

**LODI CITY COUNCIL
SHIRTSLEEVE SESSION
CARNEGIE FORUM, 305 WEST PINE STREET
TUESDAY, MARCH 13, 2012**

A. Roll Call by City Clerk

An Informal Informational Meeting ("Shirtsleeve" Session) of the Lodi City Council was held Tuesday, March 13, 2012, commencing at 7:00 a.m.

Present: Council Member Hansen, Council Member Katzakian, Mayor Pro Tempore Nakanishi, and Mayor Mounce

Absent: Council Member Johnson

Also Present: City Manager Bartlam, Deputy City Attorney Magdich, and City Clerk Johl

B. Topic(s)

B-1 Discuss Other Post Employment Benefits (CM)

City Manager Bartlam introduced the subject matter of other post employment benefits (OPEB).

Deputy City Manager Jordan Ayers provided a PowerPoint presentation regarding OPEB. Specific topics of discussion included what is OPEB, auditor's findings and recommendation, actuarial valuation, accounting requirements, disclosures, OPEB history, current process, other community comparisons, and options for consideration.

In response to Mayor Mounce and Mayor Pro Tempore Nakanishi, Mr. Ayers stated that, while the City does not pay for health care for employees after retirement, there is a Cobra-like option for certain employees depending upon their hire date whereby if selected the City will pay the CalPERS 112, which equates to approximately \$1,000 annually.

In response to Council Member Hansen, Mr. Bartlam stated the auditors have made the recommendation to collect OPEB funding from departments although staff has a different recommendation consistent with the pay-as-you-go option. Further, Mr. Ayers stated every two years a request for proposals is put out for an actuarial study to be performed by a licensed actuary independent of the auditors.

In response to Mayor Mounce, Mr. Ayers stated staff will provide City Council with copies of the 2012 actuarial study when it is received.

In response to Mayor Pro Tempore Nakanishi, Mr. Ayers stated the discount rate is anticipated earnings based on the City's assumptions for its actuarial.

In response to Mayor Mounce, Mr. Ayers stated the sick leave conversion benefit is transferable to a surviving spouse.

In response to Council Member Hansen, Mr. Ayers stated life expectancy rates are considered in the actuarial process through the use of mortality tables.

In response to Mayor Mounce, Mr. Ayers stated the fund balance after the June 30 close is approximately \$3 million.

In response to Council Member Hansen, Mr. Ayers stated the sick leave participation rates are calculated based upon an assumption of how many of the current 117 employees eligible for

the program will take the conversion option versus other options such as service credit or cash.

In response to Mayor Mounce, Mr. Bartlam stated the \$17 million number for Lodi is very different from the number in Stockton because it is considerably smaller, the program participant number is smaller, the program itself was capped in 1994/95, and there has been no program expansion.

In response to Council Member Hansen, Mr. Ayers stated with pension obligation bonds it is assumed that the annual debt service would be lower than what the ongoing pension payment is and the interest earnings would help offset the liability, although that is not what happened in Stockton with market conditions. Further, Mr. Ayers and Mr. Bartlam stated while the \$900,000 number will continue to grow for a period at some point that number will start to shrink because there will be less employees in the system and even fewer in this particular program.

In response to Council Member Hansen, Mr. Ayers stated the actual costs with the pay-as-you-go option are budgeted annually while the fluctuating liability number is not.

In response to Mayor Mounce, Mr. Ayers stated Elk Grove is a fairly new City and has a combination of a defined contribution plan, a trust, and a defined benefit program with a total unfunded liability of approximately \$1.5 million. In addition, Mr. Ayers and Mr. Bartlam stated the time frame of when the liability amount will start to decrease is unknown because the number of employees who are going to retire from the City are unknown and what option they will select at that time is unknown.

In response to Council Member Hansen, Mr. Ayers stated there is no stand-alone fund for employee retirements as it is all a part of the pay-as-you-go option with an unfunded liability amount. Mr. Bartlam stated staff is recommending that the City continue with the pay-as-you-go option as it is doing currently.

In response to Council Member Katzakian, Mr. Ayers stated the CalPers payment is set by statute and does have a Consumer Price Index type of increase and the 112 liability exists with all agencies that participate in CalPers. Mr. Ayers stated the worst case scenario deals with the number of people retiring at a given time and the option they select for sick leave conversion.

In response to Council Member Hansen, Mr. Bartlam stated staff will return to Council with details regarding the budget stresses that would result by funding the \$3 million and \$17 million figures of currently unfunded liability.

In response to Myrna Wetzel, Mr. Bartlam stated contracting with a third-party administrator would include hiring an investment firm to professionally manage the funds.

Mayor Mounce requested a list of exempt employees in the City who receive administrative pay.

C. Comments by Public on Non-Agenda Items - None

D. Adjournment

No action was taken by the City Council. The meeting was adjourned at 8:00 a.m.

ATTEST:

Randi Johl
City Clerk



**CITY OF LODI
COUNCIL COMMUNICATION**

AGENDA TITLE: Discuss Other Post Employment Benefits

MEETING DATE: March 13, 2012

PREPARED BY: Deputy City Manager

RECOMMENDED ACTION: Discuss Other Post Employment Benefits.

BACKGROUND INFORMATION: During the presentation of the Comprehensive Annual Financial Report (CAFR) for FY 2010/11, it was noted that our auditors made a recommendation that the City develop a plan to charge departments for Other Post Employment Benefits (OPEB). Council asked that this item be brought back for a Shirtsleeve discussion.

Attached are a variety of documents associated with OPEB:

- The most recent actuarial valuation report for OPEB for the City dated November 12, 2010
- Pages from the FY 2010/11 CAFR that address OPEB recording and disclosure
- Auditor finding and recommendation for the year ended June 30, 2011
- Government Finance Officers Association Best Practices.

Staff will provide additional information regarding funding options during the Shirtsleeve.

FISCAL IMPACT: Dependant upon Council direction.

FUNDING AVAILABLE: Dependant upon Council direction.

A handwritten signature in black ink, appearing to read "Jordan Ayers".

Jordan Ayers
Deputy City Manager

JA/ja

Attachments

APPROVED:

A handwritten signature in black ink, appearing to read "Konradt Bartlam".

Konradt Bartlam, City Manager

CITY OF LODI

*January 1, 2010 Actuarial Valuation of
Post-Employment Benefits
Under GASB Statement No. 45*

November 12, 2010

CITY OF LODI

January 1, 2010 Actuarial Valuation of Post-Employment Benefits

Table of Contents

	<u>Page</u>
<u>Summary</u>	
Introduction and Actuarial Certification.....	1
Summary of Results.....	2
<u>Data</u>	
Valuation Census Data.....	3
<u>Accounting Information</u>	
Statement of Plan's Benefit Obligations.....	4
Schedule of Funding Progress and Annual OPEB Cost - GASB 45.....	5
Current and Projected Reconciliation of Net OPEB Obligation - GASB 45.....	6
Projection of Retirees' and City's OPEB Cash Flows.....	7
<u>Other Information</u>	
Summary of Plan Provisions.....	8
Actuarial Assumptions.....	10
Accounting Requirements.....	15
Glossary of Selected Terms.....	17

January 1, 2010 Actuarial Valuation of Post-Employment Benefits

Introduction and Actuarial Certification

The City of Lodi (the City) has hired Van Iwaarden Associates to perform an actuarial valuation of the City's Other Post-Employment Benefits (OPEB's). The 'other' refers to post-employment benefits other than pensions. Accounting for these OPEBs is now required under Government Accounting Standards Board Statement No. 45 (GASB 45).

This valuation has been prepared to present information for financial reporting purposes. It is important to recognize that calculations performed for other purposes may yield significantly different results.

In conducting the valuation, we have used the following information as of January 1, 2010:

- the provisions of the medical plans
- census data
- premium information

All premium and census data were provided by the City.

The premium information and census data were used with a review of reasonableness but without formal audit. The premium trend rate was confirmed with Health Risk Strategies, LLC.

The valuation has been conducted in accordance with generally accepted actuarial principles and practices. In our opinion, the actuarial assumptions represent reasonable expectations of anticipated plan experience. To fulfill the applicable accounting requirements, each actuarial assumption should be management's "best estimate" solely with respect to that individual assumption.

The undersigned credentialed actuaries are members of the American Academy of Actuaries and meet the Qualification Standards of the American Academy of Actuaries to render the actuarial opinion contained herein. We are available to answer questions on the material contained in the report or to provide explanations or further detail, as may be appropriate.



Mark W. Schulte, FSA, EA, MAAA
Consulting Actuary



Mary P. Ratelle, FSA, MAAA
(Medical premium trend analysis only)

November 12, 2010

CITY OF LODI

January 1, 2010 Actuarial Valuation of Post-Employment Benefits

Summary of Results

	<u>January 1, 2010</u>
A. Valuation Census Data	
1. Active employees	399
2. Covered retirees and beneficiaries	<u>163</u>
3. Total	562
B. GASB 45 Funded Status	
1. Actuarial Accrued Liability (AAL) at valuation date	\$17,710,456
2. Market value of assets	0
3. Unfunded Accrued Liability (UAL) (1. - 2.)	17,710,456
4. Covered payroll	9,409,782
5. Unfunded Accrued Liability as a percentage of payroll	188.2%
6. Projected UAAL at fiscal year-end	18,128,398
C. Reconciliation of Net OPEB Obligation (NOO)	
1. Net OPEB Obligation as of July 1, 2009	1,195,521
2. Annual OPEB Cost	1,333,881
3. Estimated City contributions to be made during the fiscal year	<u>510,338</u>
4. Estimated Net OPEB Obligation as of June 30, 2010 (1. + 2. - 3.)	2,019,064
D. Effect of a 1% increase in Discount Rate (expected investment return)	
1. Percentage change in AAL	-11.49%
2. Percentage change in Annual OPEB Cost	-9.95%
E. Key Assumptions	
1. Discount rate for liabilities (expected long-term investment return)	4.00%
2. Health care cost trend rate	8.2% to 5.5% in 9 years
3. Percentage of employees expected to continue health coverage at retirement	see page 11

CITY OF LODI

January 1, 2010 Actuarial Valuation of Post-Employment Benefits

Valuation Census Data

This section presents the demographic information for the active and retired participants included in the OPEB valuation. The actuarial valuation was based on January 1, 2010 census data provided by the City. The following exhibits summarize the personnel characteristics of the data used for the study.

	<u>Total</u>
A. Retired Participants and Widow(er)s	
1. Number receiving benefits under the "Conversion" option	56
2. Number only receiving minimum required contribution (\$105 for 2010)	66
3. Number receiving benefits under the "Bank" option*	<u>41</u>
4. Total	163
5. Average age	66.29

	<u>Total</u>
B. Active Participants	
1. Fire	16
a. Number eligible to receive SLC benefits	<u>41</u>
b. Number not eligible to receive SLC benefits	57
c. Subtotal	
2. Police	23
a. Number eligible to receive SLC benefits	<u>49</u>
b. Number not eligible to receive SLC benefits	72
c. Subtotal	
3. Other employees	88
a. Number eligible to receive SLC benefits	<u>182</u>
b. Number not eligible to receive SLC benefits	270
c. Subtotal	
4. Total**	399
5. Average age	43.24

*Liability due to the "Bank" option falls under GASB 16 and is not included in this report

**There were five additional employees listed in the original data that were excluded due to a hire date after 1/1/2010

CITY OF LODI

January 1, 2010 Actuarial Valuation of Post-Employment Benefits

Statement of Plan's Benefit Obligations

				<u>January 1, 2010</u>	
A. Actuarial Accrued Liability at January 1, 2010					\$24,964,276
1.	Total actuarial present value of OPEB				7,253,820
2.	Postretirement benefit obligation attributable to future service				<u>17,710,456</u>
3.	Actuarial Accrued Liability (AAL) on January 1, 2010 (1. - 2.)				
4.	AAL Summary			Fire	Police
				Other	Total
a.	Active	i.	CalPERS minimum contribution	\$654,952	\$881,763
		ii.	Conversion benefit	<u>0</u>	<u>679,371</u>
		iii.	Total	654,952	1,561,134
					8,496,251
					<u>\$5,469,967</u>
b.	Inactive	i.	CalPERS minimum contribution	143,029	329,238
		ii.	Conversion benefit	<u>0</u>	<u>858,444</u>
		iii.	Total	143,029	1,187,682
					5,667,408
					<u>3,734,826</u>
c.	Total	i.	CalPERS minimum contribution	797,981	1,211,001
		ii.	Conversion benefit	<u>0</u>	<u>1,537,815</u>
		iii.	Total	797,981	2,748,816
					14,163,659
					<u>9,204,793</u>
					<u>8,505,663</u>
					<u>17,710,456</u>
 B. Changes in the Actuarial Accrued Liability from July 1, 2008					
1.	Expected actuarial accrued liability (AAL)				\$23,323,165
a.	AAL as of July 1, 2008				854,741
b.	Normal cost as of July 1, 2008				448,739
c.	Normal cost as of July 1, 2009 (half year)				(566,723)
d.	Expected benefit payments from July 1, 2008 through July 1, 2009				(309,901)
e.	Expected benefit payments from July 1, 2009 through January 1, 2010				<u>1,452,997</u>
f.	Interest to January 1, 2010 on a. through e.				25,203,018
g.	Expected AAL on January 1, 2010 (sum of a. through f.)				
2.	Actual AAL on				
a.	Actual AAL at January 1, 2010 with changes to census data and plan experience				21,655,881
b.	Actual AAL at January 1, 2010 including offset for minimum required contribution and a decrease in the premium paid after age 65 for those eligible for the Conversion benefit				21,161,003
c.	Actual AAL at January 1, 2010 with widow continuation assumption change				19,151,713
d.	Actual AAL at January 1, 2010 with updated premium amounts				<u>17,710,456</u>
3.	Difference from the expected AAL				
a.	(Gain) or loss due to plan experience different from expected, and census updates/changes (2a. - 1g.)				(3,547,137)
b.	Change due to programming differences (2b. - 2a.)				(494,878)
c.	Change due to premium changes (2c. - 2b.)				(2,009,290)
d.	Change due to assumption changes (2d. - 2c.)				<u>(1,441,257)</u>
e.	Total change in AAL from expected (sum of a. through d.)				<u>(7,492,562)</u>

January 1, 2010 Actuarial Valuation of Post-Employment Benefits

Schedule of Funding Progress and Annual OPEB Cost - GASB 45

The following tables show the income statement figures if the City follows GASB 45 accounting. The unfunded accrued liability is amortized as a level dollar amount over a closed 30 year period beginning June 30, 2009. Assumptions and methods used are described in subsequent sections.

A. Schedule of funding progress

	January 1, 2010
1. Actuarial valuation date	\$0
2. Plan assets at fair value	17,710,456
3. Actuarial accrued liability (AAL)	17,710,456
4. Unfunded AAL (UAAL) (3. - 2.)	0.00%
5. Funded ratio (2. / 3.)	\$9,409,782
6. Covered payroll	188.21%
7. UAAL as a percentage of covered payroll (4. / 6.)	18,128,398
8. Projected UAAL as of June 30, 2010	

B. Annual Required Contribution (ARC)*

1. Normal cost at June 30, 2010	\$642,907
2. Amortization of UAAL over 29 years as of June 30, 2010	<u>690,512</u>
3. Total fiscal year-end ARC	1,333,419

C. Annual OPEB Cost

1. Annual required contribution as of June 30, 2010	1,333,419
2. Interest on net OPEB obligation (NOO)	47,821
3. Adjustment to ARC (amortization of NOO)	<u>(47,359)</u>
4. Annual OPEB cost (expense) (1. + 2. + 3.)	1,333,881

D. Three year history of OPEB information

Fiscal Year Ended	Annual OPEB Cost	Annual Plan Sponsor Contribution **	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
6/30/2008	N/A	N/A	N/A	N/A
6/30/2009	1,785,173	589,652	33.03%	1,195,521
6/30/2010	1,333,881	510,338	38.26%	2,019,064

*This is a misleading term, but it is prescribed by GASB 45. No contribution is actually required to be made in cash.

** Estimated contribution for fiscal year.

CITY OF LODI

January 1, 2010 Actuarial Valuation of Post-Employment Benefits

Current and Projected Reconciliation of Net OPEB Obligation - GASB 45

The following tables show the balance sheet figures when the City follows GASB 45 accounting. Assumptions and methods used are described in subsequent sections.

A. Reconciliation of estimated Net OPEB Obligation (NOO) for 2010

1. Net OPEB obligation as of July 1, 2009		1,195,521
2. Annual OPEB cost		
a. Annual required contribution	1,333,419	
b. Interest on net OPEB obligation	47,821	
c. Adjustment to ARC (amortization of NOO)	(47,359)	
d. Total (a. + b. + c.)		1,333,881
3. Contributions made including implicit subsidy (estimated)		<u>510,338</u>
4. Estimated net OPEB obligation as of June 30, 2010 (1. + 2. - 3.)		2,019,064

B. Reconciliation of estimated NOO for 2011

1. Estimated net OPEB obligation as of July 1, 2010		2,019,064
2. Annual OPEB cost		
a. Annual required contribution	1,415,969	
b. Interest on net OPEB obligation	80,763	
c. Adjustment to ARC (amortization of NOO)	<u>(82,550)</u>	
d. Total (a. + b. + c.)		1,414,182
3. Contributions made including implicit subsidy (estimated)		<u>576,894</u>
4. Estimated net OPEB obligation as of June 30, 2011 (1. + 2. - 3.)		2,856,352

CITY OF LODI

January 1, 2010 Actuarial Valuation of Post-Employment Benefits

Projection of Retirees' and City's OPEB Cash Flows

Fiscal Year	OPEB		(a) + (b)
	(a)	(b)	
<u>Ending</u>	<u>CalPers Minimum Contribution</u>	<u>Conversion Benefits</u>	<u>Total</u>
2010	\$171,044	\$339,294	\$510,338
2011	200,841	376,053	576,894
2012	218,009	416,779	634,788
2013	238,087	511,334	749,421
2014	260,230	581,978	842,208
2015	285,068	653,980	939,048
2016	311,813	733,938	1,045,751
2017	340,335	782,714	1,123,049
2018	370,164	826,368	1,196,532
2019	403,314	869,451	1,272,765
2020	437,794	921,167	1,358,961
2021	473,363	905,199	1,378,562
2022	509,898	917,243	1,427,141
2023	546,607	881,870	1,428,477
2024	584,329	863,551	1,447,880
2025	622,212	818,705	1,440,917
2026	659,859	736,252	1,396,111
2027	699,106	659,128	1,358,234
2028	737,839	592,179	1,330,018
2029	776,216	523,242	1,299,458
2030	815,519	429,024	1,244,543
2031	854,673	368,362	1,223,035
2032	893,952	267,397	1,161,349
2033	934,163	197,212	1,131,375
2034	972,926	152,765	1,125,691
2035	1,010,273	96,486	1,106,759
2036	1,045,706	70,645	1,116,351
2037	1,079,026	50,855	1,129,881
2038	1,109,794	38,118	1,147,912
2039	1,135,965	27,005	1,162,970
2040	1,157,654	19,264	1,176,918

Note: Projections are based on a "closed group": current participants only, no future entrants.

January 1, 2010 Actuarial Valuation of Post-Employment Benefits

Summary of Plan Provisions

This section describes the "substantive plan" upon which the valuation was based. This summary reflects relevant provisions used as the basis for the actuarial valuation.

Eligibility for Participation An employee of the City of Lodi that is eligible to receive a pension from CalPERS.

Eligibility for retirement benefits Age 50 with 5 years of service for the minimum contribution. Additional requirements below for Sick Leave Conversion benefit.

Premium paid by City The City will pay the minimum required premium under Government Code Section 22892 (\$105 per month for 2010 and \$108 for 2011) of the Public Employee Medical and Hospital Care Act towards a retiree's medical premium for the life of the retiree and their surviving spouse.

In addition, after 10 years of service, the following employee groups are eligible for a Sick Leave Conversion benefit (described on the next page) used to pay medical premiums after retirement.

<u>Contract Group</u>	<u>Hired prior to:</u>
• Executive management	July 1, 1994
• Mid-management	July 1, 1994
• Fire mid-management	July 1, 1994
• Police mid-management	July 1, 1994
• Dispatchers	July 9, 1994
• Police	October 10, 1994
• IBEW	January 1, 1995
• General Services	July 1, 1995
• Maintenance and Operators	July 1, 1995
• Fire	December 6, 1995

CITY OF LODI

January 1, 2010 Actuarial Valuation of Post-Employment Benefits

Summary of Plan Provisions (continued)

Sick Leave Conversion Benefit (an eligible retiree may choose between the following options):

Bank Option Accumulated unused sick leave is converted to a dollar amount and becomes the employee's "Bank." Medical premiums are paid out of this account until it is depleted. The City will then pay the minimum amount required by law towards the retiree's premium until death or discontinuation of coverage.

Conversion Option Accumulated unused sick leave is converted to a period of time during which the City will pay for a retiree's health premiums. The amount of premium paid by the City each year shall be the same amount as paid at the time of retirement. Retirees are responsible for paying for future increases in the health premiums. Once the time period is over, the City will then only pay the minimum amount required by law towards the retiree's medical premium until death or discontinuation of coverage.

The "Conversion Option" is described in detail as follows:

"The number of accumulated hours shall be multiplied by 50% and converted to days. The City shall pay one month's premium for employee and dependents for each day after conversion. For each year of employment in excess of 10 years, 2.5% shall be added to the 50% before conversion. The amount of premium paid shall be the same as the premium paid by the City at the time of retirement. In the event any differences are created by an increase in premiums the difference must be paid for by the employee. The City shall allow a surviving dependent of a retiree enrolled in the Sick Leave Conversion program to purchase medical insurance at the employee-only premium for the same period as if the retiree had not died."

This valuation does not include benefits paid for through the "Bank Option." Those benefits are valued under GASB 16.

Total monthly premium effective January 1, 2010 (Bay Area Region):*

<u>Basic Plans</u>	<u>Employee Only</u>	<u>Employee + 1</u>	<u>Employee + 2</u>
Blue Shield	\$577.33	\$1,154.66	\$1,501.06
Blue Shield NetValue	500.35	1,000.70	1,300.91
Kaiser	532.56	1,065.12	1,384.66
PERS Choice	508.74	1,017.48	1,322.72
PERS Select	474.93	949.86	1,234.82
PERS Care	868.17	1,736.34	2,257.24
PORAC	484.00	906.00	1,151.00
<u>Supplement/Managed Medicare Monthly Rates</u>			
Blue Shield	\$299.53	\$599.06	\$868.59
Blue Shield NetValue	299.53	599.06	868.59
Kaiser	298.36	596.72	895.08
PERS Choice	356.09	712.18	1,068.27
PERS Select	356.09	712.18	1,068.27
PERS Care	410.60	821.20	1,231.80
PORAC	363.00	723.00	1,157.00

*In 2010, the CalPERS medical premiums for the Bay Area/Sacramento Region were split into two separate regions. This valuation assumes that future retirees will be covered by the Bay Area premiums.

January 1, 2010 Actuarial Valuation of Post-Employment Benefits

Actuarial Assumptions

This section describes the actuarial assumptions and methods used in this valuation of postretirement benefit costs

Valuation Date	January 1, 2010
Actuarial Cost Method	OPEB benefits were calculated under the Entry Age Normal (level percent of pay) cost method with a 30-year amortization of unfunded liability (closed basis). The present value of future benefits were allocated on a level basis over the expected earnings of each employee between the hire date and assumed retirement age.
Amortization of Unfunded Actuarial Accrued Liability	Amortized as a level percent of payroll over a closed 30 year period. As of July 1, 2010, 28 years remain.
Discount Rate	4% per year
Salary Increase	Salaries are assumed to increase 3.25% per year
Payroll Growth	Total City payroll is assumed to increase 3.25% per year.
Age-based Monthly OPEB Costs	The CalPERS medical plan is a "Community-rated" plan as described in GASB 45. Each participant of employers in the region pays the same premium even though the costs to older retirees tend to be higher. This higher cost is offset by the younger participants paying a premium that tends to be higher than their medical costs. Under GASB 45 accounting rules, it is assumed that the City has no OPEB implicit subsidy liability due to the fact that the City is a relatively small component of the CalPERS community-rated plan.

Health Trend Rates	<u>Year</u>	<u>Rates</u>
	2010	8.20%
	2011	7.90%
	2012	7.60%
	2013	7.30%
	2014	7.00%
	2015	6.70%
	2016	6.40%
	2017	6.10%
	2018	5.80%
2019 & later	5.50%	

It is assumed that the minimum required premium under Government Code Section 22892 (\$105 per month for 2010 and \$108 for 2011) of the PEMHCA towards a retiree's medical premium will increase at 5% per year after 2011.

Medicare Eligibility We have assumed that all retirees will become eligible for Medicare when they reach age 65.

Administrative Expenses No administrative expenses were included in this valuation.

CITY OF LODI

January 1, 2010 Actuarial Valuation of Post-Employment Benefits

Actuarial Assumptions (continued)

Duration of Conversion Benefit It is assumed that all future retirees electing the Conversion benefit will receive it for 9 years. Current retirees receive the Conversion benefit until the end of their actual conversion period. These assumptions were developed by the prior actuary based on analysis of participant data.

Spouse ages Wives are assumed to be three years younger than husbands.

Participation Rates Actives

It is assumed that 100% of future retirees elect to continue medical coverage and 75% elect spouse coverage. Participants are assumed to continue in their current medical plan. It is assumed that 10% of widows elect to continue the CalPERS minimum benefit after the participant's death.

Eligible future retirees are assumed to elect the Conversion option over the Bank option as follows:

100%	General Service	50%	Mid Management
100%	Maintenance and Operations	50%	Police
100%	Dispatchers	0%	IBEW
50%	Executive Management	0%	Fire

Inactives

It is assumed that 100% of retirees will continue in their current coverage until death. 10% of married participants are assumed to have spouses that elect to receive the CalPERS minimum benefit after the participants death.

Mortality The mortality rates are the same as those used in the January 1, 2008 actuarial valuation and are from the 2008 CalPERS retirement plan valuation.

Sample rates are as follows:

Age	Pre-Retirement		Post-retirement	
	Male	Female	Male	Female
55	0.248%	0.178%	0.429%	0.253%
60	0.344%	0.256%	0.721%	0.442%
65	0.480%	0.369%	1.302%	0.795%
70	0.671%	0.537%	2.135%	1.276%
75			3.716%	2.156%
80			6.256%	3.883%
85			10.195%	7.219%
90			17.379%	12.592%

Disability The disability rates are the same as those used in the January 1, 2008 actuarial valuation and are from the 2008 CalPERS retirement plan valuation.

Sample rates are as follows:

Age	Fire	Police
25	0.10%	0.28%
30	0.21%	0.56%
35	0.31%	0.84%
40	0.41%	1.12%
45	0.51%	1.40%
50	0.62%	1.67%
55	6.01%	5.81%

CITY OF LODI

January 1, 2010 Actuarial Valuation of Post-Employment Benefits

Actuarial Assumptions (continued)

Withdrawal Rates The withdrawal rates are the same as those used in the January 1, 2008 actuarial valuation. Rates for Fire and Police employees are based on the 2008 CalPERS 3% @ 50 valuation. Rates for other City employees are based on the 2008 CalPERS miscellaneous employees valuation.

Sample annual rates of withdrawal are as follows:

Completed Years of Service	Fire	Police	Completed Years of Service	Fire	Police
0	9.47%	12.99%	8	1.56%	2.47%
1	7.39%	8.16%	9	1.23%	2.30%
2	5.31%	3.48%	10	0.90%	2.13%
3	3.23%	3.31%	15	0.79%	1.29%
4	2.90%	3.14%	20	0.69%	0.97%
5	2.57%	2.97%	25	0.57%	0.82%
6	2.23%	2.81%	30	0.54%	0.76%
7	1.89%	2.63%	35	0.09%	0.12%

All other City employees

Age	Entry Age						
	20	25	30	35	40	45	50
0	17.600%	16.910%	16.220%	15.525%	14.830%	14.140%	13.450%
1	15.610%	14.920%	14.230%	13.535%	12.840%	12.150%	11.460%
2	13.620%	12.930%	12.240%	11.545%	10.850%	10.160%	9.470%
3	11.630%	10.940%	10.250%	9.555%	8.860%	8.170%	7.480%
4	9.640%	8.950%	8.260%	7.565%	6.870%	6.180%	5.490%
5	7.650%	6.965%	6.270%	5.575%	4.880%	3.085%	1.290%
6	7.270%	6.580%	5.880%	5.190%	4.500%	2.810%	1.120%
7	6.890%	6.190%	5.500%	4.815%	4.110%	2.535%	0.960%
8	6.500%	5.805%	5.120%	4.425%	3.730%	2.265%	0.800%
9	6.120%	5.430%	4.730%	4.040%	3.350%	2.000%	0.650%
10	5.740%	5.045%	4.350%	3.660%	0.950%	0.730%	0.510%
15	4.460%	3.755%	3.070%	6.450%	0.460%	0.270%	0.080%
20	3.180%	2.490%	0.410%	0.250%	0.090%	0.055%	0.020%
25	1.900%	0.215%	0.090%	0.055%	0.020%	0.020%	0.020%
30	0.100%	0.060%	0.020%	0.020%	0.020%	0.020%	0.020%
35	0.200%	0.200%	0.020%	0.020%	0.020%	0.010%	0.000%

"Frozen" Sick Leave Conversion: It is assumed that current retirees entitled to a future Sick Leave Conversion benefit will begin receiving these benefits 3 years from the valuation date.

Changes since prior valuation The assumed percentage of widows continuing the CalPERS minimum benefit after a participant's death was changed from 100% to 10%.

*January 1, 2010 Actuarial Valuation of Post-Employment Benefits***Accounting Requirements**

This section presents the actuarial calculations used to fulfill the applicable accounting requirements for the plan.

Accounting Information under GASB 43 and GASB 45

The Governmental Accounting Standards Board (GASB) finalized Statements No. 43 (GASB 43 for funded OPEB plans) and 45 (GASB 45 for employers) in 2004. The statements' objectives are to establish uniform standards of financial reporting by state and local governmental entities for postemployment benefit plans other than pension benefits (OPEB plans). This includes benefits such as postemployment healthcare benefits, dental insurance and life insurance.

For OPEB plans sponsored by governmental entities, these GASB Statements require certain standards and disclosures of plan and fund information including financial reporting of plan assets, liabilities of plan, changes in net assets, funded status and funding progress of the plan, and contributions to the plan in comparison to the annual required contributions of the employer (ARC).

Valuing Postretirement Health Benefits

Determining the value of future health care benefits is challenged by the fact that assumptions must be made about many future events that are especially hard to predict. Future increases in health care costs are affected by many factors, including:

- OPEB inflation
- Changes in utilization patterns
- Technological advances
- Cost shifting (i.e., increases in private plans' costs in non-managed programs due to uninsured claims, changes in the Medicare payment structure, and increased emphasis on managed care programs)
- Cost leveraging (i.e., erosion of fixed deductibles and out-of-pocket maximums)
- Changes to government medical programs, such as Medicare, when applicable. Under the Medicare Modernization Act of 2003 (MMA), a new prescription drug program called Medicare Part D was established. GASB requirements state that the determination of the actuarial accrued liabilities, the annual required contribution, and the annual OPEB cost should be done without reduction for Medicare Part D payments.

*January 1, 2010 Actuarial Valuation of Post-Employment Benefits***Accounting Requirements (continued)**

OPEB obligations are also heavily influenced by demographic assumptions such as:

- Withdrawal rates (i.e., employees terminating before receiving benefits)
- Retirement rates (i.e., employees retiring at various ages and subsidy levels)
- Participation (i.e., retirees electing coverage, the percentage married, and elections to contribute for coverage of spouses)
- Mortality rates (i.e., how long employees and spouses will receive benefits)

The Actuarial Assumptions section outlines the assumptions used in this valuation.

Estimating Health Care Costs

In addition to estimating future increases in health care claims costs, it is necessary to develop a starting claims cost value on a per covered individual basis for self-insured plans and even some insured plans.

For insured plans, the premiums represent a blended average cost of both active and retired individuals. Since older, pre-65 retirees generally incur higher claims than younger active employees, GASB requires employers to value retiree liability based on estimated retiree costs rather than premiums. Age-adjusted claims are developed and used to value the OPEB liability.

*January 1, 2010 Actuarial Valuation of Post-Employment Benefits***Glossary of Selected Terms**

This section provides the definitions of applicable terminology in the actuarial valuation, with references to both the Governmental Accounting Standards Nos. 43 (GASB 43) and 45 (GASB 45).

Actuarial Cost Method - a procedure for determining the actuarial present value of benefits and for developing an allocation of such value to time periods.

Actuarial Present Value - the value of an amount or series of amounts payable or receivable at various times, determined as of a given date by the application of a set of actuarial assumptions.

Actuarial Accrued Liability - the portion of the actuarial present value which is not provided for by future normal costs, determined under the actuarial cost method.

Annual OPEB Cost - the OPEB expense recognized in the employer's financial statements.

ARC - the Annual Required Contribution (ARC) - the basis for the annual OPEB cost shown in the employer's financial statements. This term is misleading: no annual cash contribution is actually required to fund OPEB benefits.

Discount Rate - the interest rate used to adjust liabilities and obligations for the time value of money.

GASB Statement No. 43 - the Governmental Accounting Standards Statement Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans

GASB Statement No. 45 - the Governmental Accounting Standards Statement Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions

Implicit Subsidy or Implicit Rate Subsidy - the difference between the actual and apparent cost of OPEB coverage. The actual cost for early retirees is higher than the average per-person premium for the active/retiree group. Plans in which retirees pay the average active/retiree rate (the apparent cost) give rise to an implicit rate subsidy: the employer pays the difference between the actual and apparent cost.

Net OPEB obligation - the OPEB liability (asset) at transition, if any and the cumulative difference since the effective date of Statement No. 45 between annual OPEB cost and the employer's contributions.

Normal Cost - the portion of the actuarial present value which is allocated to the valuation year by the actuarial cost method.

Valuation Date - the date as of which assets and liabilities are measured in determining the OPEB liability of the plan.

CITY OF LODI
Notes to Basic Financial Statements (continued)
June 30, 2011

The schedule of funding progress, presented as RSI following the notes to the financial statements, presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability of benefits.

(10) POSTEMPLOYMENT BENEFITS OTHER THAN PENSIONS

(a) Plan Description

The City sponsors a single-employer defined-benefit postemployment healthcare plan (Plan) to provide medical insurance benefits to eligible retired employees and their spouses. The Plan does not issue a publicly available financial report. Medical coverage is provided through PERS healthcare program. Employees who retire from the City and receive a PERS pension are eligible for postemployment medical benefits. The City contributes the minimum amount provided under Government Code Section 22825 of the Public Employees Medical and Hospital Care Act. In general, retirees must contribute any premium amounts in excess of the City contribution. However, as described below, a closed group of active employees and retirees receive additional postemployment benefits.

Employees hired prior to the dates shown in the following table are allowed to convert their accumulated sick leave into postemployment medical benefits at retirement as long as they have ten or more years of service with the City.

Group	Hired prior to:
Executive Management	July 1, 1994
Mid-Management	July 1, 1994
Fire Mid-Management	July 1, 1994
Police Mid-Management	July 1, 1994
General Services	July 1, 1995
IBEW	July 1, 1995
Maintenance and Operators	July 1, 1995
Dispatchers	July 1, 1995
Police	July 9, 1994
Fire	October 10, 1994
	December 6, 1995

The most widely elected options are the "Bank" option and the "Conversion" option. Under the "Bank" option, accumulated sick leave amounts are translated by specified formulas into a bank amount that is then used to pay postemployment healthcare premiums until the "Bank" is

CITY OF LODI
Notes to Basic Financial Statements (continued)
June 30, 2011

exhausted. Under the "Conversion" option, the accumulated sick leave hours are converted by specified formulas into a period of time during which the retiree will receive postemployment benefits. The number of hours is multiplied by 50% and converted to days. The City pays one month's premium for employee and dependents for each day after conversion. For each year of employment in excess of ten years, 2.5% is added to the 50% before conversion. The amount of premium paid will be the same as the premium paid by the City at the time of retirement. In the event that the premium increases, the retiree pays the difference.

The City also allows a surviving dependent of a retiree to enroll in the Sick Leave Conversion program to purchase medical insurance at the employee only premium for the same period as if the retiree had not died. Retirees are allowed to enroll in any of the available PERS medical plans. The PERS minimum amount will continue for the life of the retiree and surviving spouse. The "Conversion" benefit will continue until the end of a period that is based on accumulated sick leave at retirement.

(b) Funding Policy

Contribution requirements of the postemployment benefit are based on pay-as-you-go financing. For fiscal year 2010-11, the City contributed \$469,593, or 33.16%, of the actuarially required contributions.

(c) Annual OPEB Cost and Net OPEB Obligation

The City's annual other postemployment benefits (OPEB) cost is calculated based on the annual required contribution (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and to amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years.

The following table shows the components of the City's annual OPEB cost for the year, the amount actually contributed to the plan, and changes in the City's net OPEB obligation:

Annual required contribution	\$ 1,415,969
Interest on net OPEB obligation	80,763
Adjustment to annual required contribution	<u>(82,550)</u>
Annual OPEB cost (expense)	1,414,182
Contribution made	<u>(469,593)</u>
Increase in net OPEB obligation	944,589
Net OPEB obligation - beginning of year	2,070,199
Net OPEB obligation - end of year	<u>\$ 3,014,788</u>

CITY OF LODI
Notes to Basic Financial Statements (continued)
June 30, 2011

The City's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation, are as follows:

Fiscal year ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
06/30/2009	\$ 1,785,173	33.03%	\$ 1,195,521
06/30/2010	1,333,881	34.43%	2,070,199
06/30/2011	1,414,182	33.21%	3,014,788

(d) Funding Status and Funding Progress

As of January 1, 2010, the most recent actuarial valuation date, the funded status of the Retiree Health Plan was as follows:

Actuarial accrued liability (AAL)	\$ 17,710,456
Actuarial value of plan assets	0
Unfunded actuarial accrued liability (UAAL)	<u>\$ 17,710,456</u>
Funded ratio (actuarial value of plan assets/AAL)	0.0%
Annual covered payroll (active plan members)	\$ 9,409,782
UAAL as percentage of annual covered payroll	188.21%

(e) Actuarial Methods and Assumptions

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 contribution of the employer 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 multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

CITY OF LODI
Notes to Basic Financial Statements (continued)
June 30, 2011

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

In the January 1, 2010 actuarial valuation, the entry age normal cost method was used. The actuarial assumptions included a 4% discount rate to calculate the present value of future benefit payments; an annual healthcare cost trend rate of 8.5% initially, reduced by .3 percent increments to an ultimate rate of 5.5% in the eleventh year and beyond; the PERS minimum benefit will increase 5% per year; a 3.25% annual rate of increase in payroll; assumed that 100% of future eligible retirees will elect to maintain their enrollment in a PERS medical plan and qualify for the City's minimum contribution; 75% of future retirees will enroll a spouse; and also assumed that 100% of General Services, Maintenance and Operators and Dispatchers will elect the conversion option and 50% of Executive Management, Mid Management and Police will elect the option. The conversion option is not available to IBEW and Fire retirees. The unfunded actuarial accrued liability is amortized as a level of percentage of expected payroll over a closed thirty year period.

Since the prior valuation in 2008, there have been several factors which decreased the City's GASB 45 Actuarial Accrued Liability. These include (1) fewer participants covered under the Conversion option due to pre-retirement termination of employment or cessation of medical coverage with the City; (2) updated actuarial assumptions and methods regarding coordination of the PERS minimum benefit and the Conversion benefit, effect of Medicare premiums on the Conversion benefit, and assumed duration of the PERS minimum benefit for widows; and (3) health premium increases which were lower than expected.

(11)

CLAIMS AND BENEFITS

The City is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The City is self-insured as discussed in the following paragraphs for which liabilities are recorded in the Internal Service Fund-Insurance Funds.

The City is self-insured for general liability up to the first \$500,000 per occurrence with claims from \$500,000 to \$40,000,000 per occurrence and in the aggregate insured through the California Joint Powers Risk Management Authority. The City never had any settlements that exceeded its general liability insurance coverage (See Note 13).

The City is self-insured for workers' compensation up to the first \$250,000 per claim. Any claims of \$250,000 up to California statutory limits are covered under a purchased policy through the membership with the Local Agency Workers' Compensation Excess Joint Powers Authority with coverage up to \$300,000,000 in the current year. The City never had any settlements that exceeded its workers' compensation insurance coverage (See Note 13).

City of Lodi
Required Supplementary Information
Schedule of Funding Progress – OPEB Plan
June 30, 2011
 (in thousands of dollars)

Actuarial Valuation Date	Actuarial Value of Assets (A)	Normal Accrued Liability (B)	Unfunded Liability [(B) - (A)]	Funded Ratio [(A) / (B)]	Annual Covered Payroll (C)	JAAL As a Percentage of Covered Payroll $\frac{[(B) - (A)]}{(C)}$
1/1/08	\$ 0	\$ 23,323	\$ 23,323	0%	\$ 9,846	237%
1/1/10	0	17,710	17,710	0%	9,410	188%

As, required by GASB Statement No. 45, the City will report three years of data in the above table, as the information becomes available in subsequent years.

CITY OF LODI
COMBINING STATEMENT OF NET ASSETS
INTERNAL SERVICE FUNDS
 June 30, 2011

	Fleet Services	Benefits	Insurance	Total
ASSETS				
Current assets:				
Cash and investments	\$ 115,724	151,351	8,530,181	\$ 8,797,256
Receivables:				
Accounts, net		159	17,942	17,942
Interest			9,107	9,266
Inventory	124,816			124,816
Noncurrent assets:				
Capital assets (net)	33,286			33,286
Total current assets	273,826	151,510	8,557,230	8,982,566
LIABILITIES				
Current liabilities:				
Accounts payable and other liabilities	70,844	71,386	493,279	635,509
Self-insurance liability			1,445,428	1,445,428
Accrued compensated absences	42,354			42,354
Noncurrent liabilities:				
Self-insurance liability	64,927		6,904,910	6,904,910
Accrued compensated absences			64,927	64,927
Net OPEB obligation		3,014,788		3,014,788
Total liabilities	178,125	3,086,174	8,843,617	12,107,916
NET ASSETS (DEFICIT)				
Invested in capital assets, net of related debt	33,286			33,286
Unrestricted (deficit)	62,415	(2,934,664)	(286,387)	(3,158,636)
Total net assets (deficit)	\$ 95,701	(2,934,664)	(286,387)	\$ (3,125,350)

CITY OF LODI, CALIFORNIA
Report to City Council
Current Year Recommendation
For the Year Ended June 30, 2011

DEFICIT BENEFITS INTERNAL SERVICE FUND

Condition

For the year ended June 30, 2011, the revenue charged to user funds and/or departments by the City's Benefits Internal Service Fund was \$255,951 less than the CalPERS invoice billings of health insurance premiums for active participants enrolled in the health care plans offered by CalPERS. Absent a reconciliation of the enrolled participants in the CalPERS health care plans and the City's internal payroll and Human Resources system, the costs related to the CalPERS invoice billings of health insurance premiums could be permanently stranded in the internal service fund, and therefore, the user funds and/or departments not being charged their proportionate share of the costs.

In addition, the City isn't recovering its annual OPEB costs of \$944,589 from user funds and/or departments.

Internal service funds are expressly designed to function as *cost-reimbursement devices*. That is, an internal service fund is simply a means of accumulating costs related to a given activity on an accrual basis so that the costs can subsequently be allocated to the benefiting funds in the form of fees and charges. This condition resulted in an increase in the net deficit of the Benefits Internal Service Fund of \$1,003,790 to \$2,934,664.

Recommendation

Management and/or authorized employees should perform a monthly reconciliation of the enrolled participants in the health care plans as reported by CalPERS in the monthly health insurance invoice roster detail with the City's internal payroll system and Human Resources records to ensure accuracy and completeness of the roster.

Furthermore, the City should develop a plan to begin charging funds and/or departments their share of the annual OPEB costs as opposed to limiting the charges to their share of the contributions made.

Management Response

Procedures for an annual reconciliation and adjustment are in place. However, due to staff turnover at year-end, the reconciliation and adjustment were not performed timely.

With regard to Other Post Employment Benefit (OPEB) costs, the City Council has chosen to operate on a pay-as-you-go basis. The City understands and accepts that an impact of this choice is a deficit net assets position in this internal services fund.



BEST PRACTICE

Ensuring the Sustainability of Other Postemployment Benefits (2007) (CORBA & BUDGET)

Background. Employee compensation packages for active workers often include healthcare and similar benefits following the completion of active service. Generically, such benefits are described as *other* postemployment benefits (OPEB) to distinguish them from pensions.¹ For many years, employers have been required to recognize expenses for the cost of pension benefits as those benefits are earned by employees during their active service life. The Governmental Accounting Standards Board (GASB) has now extended this same requirement to OPEB.² The change in accounting standards has focused attention as never before on the costs of OPEB. These concerns are exacerbated by rising healthcare costs and an aging public-sector workforce. The real issue is not the new accounting for OPEB, as such, but rather the underlying *budgetary and funding* challenge that those accounting standards highlight. Meeting this challenge will require that government finance officers ensure that any such benefits they offer are *sustainable* over the long term (i.e., benefits *are, and reasonably may be expected to remain*, affordable to the government, competitive and sufficient to meet employee needs).

Recommendation. Governments should develop a deliberative process to ensure the sustainability of any OPEB they offer to their employees. These steps should include:

- 1) Developing principles and priorities to guide decision-making for OPEB that considers benefit design, funding approaches, and the needs of all stakeholders. (Because OPEB are a form of employee compensation, they should always be considered as an integral part of an employee's total compensation package. Likewise, governments should strive to avoid benefit reductions that place an undue burden on employees, or that risk making the government uncompetitive as an employer).
- 2) Carefully evaluating and designing benefits to ensure they are sustainable. In doing so, a government may wish to consider the following possibilities of enhancing sustainability:
 - a) implementing healthcare cost containment measures³
 - b) improving coordination with Medicare benefits
 - c) establishing vesting rules that provide levels of benefits that are commensurate with years of service
 - d) establishing eligibility rules that avoid including retirees, dependents, and spouses who are otherwise insured
 - e) creating a tiered system of benefits based on hiring dates
 - f) replacing defined benefits with a defined contribution or hybrid model⁴

¹ Some government employers choose to augment other elements of employee compensation rather than providing OPEB.

² See GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* (2004). The Financial Accounting Standards Board (FASB) has required the same of private-sector employers since the implementation of FASB Statement No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, which was released in 1990 and first took effect for calendar fiscal year 1993.

³ See the GFOA Best Practice, *Health Care Cost Containment*, 2004.

⁴ A *hybrid* model combines elements of a defined *benefit* plan with elements of a defined contribution plan--for example, fixed employer payments (i.e., a defined *contribution*) combined with a guaranteed minimum earnings rate on the resources accumulated (i.e., a defined *benefit*).

- g) considering whether to continue using the same blended or common premium to both retirees and active employees (i.e., the *implicit rate subsidy*).
- 3) Once a government has satisfied itself that its plan design for OPEB is sustainable, it should intentionally select an appropriate funding approach.
- a) The government should refrain from offering incentive packages for early separation without first considering their impact on the cost of OPEB⁵;
 - b) The government should decide whether it will fund benefits as they are being earned over an employee's active service life (i.e., *advance funding*) or only as benefit payments come due (i.e., *pay-as-you-go* or *pay-go* funding)⁶;
 - c) If the government elects to advance fund benefits it should decide:
 - i) which actuarial cost allocation method is most appropriate to its objectives and circumstances,
 - ii) whether to do so for all OPEB, or to exclude the implicit rate subsidy for healthcare,
 - iii) whether to fully pre-fund benefits or only partially pre-fund benefits, and
 - iv) whether to establish a separate trust fund for the purpose or earmark resources that remain in the government's control (e.g., a separate fund or account).
- 4) If the government elects to establish a trust fund, it should consider all of the following:
- a) potential need to seek new legislation to allow appropriate trust arrangements and investment guidelines
 - b) impact on annual required contribution of prompt implementation and funding⁷
 - c) possibility of collaborating with others including pension plans to lower administrative costs and leverage investing expertise
 - d) advantages and disadvantages of each trust option
 - e) administrative and reporting requirements (including the need for a private letter ruling from the IRS in certain circumstances)
 - f) governance structure (oversight board, investment policy, investing infrastructure)
 - g) appropriate flexibility (e.g., appropriate adjustments if a form of state or national universal health care is adopted) without compromising compliance with GASB requirements to qualify as a "trust" for accounting and financial reporting purposes.
- 5) Governments should exercise considerable caution before issuing debt to fund their unfunded actuarial accrued liability.⁸
- 6) Governments should consider how to most effectively communicate with and educate affected stakeholders on the impact of the decisions made regarding OPEB.

Approved by the GFOA's Executive Board, October 19, 2007.

⁵ See GFOA's Best Practice, *Evaluating the Use of Early Retirement Incentives*, 2004.

⁶ One clear benefit of advance funding over pay-as-you-go funding is that amounts accumulated for future benefits partially offset their cost.

⁷ As already noted, earnings on amounts accumulated for future benefits help to offset the cost of these benefits. Thus, the sooner the trust is funded, the greater the impact on the cost of the OPEB. This fact needs to be considered when a government considers an OPEB funding strategy.

⁸ See GFOA's Advisory, *Need for Considerable Caution in Regard to OPEB Bonds*, 2007.



BEST PRACTICE

Considerations for Prefunding OPEB Obligations (2008) (BUDGET and CORBA)

Background. Employee compensation packages for active workers often include healthcare and similar benefits following the completion of active service. Generically, such benefits are described as *other* postemployment benefits (OPEB) to distinguish them from pensions.¹ For many years, employers have been required to recognize expenses for the cost of pension benefits as those benefits are earned by employees during their active service life. The Governmental Accounting Standards Board (GASB) has now extended this same requirement to OPEB, in GASB Statement 45.²

An actuarial accrued liability for OPEB can result from an employer's obligation to provide *explicit* benefit payments (e.g., the employer will pay a percentage of retiree healthcare premiums or the employer will pay a fixed dollar amount toward retiree healthcare premiums) or from an *implicit* rate subsidy (i.e., retirees are allowed to pay the same rates as active employees, even though their age-adjusted premium would have been higher). For financial reporting purposes, both situations are treated identically. That is, the cost of the benefit is actuarially allocated to each period in the form of an annual required contribution (ARC). An employer's failure to fully fund the ARC results in an accounting liability (i.e., *net OPEB obligation*) in financial statements prepared using the accrual basis of accounting.

OPEB involving explicit benefit payments share the essential characteristics of pension benefits. Both are highly resistant to changes that would reduce current benefit levels. In the case of OPEB arising in connection with an implicit rate subsidy, the level of benefits for retirees will mirror changes in active employee benefits. This fact is important because employers have been known to change healthcare benefits for active employees in response to the budgetary challenge of increased healthcare costs (e.g., increases in deductibles, increases in employee contributions, changes in covered services). Accounting standards, however, require actuaries to assume that current healthcare benefit levels will remain unchanged for purposes of calculating the actuarial accrued liability for OPEB, including those benefits resulting from an implicit rate subsidy.

Recommendation. The Government Finance Officers Association (GFOA) recommends that the financing of postemployment benefits as they are earned (i.e., prefunding v. pay-as-you-go funding) offers significant advantages from the vantage point of equity and sustainability. Just as important, the earnings on the resources thus accumulated will lower the amount that ultimately must be budgeted by the employer.

GFOA strongly recommends that OPEB involving explicit benefit payments be prefunded on an actuarial basis, as discussed in GFOA's Best Practice, *Ensuring the Sustainability of Other Postemployment Benefits*.

GFOA believes that the prefunding of OPEB resulting from an implicit rate subsidy also is desirable. Prefunding provides equity among generations of taxpayers, levels annual retiree healthcare costs and helps ensure sustainability of the benefit. At the same time, GFOA recognizes that maintaining pay-as-you-go funding or

¹ Some government employers choose to augment other elements of employee compensation rather than providing OPEB.

² See GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* (2004). The Financial Accounting Standards Board (FASB) has required the same of private sector employers since the implementation of FASB Statement No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, which was released in 1990 and first took effect for calendar fiscal year 1993.

prefunding an amount less than the annual required contribution (ARC) may be appropriate in some situations, given the greater likelihood that benefit levels will be adjusted over time to counterbalance, at least in part, the effects of healthcare inflation.³ If a government does decide to prefund less than the ARC each year, the level of funding selected should be explained and documented following appropriate consultation with legal counsel and actuaries.

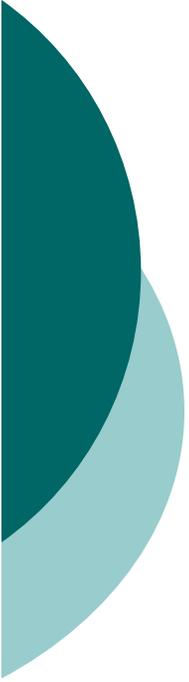
Approved by the GFOA's Executive Board, October 17, 2008.

³ While the actuarial valuation takes into account plan design changes that have occurred since the last valuation, they can not take into account prospective changes that may occur as governments adjust the plan design of active employees to take into account budget constraints and industry changes. This is particularly relevant in cases where the OPEB liability results from retiree participation in an employer group plan, which includes active employees and is subject to ongoing benefit changes.



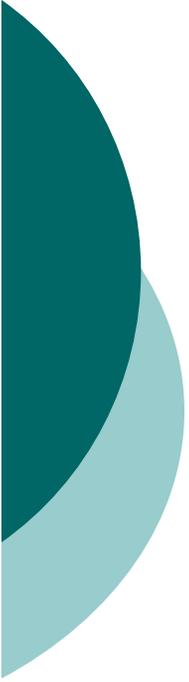
Other Post Employment Benefits (OPEB)

City Council Shirtsleeve
March 13, 2012



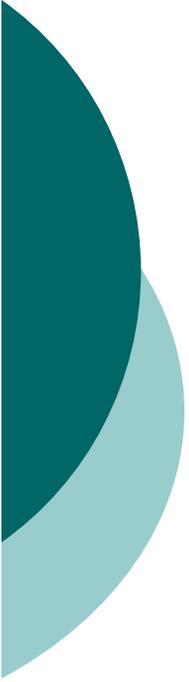
What is OPEB?

- Liability to the City for post-employment benefits payable to retirees and beneficiaries
 - Sick Leave Conversion
 - Limited to employees hired before July 1, 1994 or 1995, depending upon bargaining unit
 - Finite group getting smaller each year
 - City minimum required payment to PERS for each retiree/surviving spouse for medical premiums



Auditor's Finding & Recommendation

- Finding: City isn't recovering annual actuarial OPEB costs from departments
- Recommendation: City should develop a plan to begin charging departments their share of costs



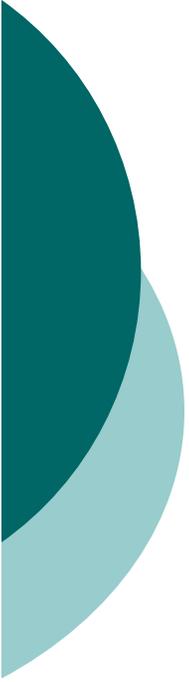
Actuarial Valuation

- Every other year
 - Last done as of January 2010
 - Currently under way for January 2012
- Multiple Assumptions
 - Discount Rate
 - Payroll Growth
 - Health Care Costs
 - Duration
 - 30-year amortization-closed period



Accounting Requirements

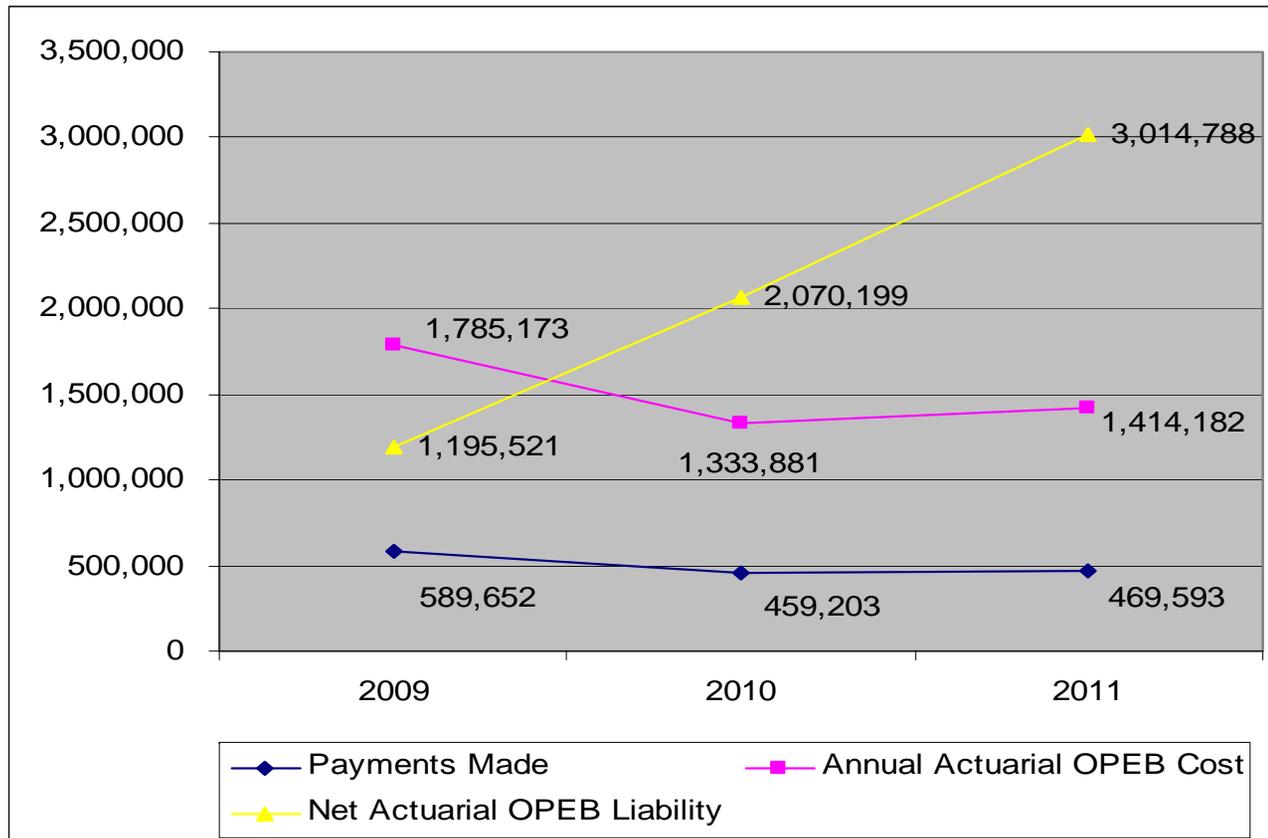
- Book net OPEB liability on face of statements
 - City uses Benefits Fund
- Note disclosure
- Required Supplemental Information

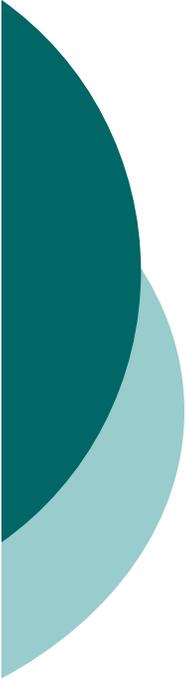


June 30, 2011 Disclosures

- Annual actuarial OPEB cost
 - \$1,414,182
- Payment made
 - \$469,593
 - SLC \$323,682
 - PERS Medical \$145,911
- Net actuarial OPEB Liability
 - \$3,014,788
- Unfunded actuarial accrued liability
 - \$17,710,456
 - SLC \$8,505,663
 - PERS Medical \$9,204,793

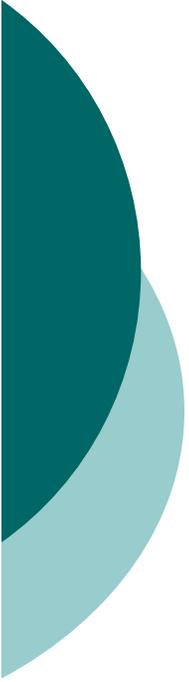
OPEB History





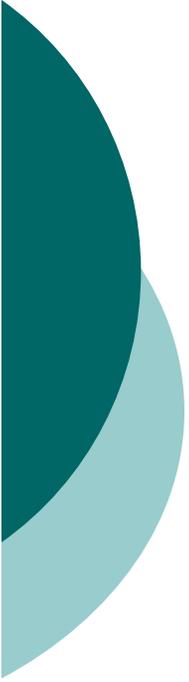
Current Process

- City charges departments for current year cost
 - \$469,593 for FY 2010/11
- Referred to as “Pay-as-you-go”
- Results in an increasing unfunded liability
 - Actual annual cost is covered
 - Liability is highly variable due to underlying actuarial assumptions



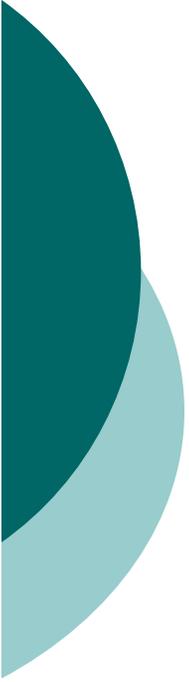
What are others doing?

- Stockton: Pay-as-you-go
- Manteca: Pay-as-you-go
- Tracy: Pay-as-you-go
- Elk Grove: 3 programs funded at various levels
- Galt: Pay-as-you-go
- Lathrop: Pay-as-you-go



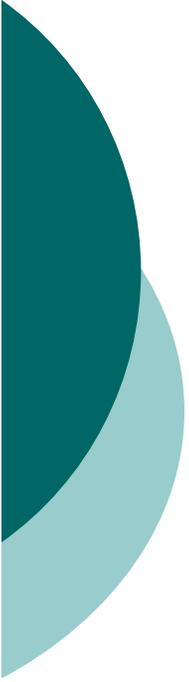
Options

- Continue pay-as-you-go processes
 - Advantages
 - Simplicity
 - Covers current year costs
 - Disadvantages
 - Actuarial liability likely to increase



Options

- Increase charges to departments to set aside funds to cover actuarial liability
 - Advantages
 - Reduces actuarial liability
 - Disadvantages
 - Budgetary stresses



Options

- Establish a trust with a third party and fund the actuarial liability
 - Advantages
 - Reduces actuarial liability
 - Professionally managed funds
 - Disadvantages
 - Budget stresses



Questions?
