

Grand Jury Report

RESPONSE FORM

Grand Jury Report Title : MCERA Evaluation

Report Dated : April 18, 2012

Response Form Submitted By:

Mendocino County Employee's Retirement Association
625 B Kings Court
Ukiah, CA 95482

Response MUST be submitted, per Penal Code §933.05, no later than:
August 8, 2012

I have reviewed the report and submit my responses to the FINDINGS portion of the report as follows:

- I (we) agree with the Findings numbered:
1, 2, 3, 4, 7, 12, 14, 15, 16, 18, 19
- I (we) disagree wholly or partially with the Findings numbered below, and have **attached, as required**, a statement specifying any portion of the Finding that are disputed with an explanation of the reasons therefore.
10, 11, 13, 17, 20, 21, 22, 23, 24, 25

I have reviewed the report and submit my responses to the RECOMMENDATIONS portion of the report as follows:

- The following Recommendation(s) have have been implemented and **attached, as required**, is a summary describing the implemented actions:
1, 7
- The following Recommendation(s) have not yet been implemented, but will be implemented in the future, **attached, as required** is a time frame for implementation:

- The following Recommendation(s) require further analysis, and **attached as required**, is an explanation and the scope and parameters of the planned analysis, and a time frame for the matter to be prepared, discussed and approved by the officer and/or director of the agency or department being investigated or reviewed: (This time frame shall not exceed six (6) months from the date of publication of the Grand Jury Report)
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- The following Recommendations will NOT be implemented because they are not warranted and/or are not deemed reasonable, **attached, as required** is an explanation therefore:

2, 8

I have completed the above responses, and have attached, as required the following number of pages to this response form:

Number of Pages attached: 6

I understand that responses to Grand Jury Reports are public records. They will be posted on the Grand Jury website: www.co.mendocino.ca.us/grandjury. The clerk of the responding agency is required to maintain a copy of the response.

I understand that I must submit this signed response form and any attachments as follows:

First Step: E-mail (word documents or scanned pdf file format) to:

- The Grand Jury Foreperson at: grandjury@co.mendocino.ca.us
- The Presiding Judge: grandjury@mendocino.courts.ca.gov

Second Step: Mail all originals to:

Mendocino County Grand Jury
P.O. Box 939
Ukiah, CA 95482

Printed Name: RICHARD A. WHITE, JR

Title: RETIREMENT ADMINISTRATOR

Signed: 

Date: JULY 20, 2012

Richard A. White, Jr.
Retirement Administrator



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MENDOCINO COUNTY
EMPLOYEES' RETIREMENT ASSOCIATION
625-B KINGS COURT
UKIAH, CALIFORNIA 95482-5027

Date: July 18, 2012

Subject: Response to the Grand Jury

Findings (1-4, 7, 10-25):

1. MCERA is responsible for the investment of retirement funds.

Agree.

2. The County, under the direction of the BOS, is responsible for negotiating public employee benefits.

Agree.

3. In 1998, retiree health benefits were discontinued for new employees after the date of the resolution.

Agree. Retiree health benefits were discontinued by the Board of Supervisors by Resolution 98-147 for new employees hired after Sept. 1, 1998, as specified in the resolution.

4. The County continues to partially fund non-Medicare eligible retirees.

Agree. MCERA's response is to the best of its knowledge. The County's funding of non-Medicare eligible retirees is not a MCERA function. This should be verified with the County.

7. COLA increases are allowed up to 3% per year.

Agree. To clarify the Grand Jury's finding, MCERA assumes the finding refers to pension COLA as defined by Government Code Section 31870.1.

10. The Buck Consulting firm and MCERA collaborated in 2005 on questionable actuarial practices to justify “excess earnings” of \$9.6 million.

Disagree. MCERA actions in 2005 related to excess earnings were based on the advice of accounting and actuarial professionals who, at that time, advised that these actions were in accordance with accepted principles. MCERA has since hired new actuaries and accountants who recommended different methodology and practices. MCERA has followed this new advice. MCERA also was advised that there are differences between State law and IRS rules relating to retiree health benefits that we must reconcile. This led the Board of Retirement to initiate a review by the IRS to determine if MCERA’s actions were in compliance with IRS tax laws, and if not, to guide us in a Voluntary Correction Program (VCP) to come into full compliance. We are also working with the law firm of Hanson Bridgett, experts in tax law as it pertains to public pension plans, to review the \$9.6 million allocation of excess earnings and help us work with the IRS toward compliance if necessary.

Note: MCERA disagrees with the characterization implied by the Grand Jury’s choice of words in this finding, which could be misconstrued by the reader as wrongdoing.

11. Some of the 2005 “excess earnings” were diverted to fund health care.

Partially disagree. Excess earnings were allocated to fund retiree health care in 2005/06 based on advice from MCERA’s actuary as described in Finding #10. MCERA disagrees with the characterization implied in the language of the finding.

12. Ultimately, this \$9.6 million was written off as a loss in FY 2010-11.

Agree. The \$9.6 million in unrealized earnings was written off as a result in a change in accounting and actuarial methodology, consistent with the practices of many retirement systems and in accord with professional advice.

13. The IRS is currently reviewing the county’s diversion of “excess earnings” as part of the Volunteer (sic) Correction Program (VCP). The VCP is associated with the maintenance of the tax-exempt status.

Partially disagree. MCERA has initiated a review by the IRS and enlisted the help of its actuary, accountants, and legal counsel. We await updates and a response by the IRS, but have not yet been advised by the IRS on its review or its timeline. MCERA is committed to working closely with the IRS if a review finds any corrections need to be made. See response to Finding #10 for further detail.

14. In February 2007, the BOS and the Board of Retirement Ad Hoc Committee recommended hiring an independent MCERA administrator.

Partially agree. The BOS and Board of Retirement did recommend hiring a professional administrator to enhance the financial expertise and management of the system, and to strengthen policies and procedures at MCERA. The position was filled but is not fully independent, as it reports to the Board of Retirement.

15. The MCERA Administrator was hired in October 2008.

Agree. That administrator has since retired and a new administrator joined MCERA in June, 2012.

16. The new administrator position was created to establish an organization with supporting policies and procedures that increase the effectiveness and transparency of MCERA.

Agree. This was an important consideration in hiring the administrator and has yielded the desired benefits. The investment in a professional staff has greatly strengthened practices and procedures, and increased the effectiveness and transparency of MCERA.

17. The hiring of the full time director and staff increased the MCERA salary costs from \$167,000 a year in 2007 to \$322,000 a year in 2010.

Partially disagree. The salary and benefit costs associated with the hiring of full-time professional staff have increased since the independence of MCERA. Please refer to the response to this finding of the Grand Jury by the Mendocino County Board of Supervisors for additional information on the actual line item expenditures. See our response to Finding #16 for additional comment on this finding.

18. The creation of an independent MCERA has increased the effectiveness and the cost of its operation with the creation of Comprehensive Annual Financial Reports (CAFR), a web presence, and televised meetings.

Agree. This response assumes that the Grand Jury refers again to the professional administrator as independent in presenting this finding. We again note that MCERA's administrator reports to the Board of Retirement. The "creation" of the administrator position has resulted in the benefits listed in this Finding. See also response to Finding #16.

19. Since 2008, the following changes have been made through a formal Request for Proposal (RFP) process:

In October 2009 the financial consultant Peter Chan was replaced by Callan Associates.

Agree.

In March 2011 the actuarial consultants Buck Consulting was replaced by Segal Company.

Agree

In July 2011 the audit consultant Jim Sligh was replaced by Gallina LLP.

Agree

20. MCERA’s unfunded actuarial accrued liability (UAAL) as of June 30, 2010 was \$91,784,613. In this year’s actuarial valuation, the UAAL has increased to \$124,912,676.

Partially disagree. This response assumes that by “this year’s actuarial valuation,” the Grand Jury refers to the valuation of FY 2010-11, ending June 30, 2011. MCERA agrees that the UAAL numbers stated in the finding are exactly as presented in the last two actuarial valuations. However, we believe it is important for the reader to understand that an increase in the UAAL of \$9,034,607, or 27% of the increase, is due to the actuary’s reclassification of some future year liabilities (normal cost) to historical liabilities (UAAL). It is ultimately a change in methodology that takes into account costs that previously were considered future costs but are now being realized as past year costs. Therefore, they are now calculated as part of the outstanding UAAL.

21. The revised GASB reporting standards, to be implemented in 2013, will reflect a current financial market value of pension assets and liabilities.

Partially disagree. The revised reporting standards (GASB 67 for plan reporting and GASB 68 for employer reporting) will become effective in 2013/2014 for the plan and in 2014/2015 for the employer. Even though the new standards mandate reporting based on market value of pension assets, plan liabilities continue to be valued using long term actuarial assumptions (i.e., no market value of liabilities). While the new GASB statements are intended to bring financial reporting standards for the plan sponsors more in line with Generally Accepted Accounting Principles (GAAP), recognizing changes in assets and liabilities more closely to the year in which they are incurred, MCERA believes that the Grand Jury’s statement reflects only one of many reporting requirements proposed by the GASB. In addition, the new GASB statements allow some changes to be recognized over a specified time period of more than one year.

22. MCERA liquidates investment assets on an “as needed” basis to meet pension requirements.

Disagree. The MCERA board has adopted a cash management and portfolio rebalancing policy which requires a cash management plan be adopted prior to the beginning of a new fiscal year and the preparation and presentation of monthly reports on the sources and uses of cash. The Grand Jury’s use of the term “as needed” could be misconstrued to suggest that such sales occur as a spontaneous response to a situation, which is not the case.

23. Decision making information has not been readily available to MCERA due to failure to produce cash flow reports.

Disagree See response to Finding #22.

24. The CAFR is produced a full year after the financial reporting period, too late for planning purposes.

Partially disagree. While monthly planning and decisions are greatly aided by the information received in regular cash flow reports and other staff reports and input, the CAFR is expressly useful for long-term planning. Because it includes voluminous reports on the economy, audits, actuarial, and other complex financial information, it cannot be captured reliably in a short period after the close of a year.

25. MCERA has lowered its 8% projected investment return rate to 7.75%, which has a 54% probability of fulfillment over the next 28 years.

Partially disagree. After an experience study in the fall of 2011, MCERA did agree with the recommendation of its actuaries to reduce the anticipated return on its investments from 8% to 7.75%. The Retirement Fund is a very long-term enterprise in which sound planning must assess our needs and project earnings on investment over many decades in the future. It is critical that people understand that it is just as misleading to project our fiscal growth using an artificially-low average rate of return (as occurs during a recession), as it is to project an artificially high rate of return (as the economy produced in some years of the last decade). Despite the volatility of the economy and other factors, MCERA's experts have advised, and we agree, that long-term experience and future economic modeling tells us that 7.75 % is an appropriate median rate of return for the future and that over a 15-year period there will be a 54% chance that MCERA will achieve an average return on its investments of at least 7.75%..

Note: It is also important to note that the Board of Retirement closely monitors many indicators and its investments and can adjust the projected rate as conditions and data warrant.

Recommendations (1, 2, 7, 8)

1. MCERA have a thorough understanding and a documented account of all fixed monthly pension costs.

The recommendation has been implemented. MCERA staff produces a statement of plan net assets and statement of changes in plan net assets for the Board on a monthly basis to ensure that the Board has comprehensive information needed to make sound policy decisions. The statements include administrative and investment expenses. In addition, staff provides the Board with a report of all material expenditures during the past month and answers any questions the Board may have relative to those expenditures. Finally, staff is now providing the Board a monthly cash flow analysis which includes all material sources and uses of cash for the month, year to date, and projected for the balance of the year.

2. MCERA encourage the BOS to revisit pension benefits to renegotiate and reduce benefits for new hires.

The recommendation will not be implemented. This is the role of the Board of Supervisors, not MCERA. The role of MCERA is to invest and safeguard assets to be used in meeting long-term pension liabilities, and to administer the pension program.

7. MCERA produce reports that facilitate better financial management to sustain principle (sic) assets and eliminate the need to sell off investment assets to pay for obligations.

The recommendation has been implemented. The Board of Retirement adopted a cash management and portfolio rebalancing policy that includes: (a) adoption of a cash management plan for the upcoming fiscal year; (b) monthly cash management reports; and (c) quarterly rebalancing of investments to targeted levels. The Board's policy recognizes the need to maintain sufficient cash on hand to meet ongoing obligations while meeting its fiduciary responsibility to invest funds in a manner that provides the greatest likelihood of meeting long-term goals for return on investments. The flexibility to sell select investment assets can be a vital strategy in allowing the Board to meet its obligations, or to reinvest its assets for greater return as markets may indicate.

8. MCERA participate in the early trial implementation of the revised GASB 25 offered by the IRS.

The recommendation will not be implemented. First, the GASB 25 was not an IRS program. It has since been restructured under the title GASB 67, and the elements and implementation of GASB 67 continue to be debated. It is envisioned by the GASB that retirement systems with larger portfolios of assets under management be first to implement the final requirements before the required implementation dates as specified in the response to finding 21. In part this recognizes the resources of larger systems and plan sponsors to test implementation of such a significant change in financial reporting. Smaller systems, like MCERA, can benefit from the lessons learned by larger systems. The benefit of learning from larger systems will likely result in a more effective and efficient implementation of the GASB 67 and, thereby, a cost savings to both the plan sponsor and the retirement system.