

Grand Jury Report

RESPONSE FORM

Grand Jury Report Title : UNFUNDED LIABILITY – OUR CHILDREN'S INHERITANCE

Report Dated : June 3, 2010

Response Form Submitted By:

BOS
c/o Executive Office
Attn: Steve Dunicliff
501 Low Gap Road
Ukiah, CA 95482

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

September 1, 2010

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:
1,5,6,7,8,9,11,12,15,16,18,19
- 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.
2, 3, 4, 10,14,17,20

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

- The following Recommendation(s) have been implemented and **attached, as required**, is a summary describing the implemented actions:
8
- 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)

Recommendations No. 1,2,3,5,6, (See Attached) _____

- 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:

Recommendations No. 4, 7 (See Attached) _____

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
- The County's Executive Office: ceo@co.mendocino.ca.us

Second Step: Mail all originals to:

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

ATTEST:

Carmel J. Angelo, Clerk of the Board
Mendocino County Board of Supervisors



DEPUTY

Printed Name: CARRE BROWN

Title: Chair, Mendocino County Board of Supervisors

Signed: _____



Date: AUG 17 2010

ATTACHMENT:

REPORT: UNFUNDED LIABILITY-OUR CHILDREN'S INHERITANCE.

FINDINGS:

PARTIALLY AGREES OR DISAGREES:

2. The Board of Supervisors partially disagrees with this finding. Resolution 98-147 stated in part that only those retirees hired before September 1, 1998, and has a minimum of ten (10) years of service with the County of Mendocino would be eligible for Retiree Health care. Active employee health care remained unaffected by this action.
3. The Board of Supervisors partially disagrees with this finding. POB's issued in December 2002 in the amount of \$91,945,000 were used in part to defease one-half (1/2) of the outstanding principle of 1996 bonds. The outstanding principle was \$23,795,000, and the proceeds used to prefund the defeasance of the 1996 bonds amount to \$13,220,000.
4. The Board of Supervisors agrees in part with this finding. The Board believes that this action was done at the recommendation of the Consultants for MCERA. See also response of MCERA.
10. The Board of Supervisors can neither agree nor disagree with this finding, as it does not know the data source used.
14. The Board of Supervisors can neither agree nor disagree with this finding as it is confusing as to whether the report refers to retirees or active employees.
17. The Board of Supervisors can neither agree nor disagree with this finding as it has no information upon which to base an opinion as to the legitimacy of analysis "critics."
20. The Mendocino County Board of Supervisors disagrees with this finding. Including Court staff, there are 1,083 retirees or surviving spouses receiving benefits from the retirement system as of June 30, 2010. This is compared to 1,273 active contributing members, and 301 inactive, deferred, or reciprocal members.

DISAGREES:

13. The Board of Supervisors disagrees with this finding as the GASB 43/45 liability for Mendocino County is zero.

21. The Board of Supervisors disagrees with this finding, because the Board of Supervisors has considered prior Grand Jury reports.

RECOMMENDATIONS:

Recommendations 1, 2, 3, 5, 6: The Mendocino County Board of Supervisors has no specific information regarding these recommendations and therefore incorporates by reference herein, the responses to findings prepared by Mendocino County Employees' Retirement Association.

Recommendation 4: The following Recommendation will not be implemented by the Mendocino County Board of Supervisors because it is not warranted and/or not deemed reasonable, attached, as required is an explanation therefore.

It is not within the authority of the Mendocino County Board of Supervisors to direct the MCERA Board to implement this recommendation. The Board supports the concept of MCERA closely monitoring the impact of the retirement fund on the County Budget, but also recognizes that comparing MCERA to other retirement systems provides important measurements of how well MCERA's Board, staff and consultants are performing their duties.

Recommendation 7: The following Recommendation will not be implemented by the Mendocino County Board of Supervisors because it is not warranted and/or not deemed reasonable, attached, as required is an explanation therefore.

It is not within the authority of the Mendocino County Board of Supervisors to direct the MCERA Board to implement this recommendation. However, several of the specific points made in this recommendation are not within the authority of MCERA. Mendocino County, as a 1937 Act County, is legally constrained in its ability to modify retirement benefits. The County is currently reviewing the implementation of a two-tier system for new hires. No payments are made to employees who opt out of the health plan. The Mendocino County Board of Supervisors supports closer monitoring of investments by MCERA, and full transparency regarding unfunded liability.

Recommendation 8: The following recommendation has been implemented by the Mendocino County Board of Supervisors and attached, as required, is a summary describing the implemented actions.

The unfunded liability is addressed by the Board on an annual basis through the County's budget process. Additionally, the Chief Executive Officer has formed a "Debt Committee" comprised of the CEO, County Auditor-Controller, County Treasurer-Tax Collector, and the Retirement Administrator. This Committee is working to systematically identify all debts of the County, and make recommendations as to how they can be addressed in a comprehensive and sustainable manner.

Findings

1. In 1996 the County authorized issuance of \$30.7 million in POB.
2. In 1998 the BOS created a two-tier employee health care system. Employees hired after 1998 no longer receive retiree health benefits.
3. In 2002 a second POB was issued for approximately \$92 million, at a time when interest rates were favorable, which included the defeasance¹ of one half of the \$31 million POB issued in 1996.
4. From 2004 through 2006 MCERA diverted over \$9.6 million from the County pension fund to pay retiree healthcare costs. This was a questionable action; MCERA devised this as a way to solve funding issues for a shortfall in retiree health care. It may have been in conflict with California Government codes §31584 and §31587. (Appendix A)
5. In 2008 the MCERA Board took the action of hiring its own manager independent of the BOS.
6. In 2009 the MCERA Board projected a \$66.9 million UAAL. This amount has been disputed by citizens who argue that using the market value of holdings makes the UAAL twice as much.

¹ Defeasance: Auditors may allow a debt to be 'defeased' or extinguished for reporting purposes provided that pre-conditions are met.

7. In 2009 the State of California instructed public entities to follow GASB standards to include UAAL as a foot note in their financial statements. This may increase the interest charges on borrowed funds.
8. The County is one of few 1937 Act Counties in the State where the "excess earnings" from investments have continued to be used to provide health insurance funding for retirees. This fund is projected to be depleted by the first quarter of 2011.
9. The MCERA Board has produced reports which demonstrate their investments have performed at or above the level of peer counties.
10. Mendocino County uses financial fund advisors to project investment performance over time. Investment returns on assets have been projected at 8% through 2026, when economic experts have said that the 30-year rolling average for a stock-bond portfolio is 4.4%.
11. Other entities have questioned the assumptions and data used by MCERA's contracted actuary.
12. An approved industry process called "smoothing" is also used to level financial changes over time. Using this process helps the County avoid dramatic annual changes in their share of payment toward the retirement fund, making the budget projections more predictable. Normally, the actuaries "smooth" investment gains and losses over five years.
13. In 2008 changes in GASB reporting standards §43 and §45 required that all State and local government entities disclose future retirement health care obligations and resources for this obligation. The County's unfunded liability for health care is currently about \$130 million.
14. In 1998 when the BOS ceased offering retiree health benefits for new employees they did not address the insufficiency of funds for health benefits already given to employees.
15. Funding for the retiree health plan was to come from excess earnings from retirement systems investments. The County states that excess earnings have been calculated on an annual basis. Critics have noted that when UAAL is considered, excess earnings have never occurred.
16. The economic downturn which began in the fall of 2008 has compounded fiscal problems for cities and counties. Major cuts from the State have severely restricted County funds.
17. Investment funds have not fully recovered from the 2008 stock market downturn. Critics have projected it would take an increase of 17% per year for eight years to grow the MCERA investments back to cover the recent losses. Critics see this as an unrealistic expectation.
18. Revenues from property and sales taxes are decreasing.
19. Individual health care and retirement payroll contributions are increasing, while positions are being eliminated due to budgetary shortfall.
20. For the first time, the number of retired County employees is expected to be greater than the number of current County employees, due to layoffs.
21. Prior GJ pension fund reports have been ignored by the BOS, evidenced by the fact that they have not adjusted the debt repayment.

Recommendations

The Grand Jury recommends that:

1. the MCERA Board adopt a rate of return that reflects the current economic environment and question the actuarial recommendations. (Findings 9-12,16-18)
2. the MCERA Board insure that an independent audit be performed on past and present actuarial assumptions and make a full and transparent disclosure of the results to the public. (Findings 6-7, 9-12)
3. a citizens' financial oversight committee be established to monitor the County obligations assumed by the transactions of the MCERA Board, and to bring a critical view, transparency and fresh ideas to the UAAL problem. (Findings 4, 6-7, 9-12,15)
4. the MCERA Board and Administrator closely monitor the impact of the retirement fund on the County budget, rather than comparing the performance with other counties. (All Findings)
5. all MCERA financial reports be structured so that both the actuarial value of assets and the market value of the pension fund assets (as of a specific date) be made public. (Findings 6, 8-9,11-12)
6. the MCERA conduct a review of excess earnings; develop a policy that articulates the definition of excess earnings and plans for future allocation. (Findings 4,6-8,10-12,15,17)
7. the MCERA Board monitor and study the issues and solutions developed by other counties. (Findings 7-20) , e.g.:
 - clearly state the Retirement Fund's financial position regularly and, when necessary project the amount needed for recovery and develop a plan,
 - design a two tier retirement plan for employees. Other counties are developing a "401-K" type plan. Existing employee plans have been frozen with future contributions put into a "401-K" type plan. The County could make a small percentage matching contribution,
 - no defined benefit plans for new employees, reducing the amount of benefits paid by the County,
 - reduce the pension plans for all employees, enabling them to retire earlier and allowing new employees to start at a lower salary and benefit levels, and/or delay pension payment until the employee reaches age 65,
 - reduce staff levels, consolidate functions, and review salaries, freeing money to pay down debt,
 - closer monitoring of investment risk,

- full disclosure of unfunded liability,
- no payment be given an employee who opts out of the health plan.

8. The BOS immediately take steps to rectify the unfunded liability.