Santa Ana	\$2,785,000	\$184,442,950	1.5%
21	Buena Park	\$636,448	\$49,520,579	1.3%
22	Stanton	\$177,000	\$14,881,860	1.2%
23	Orange	\$931,833	\$89,018,039	1.0%
24	Garden Grove	\$941,164	\$90,026,024	1.0%
25	Huntington Beach	\$1,484,000	\$185,015,000	0.8%
26	San Juan Capistrano	\$113,595	\$20,066,475	0.6%
27	Irvine	\$666,000	\$155,031,000	0.4%
28	Rancho Santa Margarita	\$48,968	\$14,301,268	0.3%
29	San Clemente	\$139,542	\$45,678,277	0.3%
30	Laguna Beach	\$150,021	\$59,572,597	0.3%
31	Lake Forest	\$50,024	\$36,884,211	0.1%
32	Laguna Niguel	\$11,965	\$27,468,565	0.0%
	TOTALS	\$96,753,806	\$4,856,977,509	2.0%

Source: Annual Comprehensive Financial Reports for FY 2012-13 obtained from agency websites

GASB 45 Requirement: Disclose Cumulative Amount Owed to Retirees

The level of overall liability recorded by the various agencies was quite significant. Table 4 displays the amount of the actuarial liability for each of the 32 agencies, which totals almost \$1.3 billion. There are some agencies that have contributed towards funding the deficit, thereby reducing the unfunded portion of their AAL.

Table 4: Retiree Health Benefit Liability

	Cities/Agencies	Most Recent Accrued Actuarial Liability (AAL)		Cities/Agencies	Most Recent Accrued Actuarial Liability (AAL)
1	County of Orange	\$528,639,000	18	Mission Viejo	\$7,500,000
2	Anaheim	\$201,108,000	19	Seal Beach	\$6,902,000
3	OCFA	\$156,623,184	20	La Habra	\$5,879,000
4	Westminster	\$62,216,000	21	Irvine	\$5,407,000
5	Santa Ana	\$44,238,000	22	Los Alamitos	\$2,724,394
6	Fullerton	\$37,800,000	23	La Palma	\$1,893,010
7	Costa Mesa	\$36,429,075	24	Cypress	\$1,725,000
8	Newport Beach	\$35,922,000	25	San Clemente	\$1,432,716
9	Fountain Valley	\$35,418,000	26	Laguna Beach	\$1,346,828
10	Placentia	\$23,732,646	27	San Juan Capistrano	\$1,207,808
11	Huntington Beach	\$20,200,000	28	Laguna Niguel	\$865,981
12	Yorba Linda	\$18,725,000	29	Stanton	\$771,000
13	Brea	\$18,197,000	30	Lake Forest	\$499,136
14	Orange	\$11,873,809	31	Rancho Santa Margarita	\$272,705
15	Garden Grove	\$10,633,859	32	Laguna Woods	\$106,225
16	Tustin	\$9,800,000	Total AAL		\$1,297,588,376
17	Buena Park	\$7,500,000	Funding Contributed		\$244,591,329
			Unfunded Liability		\$1,052,997,047

Source: Annual Comprehensive Financial Reports for FY 2012-13 obtained from agency websites

GASB Statement No. 45 requires agencies to recognize 100% of the AOPEBC every year. An analysis was undertaken to determine whether the agencies had been booking their AOPEBC in full. Table 5 presents the results of that analysis. Note that 26 of the 32 agencies were not complying with this GASB requirement, while five agencies were contributing more than their requirement and essentially prefunding their liability.

Table 5: Contributions as a Percentage of Cost

	Cities/Agencies	Annual OPEB Cost (AOPEBC)	Actual Contributions (AC)	% of Cost Contributed (AC/AOPEBC)
1	Lake Forest	\$50,024	\$247,263	494.3%
2	Huntington Beach	\$1,484,000	\$2,683,000	180.8%
3	Anaheim	\$8,574,000	\$9,826,000	114.6%
4	County of Orange	\$42,497,000	\$48,446,580	114.0%
5	Buena Park	\$636,448	\$659,520	103.6%
6	Stanton	\$177,000	\$177,000	100.0%
7	Seal Beach	\$507,830	\$502,000	98.9%
8	Mission Viejo	\$747,497	\$736,000	98.5%
9	Costa Mesa	\$2,153,804	\$1,727,148	80.2%
10	Laguna Beach	\$150,021	\$115,181	76.8%
11	Placentia	\$1,375,364	\$1,053,529	76.6%
12	La Palma	\$155,293	\$108,299	69.7%
13	Irvine	\$666,000	\$430,902	64.7%
14	Fountain Valley	\$2,533,000	\$1,613,268	63.7%
15	Brea	\$1,324,000	\$776,718	58.7%
16	Westminster	\$4,272,000	\$2,206,588	51.7%
17	Los Alamitos	\$243,447	\$122,503	50.3%
18	Fullerton	\$3,877,097	\$1,593,988	41.1%
19	Yorba Linda	\$1,583,193	\$583,255	36.8%
20	Tustin	\$1,034,400	\$372,160	36.0%
21	Garden Grove	\$941,164	\$327,517	34.8%
22	OCFA	\$13,689,125	\$4,759,104	34.8%
23	Orange	\$931,833	\$323,234	34.7%
24	Santa Ana	\$2,785,000	\$874,000	31.4%
25	San Juan Capistrano	\$113,595	\$33,801	29.8%
26	Cypress	\$462,249	\$117,249	25.4%
27	La Habra	\$556,000	\$137,000	24.6%
28	San Clemente	\$139,542	\$33,125	23.7%
29	Rancho Santa Margarita	\$48,968	\$4,750	9.7%
30	Laguna Woods	\$11,965	\$673	5.6%
31	Laguna Niguel	\$226,947	\$6,748	3.0%
32	Newport Beach	\$2,806,000	\$0	0.0%
	Totals	\$96,753,806	\$80,598,103	83.3%

Source: Annual Comprehensive Financial Reports for FY 2012-13 obtained from agency websites

The OCGJ also analyzed the data to determine how many agencies had set up a trust fund to help fund their retiree health care liability, as recommended by GASB Statement No. 45 (Governmental, 2004). The review disclosed that only 11 of the 32 agencies that had submitted data had started such a trust fund. These trust funds

convert the liability from unfunded to a funded category that reduces financial exposure and risk to the public.

As shown in Table 6, the combined AAL was less than 20% funded as of June 30, 2013. While some agencies contributed a significant amount in funding the health care obligations for retirees, some agencies did not contribute any money.

**Table 6: Contributions to Retiree Healthcare Trust Fund:
Accrued Actuarial Liability (AAL)**

	Cities/Agencies	Assets Contributed		Cities/Agencies	Assets Contributed
1	County of Orange	\$116,804,000	19	La Palma	0
2	Anaheim	\$67,747,000	20	Laguna Beach	0
3	OCFA	\$28,910,090	21	Laguna Woods	0
4	Huntington Beach	\$9,600,000	22	Laguna Niguel	0
5	Newport Beach	\$7,889,000	23	Los Alamitos	0
6	Fountain Valley	\$6,068,000	24	Orange	0
7	Mission Viejo	\$4,300,000	25	Placentia	0
8	Seal Beach	\$1,738,000	26	Rancho Santa Margarita	0
9	Stanton	\$585,000	27	San Clemente	0
10	Buena Park	\$500,000	28	San Juan Capistrano	0
11	Lake Forest	\$450,239	29	Santa Ana	0
12	Brea	0	30	Tustin	0
13	Costa Mesa	0	31	Westminster	0
14	Cypress	0	32	Yorba Linda	0
15	Fullerton	0			
16	Garden Grove	0		Total Contributed	\$244,591,329
17	Irvine	0		Total AAL	\$1,297,588,376
18	La Habra	0		Percent of AAL Contributed	18.85%

Source: Annual Comprehensive Financial Reports for FY 2012-13 obtained from agency websites

To assess the impact of the OPEB liability on the population of each agency the OCGJ conducted an analysis to determine how much each resident of an agency owed for that agency's unfunded liability. Table 6 displays the results.

As Table 7 shows, certain cities, such as Westminster, Fountain Valley and Placentia, carry a relatively high per resident liability. Other cities, like Lake Forest and Stanton carry a very low per resident liability. Unfunded liabilities have higher funding priority than other agency obligations and, in the event of a fiscal crisis, funding these unfunded liabilities will require that other agency budget items will have to be slashed.

Table 7: Funds Owed Per Resident for Retiree Healthcare

	City/Agencies	Population	Unfunded Accrued Liability(UAAL)	UAAL per Resident
1	Westminster	89,701	\$62,216,000	\$694
2	Fountain Valley	55,313	\$29,350,000	\$531
3	Placentia	50,533	\$23,732,646	\$470
4	Brea	39,282	\$18,197,000	\$463
5	Anaheim	336,265	\$133,361,000	\$397
6	Costa Mesa	109,960	\$36,429,075	\$331
7	Newport Beach	85,186	\$28,033,000	\$329
8	Yorba Linda	64,234	\$18,725,000	\$292
9	Fullerton	135,161	\$37,800,000	\$280
10	Los Alamitos	11,449	\$2,724,394	\$238
11	Seal Beach	24,168	\$5,164,000	\$214
12	County of Orange	3,010,232	\$411,835,000	\$137
13	Santa Ana	324,528	\$44,238,000	\$136
14	Tustin	75,540	\$9,800,000	\$130
15	La Palma	15,568	\$1,893,010	\$122
16	La Habra	60,239	\$5,879,000	\$98
17	Orange	136,416	\$11,873,809	\$87
18	Buena Park	80,530	\$7,000,000	\$87
19	Garden Grove	170,883	\$10,633,859	\$62
20	Laguna Beach	22,723	\$1,346,828	\$59
21	Huntington Beach	190,963	\$10,600,000	\$56
22	OCFA	3,010,232	127,713,124	\$42
23	Cypress	47,802	\$1,725,000	\$36
24	San Juan Capistrano	34,593	\$1,207,808	\$35
25	Mission Viejo	93,305	\$3,200,000	\$34
26	Irvine	212,375	\$5,407,000	\$25
27	San Clemente	63,522	\$1,432,716	\$23
28	Laguna Niguel	62,979	\$865,981	\$14
29	Laguna Woods	16,192	\$106,225	\$7
30	Rancho Santa Margarita	47,853	\$272,705	\$6
31	Stanton	38,186	\$186,000	\$5
32	Lake Forest	77,264	\$48,897	\$1

Source: Annual Comprehensive Financial Reports for FY 2012-13 obtained from agency websites

GASB 45 Requirement: Compare ARC to the Annual Payroll Cost

The next step in the data analysis was to determine whether the annual costs of retiree health benefits comprised a significant portion of each agency's annual covered payroll (ACP) costs. A comparison of each agency's ARC/ACP is depicted in Table 8.

Table 8: Annual Contributions as Percentage of Annual Payroll for FY12-13

	Agencies	Annual Required Contributions (ARC)	Annual Covered Payroll (ACP)	ARC as a % of ACP
1	Placentia	\$2,198,487	\$8,500,000	25.86%
2	Westminster	\$4,878,000	\$20,722,000	23.54%
3	Yorba Linda	\$1,748,362	\$7,619,000	22.95%
4	OCFA	\$14,307,307	\$75,432,000	18.97%
5	Garden Grove	\$925,657	\$6,528,958	14.18%
6	Fountain Valley	\$2,533,000	\$18,041,000	14.04%
7	Stanton	\$177,000	\$1,870,000	9.47%
8	Fullerton	\$3,860,848	\$45,200,000	8.54%
9	Mission Viejo	\$736,000	\$9,900,000	7.43%
10	Seal Beach	\$502,000	\$8,083,000	6.21%
11	Brea	\$1,443,000	\$24,983,000	5.78%
12	Costa Mesa	\$2,146,578	\$38,315,112	5.60%
13	Tustin	\$1,195,094	\$21,520,000	5.55%
14	Los Alamitos	\$243,447	\$4,400,809	5.53%
15	Anaheim	\$8,694,000	\$169,331,000	5.13%
16	Cypress	\$519,000	\$10,749,000	4.83%
17	Santa Ana	\$2,732,000	\$68,382,000	4.00%
18	Newport Beach	\$2,806,000	\$74,971,000	3.74%
19	La Habra	\$615,000	\$16,525,000	3.72%
20	County of Orange	\$42,713,000	\$1,273,636,000	3.35%
21	La Palma	\$159,370	\$4,788,525	3.33%
22	Rancho Santa Margarita	\$45,299	\$1,663,686	2.72%
23	Buena Park	\$563,749	\$21,600,000	2.61%
24	Huntington Beach	\$1,561,000	\$82,400,000	1.89%
25	Laguna Woods	\$14,924	\$790,122	1.89%
26	San Juan Capistrano	\$114,894	\$6,200,557	1.85%
27	Orange	\$989,285	\$55,933,448	1.77%
28	San Clemente	\$139,542	\$13,708,188	1.02%
29	Irvine	\$679,000	\$68,415,000	0.99%
30	Lake Forest	\$50,024	\$5,201,037	0.96%
31	Laguna Beach	\$153,301	\$20,159,361	0.76%
	Sub-Total	\$99,444,168	\$2,185,568,803	4.55%
	Laguna Niguel	\$242,811	No data avail	
	Total	\$99,686,979		

Source: Annual Comprehensive Financial Reports for FY 2012-13 obtained from agency websites: *Data on Laguna Niguel covered payroll not available from CAFR FY 12-13*

Table 8 reveals that some cities had OPEB annual costs that exceeded 20% of the annual payroll, while others, had costs that were less than 1% of their annual payroll. The median is approximately 5% of payroll costs. Agencies that significantly exceed the median have a greater risk of facing financial difficulties in an economic downturn. In the opinion of the OCGJ, it is in the best interest of the cities with high

ARC/ACP values to take steps to reduce their AAL, either by putting away funds (sinking fund) to meet these future expenses, or by renegotiating their future benefit payments with their employees/unions.

GASB 45 Requirement: Timely and Appropriate Recognition of Benefit

According to Generally Accepted Accounting Principles (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. Compliance with this reporting requirement is important to both the agency and the public, because it results in a more accurate representation of actual agency compensation costs. The OCGJ analyzed the compensation reports completed by the reviewed agencies to determine whether the agencies that had accrued actuarial liability of their OPEB costs had also disclosed earned retiree health benefits on their compensation reports for current employees. The analysis showed that only one agency, Anaheim, properly discloses retiree health benefits as part of employee compensation.

Other Analysis on OPEB Financial Data

The OCGJ tried to determine why certain agencies had higher OPEB liabilities than others. To determine if high OPEB benefits are a byproduct of contractual agreements between agencies and safety employees, the OCGJ compared the OPEB liabilities of agencies that have the safety employees in-house versus where they are contracted. Safety employees are defined by the California Public Employees Retirement System (CalPERS) as those employees "who are involved in law enforcement, fire suppression, or who are employed in a position designated by law as "Local Safety." Typically these employees include law enforcement officers (e.g., police officers or deputy sheriffs), their supervisors (e.g., police sergeants), and management (e.g. police lieutenants, commanders, captains, and chiefs); or fire protection officers (e.g., firefighters), their supervisors and managers (e.g., fire captains, battalion chiefs, and fire chiefs).

An analysis of the data in Table 9 confirms that generally agencies that outsource their safety functions incur lower costs than agencies that have in-house safety departments. There are a few exceptions, such as the City of Laguna Beach that has both police and fire agencies in-house yet has only \$1.3 million in unfunded OPEB liabilities, and the City of Yorba Linda that has outsourced both safety services and yet has \$18.7 million in OPEB liabilities. However, in general, it appears that outsourcing does bring down OPEB costs for agencies, and that there are budgetary implications in changing from in-house versus outsourcing of safety functions.

Table 9: Unfunded Accrued Actuarial Liability (UAAL) for Safety Services

	City/Agencies	Safety-Police	Safety-Fire	UAAL
1	County of Orange	IN HOUSE	IN HOUSE	\$411,835,000
2	Anaheim	IN HOUSE	IN HOUSE	\$133,361,000
3	Orange County Fire Authority	IN HOUSE	IN HOUSE	\$127,713,094
4	Westminster	IN HOUSE	OUTSOURCE	\$62,216,000
5	Santa Ana	IN HOUSE	OUTSOURCE	\$44,238,000
6	Fullerton	IN HOUSE	IN HOUSE	\$37,800,000
7	Costa Mesa	IN HOUSE	IN HOUSE	\$36,429,075
8	Fountain Valley	IN HOUSE	IN HOUSE	\$29,350,000
9	Newport Beach	IN HOUSE	IN HOUSE	\$28,033,000
10	Placentia	IN HOUSE	OUTSOURCE	\$23,732,646
11	Yorba Linda	OUTSOURCE	OUTSOURCE	\$18,725,000
12	Brea	IN HOUSE	IN HOUSE	\$18,197,000
13	Orange	IN HOUSE	IN HOUSE	\$11,873,809
14	Garden Grove	IN HOUSE	IN HOUSE	\$10,633,859
15	Huntington Beach	IN HOUSE	IN HOUSE	\$10,600,000
16	Tustin	IN HOUSE	OUTSOURCE	\$9,800,000
17	Buena Park	IN HOUSE	OUTSOURCE	\$7,000,000
18	La Habra	IN HOUSE	OUTSOURCE	\$5,879,000
19	Irvine	IN HOUSE	OUTSOURCE	\$5,407,000
20	Seal Beach	IN HOUSE	OUTSOURCE	\$5,164,000
21	Mission Viejo	OUTSOURCE	OUTSOURCE	\$3,200,000
22	Los Alamitos	IN HOUSE	OUTSOURCE	\$2,724,394
23	La Palma	IN HOUSE	OUTSOURCE	\$1,893,010
24	Cypress	IN HOUSE	OUTSOURCE	\$1,725,000
25	San Clemente	OUTSOURCE	OUTSOURCE	\$1,432,716
26	Laguna Beach	IN HOUSE	IN HOUSE	\$1,346,828
27	San Juan Capistrano	OUTSOURCE	OUTSOURCE	\$1,207,808
28	Laguna Woods	OUTSOURCE	OUTSOURCE	\$865,981
29	Rancho Santa Margarita	OUTSOURCE	OUTSOURCE	\$272,705
30	Stanton	OUTSOURCE	OUTSOURCE	\$186,000
31	Laguna Niguel	OUTSOURCE	OUTSOURCE	\$106,225
32	Lake Forest	OUTSOURCE	OUTSOURCE	\$48,897
	Total UAAL			\$1,052,997,047

Source: Annual Comprehensive Financial Reports for FY 2012-13 obtained from agency websites

FINDINGS

In accordance with California Penal Code Sections 933 and 933.05, the 2014-2015 Grand Jury 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 “Unfunded Retiree Health Care Obligations-A Problem for Public Agencies?,” Orange County, the 2014-2015 Orange County Grand Jury has arrived at five principal findings, as follows:

- F.1.** Aliso Viejo, Dana Point, Laguna Hills, and Villa Park were not in compliance with GASB Statement No. 45 regarding the authorization of a study to determine other post-employment benefit liabilities. Aliso Viejo, Dana Point, Laguna Hills, Laguna Woods, and Villa Park were not in compliance with the disclosure of post-employment benefits in the Notes Section of their Comprehensive Annual Financial Report for the FY2012-13
- 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 in the future. This is an imprudent level of contribution.
- 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.
- F.4.** All agencies surveyed (except Anaheim) do not disclose retiree health benefits as part of employee compensation per GAAP standards.

RECOMMENDATIONS

In accordance with California Penal Code sections 933 and 933.05, the 2014-2015 Grand Jury 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 “Unfunded Retiree Health Care Obligations-A Problem for Public Agencies?,” the 2014-2015 Orange County Grand Jury makes the following four recommendations:

- R.1.** The cities of Aliso Viejo, Dana Point, Laguna Hills, Villa Park, and Laguna Woods should measure and disclose their liability in accordance with Governmental Accounting Standards Board Statement No. 45. (F.1.)
- R.2.** The 21 agencies that have not contributed into an irrevocable trust fund to finance their retiree health obligations should begin to put aside monies to fund this obligation and reduce their unfunded public liabilities (F.2.)

- R.3.** The 26 agencies that are not recognizing the full amount of their Annual Required Contribution as expense in the current period and should comply with the requirement to do so. (F.3.)
- R.4.** All agencies surveyed should recognize retiree health care benefits in employee compensation in conformity with GAAP. (F.4.)

REQUIRED RESPONSES

The California Penal Code section 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 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, subdivisions (a), (b), and (c), provides 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 from Orange County, the Orange County Fire Authority, and the Mayors of the cities as denoted in the following Response Matrix:

RESPONSE MATRIX									
		Findings				Recommendations			
		F1	F2	F3	F4	R1	R2	R3	R4
1	Aliso Viejo	x				x			
2	Anaheim								
3	Brea		x	x	x		x	x	x
4	Buena Park				x				x
5	Costa Mesa		x	x	x		x	x	x
6	County of Orange (BOS)				x				x
7	Cypress		x	x	x		x	x	x
8	Dana Point	x				x			
9	Fountain Valley			x	x			x	x
10	Fullerton		x	x	x		x	x	x
11	Garden Grove		x	x	x		x	x	x
12	Huntington Beach				x				x
13	Irvine		x	x	x		x	x	x
14	La Habra		x	x	x		x	x	x
15	La Palma		x	x	x		x	x	x
16	Laguna Beach		x	x	x		x	x	x
17	Laguna Hills	x				x			
18	Laguna Niguel		x	x	x		x	x	x
19	Laguna Woods	x	x	x	x	x	x	x	x

RESPONSE MATRIX									
		Findings				Recommendations			
		F1	F2	F3	F4	R1	R2	R3	R4
20	Lake Forest				X				X
21	Los Alamitos		X	X	X		X	X	X
22	Mission Viejo			X	X			X	X
23	Newport Beach			X	X			X	X
24	Orange		X	X	X		X	X	X
25	Orange County Fire Authority			X	X			X	X
26	Placentia		X	X	X		X	X	X
27	Rancho Santa Margarita		X	X	X		X	X	X
28	San Clemente		X	X	X		X	X	X
29	San Juan Capistrano		X	X	X		X	X	X
30	Santa Ana		X	X	X		X	X	X
31	Seal Beach			X	X			X	X
32	Stanton				X				X
33	Tustin		X	X	X		X	X	X
34	Villa Park	X				X			
35	Westminster		X	X	X		X	X	X
36	Yorba Linda		X	X	X		X	X	X

REFERENCES

California Debt and Investment Advisory Commission. OPEBs & GASB 45, A Question and Answer Guide CDIAAC # 06-09(2009)

Comprehensive Annual Financial Reports for FY 2012-13, as retrieved from the following city/agency web sites:

Aliso Viejo
Anaheim
Brea
Buena Park
Costa Mesa
Cypress
Dana Point
Fountain Valley
Fullerton
Garden Grove
Huntington Beach
Irvine
Laguna Beach
Laguna Hills
Laguna Niguel
Laguna Woods
La Habra
Lake Forest
La Palma
Los Alamitos
Mission Viejo
Newport Beach
Orange
Placentia
Rancho Santa Margarita
San Clemente
San Juan Capistrano
Santa Ana
Seal Beach
Stanton
Tustin
Villa Park
Westminster
Yorba Linda
County of Orange
Orange County Fire Authority

Governmental Accounting Standards Board GASB (2004). Summary of Statement No.45, as retrieved from :
http://www.gasb.org/jsp/GASB/Pronouncement_C/GASBSummaryPage&cid=1176156700943

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Legislative Analyst Office. Consider phasing out retiree health care. (2015): as retrieved from: <http://calpensions.com/2015/03/23/lao-consider-phasing-out-retiree-health-care>.

New Reports Detail Pension Fund Finances(2015) as retrieved from:
<https://www.calpers.ca.gov/index.jsp?bc=/about/newsroom/news/new-report-fund-finances.xml>

Torres, Zahira (2015, March 7). Health benefits are a promise school districts find hard to keep. Los Angeles Times.

APPENDIX: GLOSSARY OF TERMS

Governmental Accounting Standards Board (GASB): GASB is the source of generally accepted accounting principles (GAAP) used by state and local governments in the United States. As with most of the entities involved in creating GAAP in the United States, it is a private, non-governmental organization.

The GASB is subject to oversight by the Financial Accounting Foundation (FAF), which selects the members of the GASB and the Financial Accounting Standards Board and funds both organizations.

The mission of the GASB is to establish and improve standards of state and local governmental accounting and financial reporting that will result in useful information for users of financial reports and guide and educate the public, including issuers, auditors, and users of those financial reports.

The GASB has issued Statements, Interpretations, Technical Bulletins, and Concept Statements, defining GAAP for state and local governments since 1984. GAAP for the Federal government is defined by the Federal Accounting Standards Advisory Board.

Other Post-Employment Benefits (OPEB): are part of total compensation offered by employers to attract and retain employees. OPEB includes postemployment health care, as well as other postemployment benefits e.g. life insurance when provided separately from a Pension Plan.

The applicable GASB statements are:

- Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*
- Statement No. 26, *Financial Reporting for Post-employment Healthcare Plans Administered by Defined Benefit Pension Plans*
- Statement No. 43, *Financial Reporting for Post-employment Benefit Plans, Other Than Pension Plans*
- Statement No. 45, *Accounting and Financial Reporting by Employers for Post-employment Benefits, Other Than Pensions*

GASB pronouncements apply to governmental entities, public benefit entities, public employee retirement systems, and public utilities, hospitals and other healthcare providers, and colleges and universities.

Unfunded Accrued Actuarial Liability (UAAL) is the amount of retirement benefits that are owed to employees in future years that exceed current assets and their projected growth.

Annual Required Contribution (ARC) is the employer's required contributions for the year, calculated in accordance with certain parameters and includes (a) the normal cost

for the year and (b) a component for amortization of total unfunded actuarial accrued liabilities(or funding excess) of the plan over a period not to exceed thirty years.