



CITY OF MORRO BAY

Citizens Oversight Committee

Acting as Citizens Finance Advisory Committee

AGENDA

Mission Statement

The City of Morro Bay provides essential public services and infrastructure to maintain a safe, clean and healthy place for residents and visitors to live, work and play.

REGULAR MEETING

TUESDAY, JANUARY 19, 2021 – 3:00 PM

Held Via Teleconference

ESTABLISH QUORUM AND CALL TO ORDER

COMMITTEE MEMBERS ANNOUNCEMENTS & PRESENTATIONS

- Welcome New Committee Member – Stephen Peck

PUBLIC COMMENT PERIOD

Pursuant to Section 3 of Executive Order N-29-20, issued by Governor Newsom on March 17, 2020, this Meeting will be conducted telephonically through Zoom and broadcast live on Cable Channel 20 and streamed on the City website (click [here](#) to view). Please be advised that pursuant to the Executive Order, and to ensure the health and safety of the public by limiting human contact that could spread the COVID-19 virus, the Vet's Hall will not be open for the meeting.

Public Participation:

In order to prevent and mitigate the effects of the COVID-19 pandemic, and limit potential spread within the City of Morro Bay, in accordance with Executive Order N-29-20, the City will not make available a physical location from which members of the public may observe the meeting and offer public comment. Remote public participation is allowed in the following ways:

- *Community members are strongly encouraged to submit agenda correspondence in advance of the meeting and watch the meeting live on either cable Channel 20 or as streamed on the City's [website](#). Agenda correspondence may be mailed the CFAC Committee care of the City Clerk at 595 Harbor Street, Morro Bay, CA 93442, or emailed to the City Clerk's office at cityclerk@morrobayca.gov prior to the meeting will be published on the City website with a final update one hour prior to the meeting start time. Agenda correspondence received less than an hour before the meeting start time may not be posted until after the meeting.*
- *Members of the public may watch the meeting either on cable Channel 20 or as streamed on the City [website](#).*
- *Alternatively, members of the public may watch the meeting and speak during general Public Comment or on a specific agenda item by logging in to the Zoom webinar using the information provided below. Please use the "raise hand" feature to indicate your desire to provide public comment. Each speaker will be allowed three minutes to provide input.*

Please click the link below to join the webinar:

- <https://us02web.zoom.us/j/82722747698?pwd=aWZpTzcwTHlRTk9xaTlmWVNWRWFUQT09>
Password: 135692
- Or Telephone Attendee: 1(408) 638-0968 or 1 (669) 900 6833 or 1 (346) 248 7799;
Webinar ID: 827 2274 7698; Password: 135692; Press **** 9** (star-9) to **raise your hand** for Public Comment

A. CONSENT CALENDAR

1. APPROVAL OF MINUTES FOR THE DECEMBER 15, 2020, CITIZENS OVERSIGHT/FINANCE ADVISORY COMMITTEE MEETING

RECOMMENDATION: Receive and Approve.

B. BUSINESS ITEMS

1. REVIEW OF THE FY 2019/20 DRAFT COMPREHENSIVE ANNUAL FINANCIAL REPORT; (FINANCE)

RECOMMENDATION: Receive the draft Fiscal Year 2019/20 Comprehensive Annual Financial Report and provide feedback.

2. PRESENTATION TO THE CITY COUNCIL REGARDING CFAC'S REVIEW OF THE FY 2019/20 UNAUDITED TRANSACTIONS FROM THE COLLECTION OF THE GENERAL-PURPOSE LOCAL SALES TAX, COMMONLY KNOWN AS "MEASURE Q"; (CHAIRMAN JOHN MARTIN)

RECOMMENDATION: Receive and approve the draft presentation to the City Council of the FY 2019/20 unaudited transactions from the collection of the general-purpose local sales tax, commonly known as "Measure Q."

3. SECOND QUARTER INVESTMENT REPORT (PERIOD ENDING DECEMBER 31, 2020) for FISCAL YEAR 2020/21; (FINANCE)

RECOMMENDATION: Receive the Second Quarter Investment Report (Period Ending December 31, 2020) for Fiscal Year 2020/21.

4. PRESENTATION ON CALIFORNIA PUBLIC EMPLOYEES RETIREMENT SYSTEM (CalPERS); (FINANCE)

RECOMMENDATION: Receive presentation and provide questions to staff for further research related to CalPERS.

C. FUTURE AGENDA ITEMS

D. SCHEDULE NEXT MEETING

February 16, 2021

E. ADJOURNMENT

THIS AGENDA IS SUBJECT TO AMENDMENT UP TO 72 HOURS PRIOR TO THE DATE AND TIME SET FOR THE MEETING. PLEASE REFER TO THE AGENDA POSTED AT CITY HALL FOR ANY REVISIONS, OR CALL CITY HALL AT 772-6201 FOR FURTHER INFORMATION.

MATERIALS RELATED TO AN ITEM ON THIS AGENDA SUBMITTED TO THE COMMITTEE AFTER DISTRIBUTION OF THE AGENDA PACKET ARE AVAILABLE FOR PUBLIC INSPECTION AT CITY HALL LOCATED AT 595 HARBOR STREET DURING NORMAL BUSINESS HOURS.

IN COMPLIANCE WITH THE AMERICANS WITH DISABILITIES ACT, IF YOU NEED SPECIAL ASSISTANCE TO PARTICIPATE IN A CITY MEETING, PLEASE CONTACT THE CITY CLERK'S OFFICE AT LEAST 72 HOURS PRIOR TO THE MEETING TO INSURE REASONABLE ARRANGEMENTS CAN BE MADE TO PROVIDE ACCESSIBILITY TO THE MEETING.

**MINUTES – CITIZENS OVERSIGHT/ FINANCE
ADVISORY COMMITTEE
REGULAR MEETING – December 15, 2020
VETERANS MEMORIAL HALL – 3:00 P.M.**

MEMBERS PRESENT: John Martin Chair
 Barbara Spagnola Vice-Chair
 Bart Beckman Member
 Lois Johnson Member
 Tina Wener Member
 Homer Alexander Member

STAFF PRESENT: Katie Lichtig Interim Finance Director
 Scott Collins City Manager

ESTABLISH A QUORUM AND CALL TO ORDER

Chair Martin called the meeting to order at 3:04 p.m., with 6 members present.

COMMITTEE MEMBERS ANNOUNCEMENTS & PRESENTATIONS

No Announcements

STAFF ANNOUNCEMENTS

Katie Lichtig, Interim Finance Director, introduced herself.

PUBLIC COMMENT PERIOD

No public comment

A. CONSENT CALENDAR

1. APPROVAL OF MINUTES FOR THE OCTOBER 20, 2020 CITIZENS OVERSIGHT/FINANCE ADVISORY COMMITTEE MEETING.

https://youtu.be/5zbx_GcJNWw?t=282

Chair Martin requested the adjournment time of 4:03 pm be added to the minutes.

MOTION: Chair Johnson moved to approve A-1 as amended. Vice Chair Spagnola seconded. Motion carried 6-0.

B. BUSINESS ITEMS

1. REVIEW OF FY 2019/20 UNAUDITED TRANSACTIONS FROM THE COLLECTION OF THE GENERAL PURPOSE LOCAL SALES TAX, COMMONLY KNOWN AS “MEASURE Q” (INTERIM FINANCE DIRECTOR)

https://youtu.be/5zbx_GcJNWw?t=370

Interim Finance Director Lichtig answered committee member questions on the previously submitted report.

Public Comment
None

Chair Martin closed public comment.

MOTION: Vice Chair Spagnola moved that the committee accept item B1 Measure Q report subject to the outstanding questions which the Interim Finance Director will respond to all CFAC members. Member Alexander seconded. Motion carried 6 – 0.

2. REVIEW CITIZENS FINANCE ADVISORY COMMITTEE'S (CFAC) WORK PLAN RELATED TO THE WATER RECLAMATION FACILITY (WRF) AND CONFIRM THE CFAC SCHEDULE FOR WRF QUARTELY UPDATE REVIEW FOR CALENDAR YEAR 2021; (CITY MANAGER)

https://youtu.be/5zbx_GcJNWw?t=1870

City Manager Collins discussed the report and schedule and answered committee member questions.

Public Comment
None

Chair Martin closed public comment.

MOTION: Vice Chair Spagnola moved that the Committee accept the schedule as presented with the option of a special meeting during the year if needed. Member Johnson seconded. Motion carried 6 – 0.

3. REVIEW OF THE FY 2020/21 FIRST QUARTER INVESTMENT REPORT (PERIOD ENDING SEPTEMBER 30, 2020) FOR FISCAL YEAR 2020/21; (INTERIM FINANCE DIRECTOR)

https://youtu.be/5zbx_GcJNWw?t=3896

The Interim Finance Director made a brief presentation and answered committee member questions.

Public Comment
None

Chair Martin closed public comment.

MOTION: Member Johnson moved to approve the investment report. Vice Chair Spagnola seconded. Motion carried 6 – 0.

4. FISCAL YEAR 2020/21 FIRST QUARTER BUDGET PERFORMANCE AND STATUS REPORT FOR THE THREE-MONTH PERIOD ENDING SEPTEMBER 30,2020; (FINANCE)

https://youtu.be/5zbx_GcJNWw?t=4476

The Interim Finance Director Lichtig answered questions from committee members.

Public Comment
None

Chair Martin closed public comment.

The presentation was received and filed.

C. FUTURE AGENDA ITEMS

https://youtu.be/5zbx_GcJNWw?t=5391

The following items were address as future agenda items:

1. CAFR Presentation
2. Discuss service recommendations for Sate Revolving Funds (SRF) and WFIA for the WRF program, a four-part request for a potential staff report:
 - Explanation of CALPERS charges at the beginning of the fiscal year of the City's unpaid balances for the various pension funds to include the current interest rate and dollar amounts involved for the 20/2021 year and any future years that might be available.
 - Issues with the state if the City decides to substitute additional clean water act SRF borrowed funds to complete the WRF project vs. the City's existing cash.
 - Legality of the general Harbor Fund to borrow cash from the City's own utility funds to be used for non-utility funded expenses.
 - Anticipated net annual savings to the general and harbor water and sewer funds if a portion of the CALPERS liability was reduced.
3. Review CALPERS for a general understanding of how it works.

D. SCHEDULE NEXT MEETING

The next CFAC meeting will be held on **Tuesday, January 19, 2021** at 3:00 p.m. via teleconference.

E. ADJOURNMENT

The meeting adjourned at 4:56 pm

Recorded by:
Tracy McConnell



AGENDA NO: B-1

MEETING DATE: January 19, 2021

Staff Report

TO: Chairman and Committee Members

DATE: January 15, 2021

FROM: Katie Lichtig, Interim Finance Director

SUBJECT: Review of the Draft Fiscal Year 2019/20 Comprehensive Annual Financial Report

RECOMMENDATION

Receive the FY 2019/20 Comprehensive Annual Financial Report (CAFR) and provide feedback for the Council. This item is scheduled to be heard by the Council at their meeting on January 26, 2021.

DISCUSSION

In 2015 the City issued a Request for Proposal (RFP) for auditing services and the Pun Group was the selected as the most responsive proposer. The City entered into agreement with the Pun Group to perform auditing services for the fiscal years ending June 30, 2015, 2016, 2017 and 2018, with the option to renew for two additional fiscal years (2019 through 2020). The Auditors conducted their field work virtually in October 2020. The same reviews were conducted as if they were in our offices by staff uploading reports, receipts, workpapers, journal entries and any other documentation to review expenditures, revenues, contracts and general accounting processes. The scope of work for the auditors is to review both accuracy and internal controls (fraud prevention). After the audit team collected information and conducted the required analysis no issues were discovered which resulted in no audit findings in the attached Comprehensive Annual Financial Report (CAFR). The Internal Controls Review report has not yet been published but the auditor's informal discussion with the City indicates that there will likely be no findings.

Attached are the CFAC's comments provided to the City Council when the CAFR was reviewed as well as the feedback provided by the Government Financial Officers Association (GFOA). In order to continue to improve the CAFR, the auditors and staff incorporated changes that addressed these suggestions. One request that was inadvertently left out of the published copy was a footnote related to variations in the Sewer Fund. The following is the footnote that was prepared but not printed in the CAFR.

Prepared By: KL

Dept Review: _____

City Manager Review: _____

City Attorney Review: _____

Sewer Footnotes excluded from print parameters on Page 153 - be sure to add to sewer page in 20-21						
1	FY 19/20	Variations between fiscal years relate to year end pension expense accrual entires.				
2	FY 19/20	Line restated for FY 18-19 to include expenses paid by sewer fund for Morro Bay's share of WWTP Operations				
2	FY 19/20	Variations in Administration for FY 17-18 line relates to WRF Project Capital Expenditures				
		not classified to balance sheet until after report date. In FY 18-19 correct recording				
		left minimal amount in administration grouping				

This information will be included in the FY2020-21

City staff intends to submit the final audit report to GFOA for award consideration. After receiving feedback from CFAC the Council presentation is tentatively scheduled for January 26, 2021.

Vanessa Burke is the Partner-In-Charge with The Pun Group in their Bay Area, California and Phoenix, Arizona offices. Ms. Burke will represent the Pun Group and give a presentation regarding the CAFR at the CFAC meeting. Ms. Burke has 27 years of combined experience in auditing, consulting and finance. She has served clients in a variety of industries, including small to very large state and local governmental agencies, public pension plans, insurance companies, not-for-profits, healthcare, technology and manufacturing and distribution clients. Ms. Burke also served as the Chief Finance Officer at the City of Stockton, California for five years where she successfully navigated the finance and administrative services department through the City's chapter 9 bankruptcy filing and testified on trial during the bankruptcy hearings.

ATTACHMENTS:

1. City of Morro Bay FY 2019/20 Comprehensive Annual Financial Report: https://www.morro-bay.ca.us/DocumentCenter/View/15075/2020_City-of-Morro-Bay_FINAL_CAFR.
2. CFAC memorandum to Council regarding FY 2018-19 CAFR dated January 22, 2020
3. GFOA comments to the City regarding FY 2018/19 CAFR

Date: January 22, 2020
To: Morro Bay City Council
From: Citizens Finance Advisory Committee
Subject: **Review of June 30, 2019 Comprehensive Annual Financial Report (CAFR)**

The first duty of the Citizens Finance Advisory Committee as listed in the CFAC by-laws is “Annual review of independent financial audit, with recommendations, as appropriate.” To fulfill this duty, CFAC appointed an ad-hoc subcommittee (Lois Johnson and John Martin) to perform a detailed review of the 2019 CAFR and produce a memo to Council. This memo was reviewed and approved by CFAC at its meeting on January 21, 2020.

Last year, management submitted the City’s 2018 CAFR to the Government Finance Officers Association and was awarded the coveted “Certificate of Achievement for Excellence in Financial Reporting.” In addition, the GFOA reviewer deemed the City “Proficient” in every one of the seventeen grading categories. This is a milestone achievement for which management and Council should be proud. The 2019 CAFR is even better than last year’s, with better and more complete narrative explanations of the financial statements. Moreover, management has fully implemented the auditor’s recommendation from last year that a comprehensive accounting manual be completed and implemented.

Management was completely cooperative with our review of the CAFR. It is obvious that they are dedicated to transparency and accuracy. It is clear that they understand the importance of the CAFR, which is the City’s permanent record in all things financial. However, during our review, we noted certain issues that we believe present opportunities to make the CAFR even more accurate, understandable and relevant. These issues may be organized into three areas: 1) technical, 2) substantive and 3) process. Technical issues (typos, duplications, reverse entries, formatting, headings, dates, etc.), which are inevitable in a complex document of this size, have been discussed directly with management and will not be presented in this report.

Substantive Issues

Presentation of Reserves

In the letter of transmittal, management describes the City’s relevant financial policies, which is an excellent practice. Some of the noted resolutions designate Council-approved reserves for the various funds. Res. No. 85-18 is the prevailing document regarding several reserves, including the City’s most important general fund emergency reserve. Management reports on this reserve in the fifth bullet point on page 5 of the Management’s Discussion and Analysis (MD&A), but other reserves are not so clearly reported.

Recommendation #1: In the letter of transmittal, management should present a table showing the dollar amounts (fund balance) of the various reserves at fiscal year-end compared with the minimum and target reserves per the noted resolutions. The status of the reserves will be clearly shown in one easy-to-read table.

Committed and Assigned General Fund Balances

In the CAFR there are six budgeted funds rolled up into the financial statements presented for the general fund. Those six funds, with their 6/30/19 fund balances are:

Fund Number and Name	Fund Balance
050 – Vehicle Replacement	\$ 325,747
052 – Facility Maintenance	110,603
460 – Capital Accumulation	207,998
470 – Project Accumulation	295,728
480 – Opportunity Fund	31,448
051 – General Fund Emergency Reserve	3,808,577

For a reason unknown to CFAC, only the facility maintenance fund balance is shown as committed on the general fund balance sheet (page 29), and the remaining \$4,669,499 is shown as unassigned. One could easily mistake this amount as the general fund emergency reserve, but it is not. Management has addressed this on page 5 of the MD&A, which states, “A total of \$4.7 million is held as unassigned with \$3.9 million allocated to the General Fund Emergency Reserve which meets the City’s General Fund reserve policy.” This \$3.9 million figure does not appear anywhere in any of the financial statements, notes or statistical section of the CAFR. It appears that the actual amount is closer to \$3.8 million.

Recommendation #2: Show the fund balances of the other general fund sub-funds as “committed” (imposed by City Council) or “assigned” (imposed by management) on the general fund balance sheet on page 29 and on pages 144-145 (refer to note 1 section Q on page 60 for a discussion of committed and assigned fund balances).

Fluctuating Expenses

We note that there are significant fluctuations in expenses in the category of “Employee Wages and Benefits” in the water and sewer enterprise funds (see page 38). This can best be seen in the 10-year trend table shown on pages 150-153. The expense for employee wages and benefits in the water enterprise decreased from \$930,294 to \$230,440 without explanation. Conversely, the same expense in the sewer enterprise increased from \$198,120 to \$794,060 without explanation. The magnitude of these fluctuations is startling. Significant fluctuations

(though not as severe) are also seen in the harbor enterprise fund expense for employee wages and benefits (page 155).

Significant fluctuations are also seen in the sewer fund's expenses for wastewater treatment and administration (page 153). No explanation is offered.

Recommendation #3: Management should explain the causes of these significant expense fluctuations.

Transfers

When GFOA reviews the CAFR, they provide the City with comments for improvement. One of their comments states:

“Reimbursements should not be displayed in the financial statements as transfers. The disclosure makes it appear as though reimbursements are reported as transfers. Reimbursements should be treated as a reduction to the originally booked expense/expenditure and therefore would not be reported as an item in the external financial statements.”

The City's disclosure regarding transfers (Note 3 on page 65) is the same as the prior year CAFR, so it appears that management did not address GFOA's concern.

Also, without questioning the legitimacy of the transfers, we note that there isn't much in the way of explanation, or citing of authorities to transfer. For example, we see that \$40,808 was transferred from the sewer fund to the water fund, but we don't know why. One curiosity is that the table shows \$106,194 being transferred from the general fund to the general fund.

Recommendation#4: Management should draft a more robust Note 3 disclosure of transfers with better explanations and citing of authorities, and they should address GFOA's comment. Transfers concerning only the general fund should be netted to zero.

Process Issues

The deadline to submit the CAFR to GFOA for the Certificate of Achievement is December 31, or six months after fiscal year end. CFAC has sought to review the CAFR at its December meeting prior to the GFOA submittal. To accommodate CFAC, management pressed the auditor to provide the draft financial statements to meet that schedule with the result that the auditors sent three drafts (12/4/19, 12/5/19 and 12/12/19) each with slightly different numbers. Then they produced the final complete document just prior to the GFOA deadline. This resulted in much confusion and additional work for the subcommittee and management. Management cannot write the Management's Discussion and Analysis (MD&A) portion of the CAFR until the

auditor provides the completed financial statements. This leads to the risk that some things in the MD&A may not be correct because of the numerous times that management must rewrite and update figures from subsequent financial statement drafts provided by the auditor. Unfortunately, this did in fact occur in 2019 as some of the figures in Table 2 of the MD&A were not updated per the auditor's final draft (compare the 2019 expenses for the water and sewer operating fund on page 10 with the amounts on page 38).

Recommendation #5: CFAC should review the CAFR at its meeting in January of each year and write a report (if appropriate) for the Council's consideration at its second January meeting. This means that CFAC's review would be done after the CAFR has been submitted to GFOA.

As to deadlines, management should be most concerned with meeting the GFOA submittal deadline of December 31 and not try to meet CFAC's scheduled December meeting. Management should also review and correct drafts from the auditor prior to any CFAC review. CFAC should receive the CAFR only when management considers it correct and complete.

If CFAC appoints a subcommittee, and if it is convenient for management to involve that subcommittee with the process in December, the subcommittee could review the corrected draft report and assist management as proofreaders at that stage.

In conclusion, management has produced another excellent Comprehensive Annual Financial Report for the City of Morro Bay, which we are confident will be awarded another Certificate of Achievement. We have made five recommendations for issues that we believe can be improved; however, that should in no way overshadow the excellent work that has been done by the City's very competent staff.



January 8, 2021

To the Honorable Mayor and the Members of the City Council
of the City of Morro Bay
Morro Bay, California

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Morro Bay, California (the "City") for the year ended June 30, 2020. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards and *Government Auditing Standards*, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter to you dated July 13, 2020. Professional standards also require that we communicate the following information related to our audit.

Significant Audit Matters

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the City are described in Note 1 to the basic financial statements. As described in Note 1 to the financial statements, the City implemented the following accounting standards:

New Accounting Standards

GASB Statement No. 95 - In May 2020, GASB issued Statement No. 95, *Postponement of the Effective Dates of Certain Authoritative Guidance*. The primary objective of this Statement is to provide temporary relief to governments and other stakeholders in light of the COVID-19 pandemic. That objective is accomplished by postponing the effective dates of certain provisions in Statements and Implementation Guides that first became effective or are scheduled to become effective for periods beginning after June 15, 2018, and later. Application of this statement is effective immediately and did not have a material effect on City's financial statements for the fiscal year ending June 30, 2020.

No other new accounting policies were adopted and the application of existing policies was not changed during 2020. We noted no transactions entered into by the City during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the City's financial statements were:

- Management's estimate of the investment fair market value is based on market price provided by the financial institution for investments in certificates of deposits. We evaluated the key factors and assumptions used to develop the investment fair market value in determining that it is reasonable in relation to the financial statements taken as a whole.

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To the Honorable Mayor and the Members of the City Council
of the City of Morro Bay
Morro Bay, California
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- Management's estimate of the depreciation on capital assets is based on the industry standard and past experience on actual useful life of the asset groups. We evaluated the key factors and assumptions used to develop the depreciation on capital assets in determining that it is reasonable in relation to the financial statements taken as a whole.
- Management's estimate of the net other postemployment benefits ("OPEB") liability is based on the actuarial valuation on total OPEB liability and financial statements on fiduciary net position. We evaluated the key factors and assumptions used to develop the OPEB liability in determining that it is reasonable in relation to the financial statements taken as a whole.
- Management's estimate of the net pension liability is based on the actuarial valuation on total pension liability and based on financial statements on fiduciary net position for CalPERS plans. We evaluated the key factors and assumptions used to develop the net pension liability in determining that it is reasonable in relation to the financial statements taken as a whole.

Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosures affecting the financial statements were:

- Note 1 – Summary of Significant Accounting Policies
- Note 8 – Defined Benefits Pension Plans
- Note 9 – Other Postemployment Benefits ("OPEB")
- Note 13 – Commitments and Contingencies
- Note 14 – Subsequent Events

The financial statement disclosures are neutral, consistent, and clear.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management. Management has corrected all such misstatements.

Disagreements with Management

For purposes of this letter, a disagreement with management is a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated January 8, 2021.

To the Honorable Mayor and the Members of the City Council
of the City of Morro Bay
Morro Bay, California
Page 3

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a “second opinion” on certain situations. If a consultation involves application of an accounting principle to the City’s financial statements or a determination of the type of auditor’s opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the City’s auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Other Matters

We applied certain limited procedures to the Management’s Discussion and Analysis (“MD&A”), Budgetary Comparison Schedule, the Schedules of the City’s Proportionate Share of the Net Pension Liability and Related Ratios, the Schedules of the City’s Contributions, the Schedule of Changes in Net Other Postemployment Benefits Liability and Related Ratios, which are Required Supplementary Information (“RSI”) that supplement the basic financial statements. Our procedures consisted of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management’s responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We did not audit the RSI and do not express an opinion or provide any assurance on the RSI.

We were engaged to report on the Combining and Individual Fund Financial Statements, which accompany the financial statements but are not RSI. With respect to this supplementary information, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

We were not engaged to report on the Introductory and the Statistical Sections, which accompany the financial statements but are not RSI. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

Restriction on Use

This information is intended solely for the information and use of the City Council and management of the City and is not intended to be, and should not be, used by anyone other than these specified parties.

Very truly yours,

A handwritten signature in black ink that reads "The PwC Group, LLP". The signature is written in a cursive, flowing style.

Santa Ana, California



AGENDA NO: B-2

MEETING DATE: January 19, 2021

Staff Report

TO: Committee Members

DATE: January 15, 2021

FROM: John Martin, CFAC Chairman

SUBJECT: Presentation to the City Council regarding CFAC's Review of FY 2019/20 Unaudited Transactions from the Collection of the General Purpose Local Sales Tax, commonly known as "Measure Q"

RECOMMENDATION

Review the presentation drafted by Chairman Martin and provide input before presentation to City Council scheduled on January 26, 2021.

DISCUSSION

On December 15, 2020 the Citizens Financial Oversight Committee reviewed and approved the FY 2019/20 Unaudited Transactions from the Collection of the General Purpose Local Sales Tax, commonly known as "Measure Q". Feedback is requested about the attached draft presentation which is scheduled on the City Council agenda on January 26, 2021.

ATTACHMENT:

1. Draft Presentation regarding FY 2019/20 Unaudited Transactions from the Collection of the General Purpose Local Sales Tax, commonly known as "Measure Q"

Prepared By: ___KL___

Dept Review: _____

City Manager Review: _____

City Attorney Review: _____



Citizens Oversight Committee

(Acting as the Citizens Finance Advisory Committee -
CFAC)

Agenda

- Summarize CFAC's review of all Measure Q previous fiscal year transactions (July 2019-June 2020)
- Report other CFAC activities during past year and recommendations



Citizens Oversight Committee

Measure Q Overview

- Committee met Dec 2020 to review and discuss all Measure Q fiscal year transactions (2019-2020)
 - Chairperson: John Martin
 - Members: Barbara Spagnola, Homer Alexander, Lois Johnson, Bart Beckman, and Tina Wener
- Measure Q Financial Summary
 - Tax revenue from Measure Q for the fiscal year was \$ 987K
 - Total expenditures for the fiscal year were \$ 513K
 - Carryover Measure Q fund balance is \$645K of June 30 2020
 - Debt service reserve is \$ 57K
 - Unassigned fund balance amount is \$ 588K



Citizens Oversight Committee

Measure Q Total Spending 2019-2020

- Fire Department: \$ 473K
 - Vacation relief person and OT to maintain four personnel per shift - \$ 275K
 - Fire Station debt service - \$ 98K*
 - (* \$15,582 interest accrual error to be corrected in FY 2020-21. Actual FY 2019-20 debt service was \$82,644)
 - Fire safety equipment and cardiac monitors- \$ 44K
 - Replacement engine debt service - \$ 56K



Citizens Oversight Committee

Measure Q Total Spending 2019-2020

- Street Maintenance: \$ 17K
 - Pavement Management Plan - \$ 0K
 - Street maintenance equipment rental \$17K
- Police Department: \$ 201K
 - Standby pay - \$ 25K
 - Payment to SLO Sheriff - \$ 30K
 - Task forces / CAD / data lines
 - Equipment & Supplies - \$ 103K
 - Body cameras \$27K, Tasers \$69K, first responder kits \$7K
 - New vehicle (School Resource Officer) - \$ 43K
- Storm Drains: \$0



Citizens Oversight Committee

Measure Q Recommendations

- CFAC approved Measure Q transactions during the fiscal year 2019-2020
- Carryover and unallocated cash
 - CFAC defers recommendation for the unassigned fund balance of \$ 588K until midyear 2020-21 budget review occurs
- Continue progress on the funding categories identified in the 2006 Measure Q ballot initiative



Citizens Oversight Committee

- Summary of other CFAC accomplishments
 - Review of the City’s 2019-2020 Comprehensive Annual Financial Report
 - Review of all quarterly budget reports with feedback provided to City Finance staff
 - Review and recommendations for WRF Capital Project quarterly reports
 - Review of quarterly investment reports
 - Miscellaneous reviews and discussions
 - City’s issues survey, join the conversation community outreach, and Measure E proposal



Citizens Oversight Committee

- Upcoming activities
 - Welcome and transition new member to CFAC
 - Continue Measure Q oversight
 - Begin Measure E oversight
 - Participation in midyear budget process
- Any questions ?
- Thank You



AGENDA NO: B-3

MEETING DATE: January 19, 2021

Staff Report

TO: Chairman and Committee Members **DATE:** January 14, 2021

FROM: Katie Lichtig, Interim Finance Director

SUBJECT: Second Quarter Investment Report (period ending December 31, 2020) for Fiscal Year 2020/21

RECOMMENDATION

Receive the attached Second Quarter Investment Report (period ending December 31, 2020) for Fiscal Year 2020/21.

FISCAL IMPACT

There is no fiscal impact associated with this recommendation.

DISCUSSION

Attached for your consideration is the Second Quarter Investment Report for FY 2020/21.

As of December 31, 2020, the City's weighted portfolio yield of 0.566% was slightly above the Local Agency Investment Fund (LAIF) yield of 0.54%.

Staff continues to keep significant cash in the City's LAIF account to ensure cash flow for the ongoing Water Reclamation Facility (WRF) project. Reimbursement has been received from the State Revolving Fund (SRF) planning loan. Staff have also been regularly submitting reimbursement requests for the WIFIA loan, seven requisitions have been disbursed thus far. While the picture looks promising for investing additional cash in higher yield instruments, staff recommends that no immediate actions be taken for two reasons. First, additional liquidity is likely required after the next round of SRF loan(s) are secured and reimbursements are sought from the State of California. Historically the State takes a minimum of two months to process reimbursement requests before disbursement is made to the City. A representative of the SRF program has indicated that this process has slowed due to COVID-19. Secondly, it is prudent to await the onboarding of a permanent Finance Director so that this person can assess cash flow needs and research prudent ways to balance Council adopted investment goals of safety, liquidity and yield.

During the quarter, yields have been low, reflecting the uncertainty of the economic climate. As of December 31, 2020, the City has recorded \$54,832.77 in interest earnings.

CONCLUSION

Staff recommends that the Committee receive the Second Quarter Investment Report (period ending December 31, 2020) for Fiscal Year 2020/21.

ATTACHMENT:

1. Second Quarter Investment Report for FY 2020/21 (period ending December 31, 2020)

CITY OF MORRO BAY
QUARTERLY PORTFOLIO PERFORMANCE
12/31/2020

INVESTMENT OR CUSIP NUMBER	INSTITUTION	PURCHASE PRICE	INTEREST RATE	PURCHASE DATE	MATURITY DATE	DAYS TO MATURITY
LAIF	LOCAL AGENCY INVESTMENT FUND	\$ 29,665,776	0.540%	DAILY	DAILY	1
MONEY MARKET ACCOUNT:						
MM	MECHANICS BANK - MONEY MARKET	1,445,179	0.06%	DAILY	DAILY	1
SWEEP	MECHANICS BANK - SWEEP	5,047,287	0.01%	DAILY	DAILY	1
CERTIFICATES OF DEPOSIT:						
38148PGK7	ZION BANK - Goldman Sachs	250,003	1.550%	8/3/2016	8/3/2021	215
02007GHD8	ZION BANK - Ally Bank UT	246,000	2.900%	1/24/2019	1/24/2022	389
949763XU5	ZION BANK - Wells Fargo	249,000	2.800%	2/27/2019	2/28/2022	424
1404202A7	ZION BANK - Capital One	250,005	2.400%	4/12/2017	4/12/2022	467
61760AUU1	ZION BANK - Morgan Stanley	246,000	3.000%	1/24/2019	1/24/2023	754
61690UDL1	ZION BANK - Morgan Stanley	246,000	3.100%	1/24/2019	1/24/2024	1,119
1731202F5	ZION BANK - Citibank	246,000	3.200%	1/25/2019	1/25/2024	1,120
3090683803	STATE FARM BANK	250,435	3.050%	10/21/2013	10/24/2023	1,027
		<u>\$ 38,141,684</u>				
			RECORDED INTEREST AS OF 12/31/2020	% OF LIQUID PORTFOLIO HOLDINGS	WEIGHTED AVERAGE RATE OF EARNINGS	WEIGHTED AVERAGE MATURITY
			<u>\$ 54,832.77</u>	<u>94.800%</u>	<u>0.566%</u>	<u>37</u>

Portfolio holdings as of the quarter ended December 31, 2020, are in compliance with the current Investment Policy. With 94.800% of the portfolio held in liquid instruments, the City's portfolio is well above the 65% to 70% target liquidity rate approved by the City Council in March 2018.



AGENDA NO: B-4

MEETING DATE: January 19, 2021

Staff Report

TO: Chairman and Committee Members

DATE: January 15, 2021

FROM: Katie Lichtig, Interim Finance Director

SUBJECT: Presentation of background information on the California Public Employees Retirement System (CalPERS)

RECOMMENDATION

Receive background information and provide questions to staff for further research related to the California Public Employees Retirement System (commonly referred to as CalPERS). No action is required of the CFAC at this time.

DISCUSSION

At the December 15, 2020 meeting of this committee requested a presentation on basics of the CalPERS benefits that are provided to all full-time permanent employees after five years of service with any agency that is a CalPERS participant and meets a certain age. The benefit is a “defined benefit” which means for every year an employee works they accrue a percentage of their pay as retirement income.

City of Morro Bay permanent employees participate in CalPERS. Sworn employees (fire, police and harbor patrol) are covered under the Fire and Police Safety plans respectively, while all other employees are covered in the Miscellaneous plan, which is a separate plan. California law required a pooled plan for those agencies who had fewer than 100 active members, which was applicable to the City’s plans. These assets and liabilities are pooled with all other pooled plans in the State with fewer than 100 active members to provide a large, risk sharing pool. This risk sharing dramatically reduces or eliminates large fluctuations in an employer’s pension contribution rate caused by unexpected demographic events.

Depending on an employee’s position and hire date, a City employee is included in one of the nine possible plans as follows:

Plan	Miscellaneous	Safety Fire	Safety Police
Classic Members	2.7% at Age 55	3% at Age 50	3% at Age 50
Tier 2	2% at Age 60 (Effective Dec 10, 2011)	3% at Age 55 (Effective Mar 19, 2011)	3% at Age 55 (Effective Sept 17, 2011)
PEPRA Plan	2% at Age 62 (Effective Jan 1, 2013)	2.7% at Age 57 (Effective Jan 1, 2013)	2.7% at Age 57 (Effective Jan 1, 2013)

The annual employer contributions are determined by actuarial valuation reports prepared by CalPERS for each of the City's plans. Due to the amount of data involved, the employer rates for a fiscal year are set forth in actuarial valuation report that is two years in arrears.

The CalPERS retirement system is funded by three main categories: (1) CalPERS Investment Earnings; (2) Employer contribution rates; (3) Employee contributions to CalPERS.

CalPERS reports that over the past twenty years every average dollar spent on public employee pensions has been sourced from the following:

- 61 cents – CalPERS investment earnings
- 26 cents – Employer contributions to CalPERS
- 13 cents – Employee contributions to CalPERS

To help inform the discussion Attachment 2 contains a glossary of terms and an overview of the retirement system (prepared by the Institute of Local Government -a non-profit, non-partisan organization whose mission is to promote good government at the local level). An issue that is having a significant impact on many local governments financial situation is the accrual of unfunded liabilities. Unfunded Accrued Liability (UAL) is the difference between the estimated cost to pay retirement obligations and the market value of assets currently set aside to fund them. It is the present value of future employer contributions for service that has already been earned and is in addition to future normal cost contributions for active members; which represents the City's debt or pension liability.

The origins of the pension systems unfunded liabilities are caused by a variety of factors. One factor is that in 1999 the California legislature and the Governor enacted a law that permitted higher benefits (called enhanced benefits) that not only accrued pension benefits going forward but allowed employees to collect the enhanced benefit retroactively. This was done at a time when the system was "super funded" (the system was giving refunds to agencies because CalPERS had more funds than it needed to cover the benefits in the future). In other words, if a fire or police union negotiated for an enhance benefit of 3 percent for each year that he/she worked and an employee worked for 30 years with the employer paying for a benefit of 2 percent a year for 29 years and one year for the higher benefit, the agency would have to make up the difference in the form of unfunded liability payments to CalPERS.

Experts in the field have highlighted in public presentations that because investment returns have provided 65% of the retirement funds paid out to retirees the primary reason for the development of the unfunded liabilities for local government pension plans has been due to lower than expected investment returns and not primarily due to enhanced benefits that may have been agreed to in past years through the collective bargaining process. According to information released by CalPERS, the City's pension unfunded liabilities developed because of two major market downturns since 1995. The first being the downturn in the early 2000's related to the "dot com" stock market bubble and the second major loss related to the global economic "Great Recession" of 2008.

The City has taken a number of proactive steps to limit the City's exposure to steeply increasing costs by paying off pension debt. The most recent action was taken in early 2020 when the Council authorized paying off the unfunded liabilities for the newer tiers of pension benefits for miscellaneous, fire and police employees. Revenues that exceeded expenditures from the previous year funded this action. Attachment 3a and 3b contain the analysis of this issue contained in the staff report and the resolution that documents the action, respectively.

CONCLUSION

The retirement system and how to contain costs associated this benefit are complicated topics. Some questions may be able to be answered at the CFAC meeting while others will require added research. Staff will make a presentation and then be available to respond to question. This is an information and educational session only.

ATTACHMENT:

1. City of Morro Bay 2019 Council Staff Report regarding the Unfunded Pension Liabilities – [08.13.2019 Link](#)
2. IGL Pension Glossary
3. Council Staff Report dated 02.04.2020 – 3a
4. Council Resolution No. 12-20 – 3b

A Local Official's Guide to Pension Terminology

www.ca-ilg.org/PensionGlossary

v.5.1: 9/28/11

About This Guide

As local officials engage in conversations with their constituents, their bargaining representatives and each other about public pension issues, it can be helpful to have a working understanding of what key terms and concepts mean. The Institute for Local Government has prepared this plain-language glossary to assist local officials with these conversations and to offer a level of transparency to the pension process.

The glossary covers concepts relating to pension plan benefits, funding and governance. The terminology is inter-related in many ways. When a definition uses a word or phrase that itself is defined in the guide, the word or phrase will be listed in *italics*. Cross references to related terms are also listed at the end of definitions as “related concepts.”

The Institute for Local Government welcomes your thoughts and suggestions on this resource. Please send them to jspeers@ca-ilg.org (or fax them to 916.444.7535).

Thank You

The Institute wants to express its appreciation to the State Association of County Retirement Systems and the California Public Employee Retirement System for their respective glossaries,¹ which served as useful starting places for this glossary. They also are especially helpful resources for those who participate in those pension systems and/or are interested in understanding the range of options under those systems. They also each contain additional technical terminology relating to actuarial calculations for those who wish to delve into more detail relating to pension funding.

The Institute is very grateful to Institute Graduate Fellow, Shannon Bowley, whose research, writing and incorporation of peer review comments, enabled this glossary to exist.

In addition, the Institute thanks the following individuals for their review and comments on drafts of this glossary.

- John Bartel, President, Bartel Associates
- Ronald Bates, Ph.D., City Manager, Pico Rivera
- Brenda Carlson, Chief Counsel for San Mateo County Employees Retirement Association
- Andrew Carter, Council Member, City of San Luis Obispo
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- Natasha Karl, Legislative Representative, League of California Cities
- Eraina Ortega, Legislative Representative, Employee Relations, California State Association of Counties
- Owen Newcomer, Council Member, City of Whittier
- Connie L. Petersen, Health and Social Services Policy and Financial Analyst, Solano County
- Sulema Peterson, State Association of County Retirement Systems
- Christie Porter, San Bernardino County Employees' Retirement System
- Patrick Whitnell, General Counsel, League of California Cities

By the Numbers

A number of pension-related phrases draw their names from their legal roots—typically a section in the California Government Code, Internal Revenue Code or other law.

- **1937 Act Retirement System.** State law (officially “The County Employees Retirement Law of 1937”) authorizes counties to create and operate pension systems for county and other local agency employees. Twenty California counties operate pension systems under the 1937 Act. Some local agencies also participate in these county-operated systems. Two other cities have pension systems created pursuant to their charters. Other counties and local agencies participate in the California Public Employees' Retirement System ("CalPERS"), which was formed under the Public Employees Retirement Law (“PERL”). These pension systems offer defined benefit pension plans.
- **401(h) Account.** Section 401(h) of the Internal Revenue Code permits a pension plan to provide for tax free payment of benefits for sickness, accident, hospitalization and medical expenses for retired employees, their spouses and dependents. Accordingly, the method for providing tax free medical benefits in a pension plan (or money purchase plan) is by using a section 401(h) account.
- **401(k) Plan.** This is a common form of defined contribution plan. Under this type of plan, employees contribute an amount of their base salary on a pre-tax basis to an account that will be invested for their eventual retirement. Employers may contribute matching funds if they choose.
- **457 Plan.** This is a form of a defined contribution plan. Under this type of deferred compensation plan employees choose to defer a portion of their pre-tax earnings into an investment account. Employees may change their contribution amount, transfer funds among a variety of investment options, or change contribution percentage allocations. Amounts contributed to the plan and the interest earned on these investments is not subject to income tax until the money is taken out during retirement or upon separation from the employer.

Accounting Standards. See *Governmental Accounting Standards Board (GASB)*.

Active Member. *Retirement systems, including CalPERS, CalSTRS, and 1937 Act systems, refer to those who are participating in the system's pension plan as a "member" of the system.*

- A "member" can be active, inactive, or retired; a survivor or beneficiary of an employee who is a pension plan participant is also considered a member.
- "Active" members are pension plan participants who are currently working for an employer and are earning *service credit* in a retirement plan. Active members also include members on authorized leave who are not earning service credit.²

Related concepts: *member, participant*.

Actuary. *Retirement system boards hire these professionals, whose key responsibility is assessing whether a pension fund has sufficient assets to meet its financial obligations.³ They calculate pension plan obligations (often referred to as "liabilities") and assets to then determine the contributions necessary to fund promised pension benefits. They do this by estimating the present (discounted) value of future pension benefit payments, using a variety of assumptions, including worker and retiree life expectancies, past and future earnings, and estimated pension fund investment results. An actuary makes these projections on a long-term basis through a combination of mathematics, statistical analysis and financial theory in an effort to understand the effect future events will have on the pension fund obligations and resources. While not an exact science, the actuarial analysis is an important component of assuring a financially healthy pension plan.*

Related Terms:

- **Actuarial Assumptions.** Actuaries make assumptions about certain events that will affect pension costs. Assumptions generally can be broken down into two categories:
 - **Demographic Assumptions.** These include projections about such things as to when people will die (*life expectancy* or mortality), become disabled, or will retire.
 - **Economic Assumptions.** These include projections about such things as what the *pension system* will receive as a return on its investments, inflation, *base salary* growth and what level of benefits a pension plan member will receive.⁴
- **Actuarial Accrued Liability.** This number can be the result of *actuary* calculations that assess whether a pension fund is on track to meet its financial commitments to *participants*. If there is a projected shortfall, the actuary concludes that the fund has a net liability. This concept is also sometimes referred to by its acronym "AAL." Related terms: *actuarial valuation, actuarial valuation report, expected future benefits, fully*

funded, funded ratio, funding policy, normal cost, present value of projected benefits, and under-funded..

- **Actuarial Valuation.** This is a procedure actuaries use to help *pension funds* establish the amount a plan needs to collect in order to meet the fund's current and future payment obligations. One technique used is to estimate the current (present) value of the future benefits a *pension plan* should expect to pay. Once this number is calculated, then the contribution amounts necessary to cover those benefit costs can be computed. Unfunded costs are costs not currently covered by plan assets.⁵
- **Actuarial Valuation Report.** This report is an assessment of whether, given 1) current and projected levels of employee and employer contributions and 2) current and projected investment earnings, the *pension fund* will have enough money to pay amounts promised to pension beneficiaries. These reports are usually prepared annually in order to determine whether employer contribution rates need to be adjusted. The report uses past performance of plan assets to project contributions necessary to fund current estimated liabilities. A general goal is to fund the amounts necessary to pay employees' estimated pension costs while the employees are working and earning pension benefits.
- **Assumed Rate of Return.** To fund promised pension benefits, employee/employer contributions are invested. The estimated return is the *pension fund's* assumed rate of return or annual expected gain and one of the factors used by actuaries to estimate the cost of funding a *defined benefit pension plan*.⁶ Related concept: *investment policies*.

Additional Service Credit (“Air Time”). This is a practice used by some systems that allows employees to purchase additional retirement credit for time not actually worked. Related concept: *service credit*.

Asset Allocation Plan. *Pension systems* typically invest pension assets in different kinds of investments (a concept known as diversification), based on a balancing of considerations including the relative risk of certain kinds of investments, how those investments relate to inflation, and what kind of returns those investments are likely to earn.⁷ Related concepts: *duty of reasonable care and diligence, fiduciary duty, investment policy*.

Asset Smoothing. This is the practice of spreading a *pension system's* investment gains and losses over a period of time in order to minimize year-to-year contribution rate fluctuations. This is done by assigning a market-related value to a plan's assets in order to determine contribution requirements. This assigned value is called the actuarial value of assets (sometimes referred to by the acronym AVA) or the “smoothed value” of assets.⁸ Related concepts: *employee/employer contribution, investment policy, and pension cost volatility*.

Base Salary. This is the fixed rate of compensation that an employee receives from an employer for a specified job. Base salary does not include employee benefits, bonuses or any other form of special compensation that may be part of an employee's *pensionable wages*. Related concepts: *benefit formulas, one-year final compensation, employer/employee contributions, and pensionable wages*.

Benefit Formula. Also known as a “pension benefit formula,” this calculation determines the amount a retiree receives in a *defined benefit pension plan*. This amount is typically based on a mathematical formula contained in statute that takes into account the following factors:

- The number of years of service the employee has in the retirement system (known as “*service credit*”);
- The employee's *pensionable wage* level;
- Age at time of retirement; and
- A percentage factor.

For an example please see *defined benefit pension plan*. Related concepts: *enhanced benefit formulas, one-year final compensation, pension systems, pension spiking and service credit*.

Board of Retirement. For *1937 Act retirement systems*, the administration and control of each county *pension system* is entrusted to a “board of retirement,” consisting of nine members.⁹ Four members are employees (two general, one safety plus an alternate, and one retired plus an alternate) each elected by their peers for three-year terms; four are appointed to three-year terms by the county's board of supervisors; and one is the county treasurer. In Los Angeles County, this entity is known as the “Board of Retirement and a Board of Investment.”¹⁰ Related concepts: *duty of care and diligence, fiduciary duty, plan governance, retirement system board, and third-party administrator*.

California Public Employees' Retirement System (CalPERS) (Formerly PERS). This is a pension system established by the Public Employees Retirement Law¹¹ in 1932¹² for state employees. It was expanded in 1939 to include classified (non-teaching) school employees and employees in California public agencies that contract with CalPERS for retirement and/or health coverage (including local agencies).¹³ Related concepts: *CalPERS Board of Administration, defined benefit pension plan, pension funds, pension system, and Public Employees Medical and Hospital Care Act (PEMHCA)*.

CalPERS Board of Administration. This board oversees the *CalPERS retirement system* and associated programs. Under state law¹⁴ this thirteen member has the following membership:

Six elected members:

- Two elected by and from all CalPERS pension system *members*;
- One elected by and from all state employee *active members*;
- One elected by and from all CalPERS school employee *active members*;
- One elected by and from all CalPERS local agency *active members* (in other words those employed by local agencies who contract with CalPERS);
- One elected by and from the retired CalPERS plan *members*;

Three appointed members:

- Two appointed by the Governor – one of whom must be a local elected official and another from the life insurance industry; and
- One public representative appointed jointly by the Speaker of the Assembly and the Senate Rules Committee.

Four *ex officio* (by virtue of their positions) members:

- The State Treasurer;
- The State Controller;
- The Director of the Department of Personnel Administration; and
- A designee of the State Personnel Board.

The Board of Administration is responsible for the management and control of CalPERS, including the administration and investment of CalPERS' pension *trust fund*. The Board is also responsible for managing a number of other funds and programs, including the system's *457 plan* and long-term care program. In addition, the Board administers the *Public Employees' Medical and Hospital Care Act* and the state's contract with the federal government for Social Security.¹⁵ Related concepts: *duty of care and diligence, fiduciary duty, plan governance, retirement system board, and third-party administrator.*

California State Teachers' Retirement System (CalSTRS). In 1912, this pension system was founded for teachers in California.¹⁶ CalSTRS provides retirement related benefits and services to teachers in public schools and community colleges. CalSTRS provides three basic benefits:

- Service retirement based on a *benefit formula*
- Survivor benefits
- *Disability retirement*¹⁷

The system is administered in accordance with the Teachers Retirement System Law.¹⁸ Related concepts: *defined benefit pension plan, pension funds, pension system, retirement system board, Teachers Retirement Board, and third party administrator.*

Collective Bargaining. California's labor relations law, known as the *Meyers-Milias-Brown Act (MMBA)*,¹⁹ requires local agency employers to negotiate with groups of employees in good faith to try to determine mutually agreeable employment conditions. Salaries and benefits are a common subject of such negotiations—including pension and other post-employment benefits. For a glossary of terms relating to labor relations, please see the Institute's *A Local Official's Guide to Labor Relations Terminology* at www.ca-ilg.org/LaborRelationsGlossary. Related concept: *Meyers-Milias-Brown Act.*

Comprehensive Annual Financial Report. This document presents a complete picture of the agency's finances. It is sometimes referred to by the acronym CAFR (pronounced "kay-fur"). A "comprehensive annual financial report" supplements the basic financial statements; its contents are specified by generally accepted accounting principles (sometimes referred to by the acronym "GAAP"). *Pension systems* prepare comprehensive annual financial reports. In addition, when local agencies prepare their own comprehensive financial reports, one of the recommended components of the comprehensive financial report is a report on the agency's funding of pension and other post-employment benefits.²⁰

Contribution. See *employer/employee contribution.*

Contribution Holiday. A practice of not requiring contributions from employers or employees (or both) during years when investment returns are sufficiently high to enable an agency to meet its projected pension obligations without additional contributions, based on actuary calculations. In other words, those contributing to the *pension fund* get a "holiday" from making contributions to the fund. There has been advisement against the use of contribution holidays.²¹ Related concepts: *actuary, asset smoothing, fully funded, funding policy, funding ratio, GASB Statement 50, retirement system funding and super-funded.*

Cost of Living Adjustment. Some public employers have retirement benefits that include an annual cost of living adjustment (sometimes known by the acronym "COLA") that helps maintain the retiree's spending power.²² Related concept: *benefit formula.*

Defined Benefit Pension Plan. This type of plan provides public employee retirees with a guaranteed lifetime monthly income, based on a predetermined statutory formula. This approach contrasts with *defined contribution plans*, although some employers offer a combination of the two kinds of plans—a concept known as a *hybrid plan*. There are a series of considerations that have been identified for local agencies to use in determining what kind of system makes sense for the local agency,²³ and essential design elements for defined benefit pension plans.²⁴

Defined benefit pension plans are typically funded by a combination of a flat employee contribution (which, as a result of labor negotiations processes, some public employers pick up all or part) and a fluctuating employer contribution based on the retirement fund's investment performance and other factors. Under a *defined benefit pension plan*, employers bear the risk of underperforming assets that may not produce sufficient income to support a promised level of retirement benefits.

In California, the promised level of benefits in defined benefit pension plans are typically based on a formula. The formula is based on an employee's age at the time of retirement (which is then tied to a percentage factor), the employee's length of service, and the highest one-year or three-year average *pensionable wages* earned by the employee. An example is the "2 percent at 60 formula" that provides 2 percent of the employee's highest average compensation for each year of service at age 60. This means that someone retiring at 60 after 25 years of service could expect to receive 50 percent of their highest annual average compensation.²⁵ Related concepts: *1937 Act Retirement System, benefit formulas, CalPERS, CalSTRS, employee/employer contributions, enhanced benefit formulas, one-year final compensation, pension benefit, pension spiking, pension systems* and *service credit*.

Defined Contribution Plan. This type of plan starts with a specified annual contribution amount from the employer, the employee or both. This approach contrasts with *defined benefit pension plans*, although some employers offer a combination of the two plans—a concept known as a *hybrid plan*. Finance officials offer a series of factors for local agencies to consider in determining what kind of system makes sense for a particular local agency,²⁶ as well as essential design elements for such plans if they are the primary retirement plan.²⁷

The benefits that the retiree receives are based on any employer and employee contributions and investment earnings reduced by administration fees. The only guaranteed amount is the annual employer and/or employee contributions because future benefits may fluctuate depending on investment earnings. In this way, the employee assumes the risk that investment results may produce lower than hoped-for retirement income. Related concepts: *401(k) plan* and *457 plan*.

History of Defined Benefit Pension Plans and Defined Contribution Plans

Defined Benefit Pension Plans

Pensions date back to before America's founding—to colonial militias. American Express, then a railroad freight forwarder, introduced its defined benefit pension plan in 1875; other railroads followed suit, followed by AT&T in 1906. By 1920, many large corporate employers offered defined benefit pension plans. The trend towards defined benefit plans received a boost in the 1930s, when tax advantages encouraged smaller companies to offer plans.

By 1970, 45 percent of the American workforce participated in defined benefit plans. During this period, however, there were a number of notable pension plan failures. These failures led to closer regulation of private plans through the Employee Retirement Income Security Act (ERISA) in 1974.

Defined Contribution Plans

Defined contribution plans are more of a 20th century development, arising out of company profit sharing plans.

The trend toward defined contribution plans started picking up momentum in the 1980s, with the passage of Internal Revenue Code amendments in 1978 that created the "401(k)" defined contribution option for private employers that allowed employees to save towards their retirement by deferring part of their income into an investment account without having to pay tax on that income. The increasingly extensive regulation of private defined benefit pension plans (for example, through the Employee Retirement Income Security Act and accounting requirements) reinforced this momentum, as did the year-to-year volatility/unpredictability of employer obligations under defined contribution plans in light of the importance of profit margins in the private sector.

Disability Retirement. This form of retirement allows an eligible employee who is unable to perform the usual duties of his or her position due to a disability to retire early or for the duration of the disability. The disability typically relates to an illness or injury that is expected to be permanent or of an undetermined duration. The income amount is determined by a number of variables, including whether the cause of the disability is work-related, the nature of the employee's work, and the specific provisions in the contract between the *pension system* and the employer.²⁸ Related concept: *early retirement*.

Duty of Care and Diligence. Members of public *retirement system boards* are fiduciaries and must perform their responsibilities to their retirement systems with the care, skill, prudence, and diligence under the given circumstances that a person exercising good judgment, acting in a similar capacity, and familiar with these matters would use in performing the same or similar services.²⁹ This is also referred to as the "prudent person standard." Related concept: *fiduciary duty*.

Early Retirement. When an employee must stop working or chooses to stop working before the employee is eligible for normal retirement, some *1937 Act* plans may provide for payment of a retirement allowance. The retirement allowance payable at the time of early retirement is usually lower than the normal retirement allowance.³⁰ Related concept: *disability retirement*.

Employee/Employer Contribution. In public *pension systems*, the amounts paid into a retirement *trust fund* can be divided into two parts: the part paid for by the employee and the part paid by the employer.

- **Employee Contribution.** This is typically a fixed percentage of the employee's *base salary* that is necessary to help fund the retirement program. In some instances, the collective bargaining process has resulted in an employer's agreement to pick up all or part of the employee contribution. In 1937 Act systems, the employee's contribution varies by an employee's age at time of hire.
- **Employer Contribution.** In *defined benefit pension plans*, the employer contribution is typically an amount that an employer must contribute to the employer's pension *trust fund* on a sustained, ongoing basis in order for the agency's pension fund to be able to meet its obligations to employees (known as "*expected future benefit payments*," see below). The employer contribution is the result of actuarial calculations, and generally consists of two components: 1) "*Normal costs*," which are the current and future costs of employee pensions, and 2) Amortization of any *unfunded liability*.³¹ Note that for CalSTRS the employer contribution is determined by statute³².

Under some circumstances (particularly *defined contribution* systems), employers may agree to match employees' contributions.³³ Related concepts: *actuary*, *additional service credit* ("air

time”), *asset smoothing*, *benefit formula*, *contribution holiday*, *funding policy*, *matching contributions* and *retirement system funding*.

Employer Paid Member Contribution (EPMC). As part of the *collective bargaining* process, a local agency may agree to pay all or part of the *employee's contributions* required to be paid by specified members.³⁴ Specific parameters must be met.³⁵ These may or may not be included in *pensionable wages*.

Enhanced Benefit Formulas. In the late 1990s/early 2000s, legislation (SB 400³⁶/AB 616³⁷) was enacted to create more advantageous benefit options for local agencies to offer their safety and miscellaneous public employees (3 percent at 50 or 55 for safety employees and 2.5 or 2.7 percent at 55 and 3 at 60 for miscellaneous employees).

Entry-Age Normal Funding Method. A method for prefunding pension benefits performed by allocating the cost of each member's pension on a level percent of payroll between the time employment begins (entry age) and the member's assumed retirement date. This method is designed to help produce stable employer contributions that increase over time at the same rate as the employer's payroll.³⁸ Related concept: *funding policy*.

Excess Assets. This situation occurs when a *pension fund's* assets exceed its obligations to pension plan *members* (in other words, the *actuary's* calculations indicate the fund has more than sufficient assets to pay all benefits that *members* have earned).³⁹ Related concepts: *fully funded*, *funded ratio*, *funding policy*, *normal cost*, *present value of future benefits*, and *unfunded liability*.

Expected Future Benefit Payments. Payments that are determined through a series of assumptions that include the age when members are expected to retire, how long members are expected to live (*life expectancy*) and economic factors that may affect the value of benefits or the value of assets held in a *pension fund*. Some of the factors that are considered are the inflation rate and the rate of *base salary* increases. Related concepts: *actuarial assumptions*, *actuarial valuation*, *actuarial valuation report*, *actuary*, *assumed rate of return*, and *present value of future benefits*.

Fiduciary Duty. This is the principle that those on *retirement system boards* must perform their duties solely in the interest of the *pension system's participants/members*.⁴⁰ State law requires that *retirement system board* decisions must focus on providing benefits to *members* and their beneficiaries, minimizing *employer contributions* to the system, and covering the reasonable expenses of administering the system.⁴¹ When there is a conflict among these objectives, the duty to *members* and their beneficiaries takes precedence over any other duty.⁴² Related concept: *diligence* and *duty of care*.

Final Compensation. See *pensionable wages*.

Fully Funded. This status is achieved when a *pension fund* has sufficient assets to meet its commitments to *participants* (the financial target is more technically known as *accrued actuarial liability*). Note that a “fully funded” plan does not mean that *employer/employee contributions* should be zero. Related concepts: *funded ratio, funding policy, normal cost, underfunded* and *unfunded liability*.

Funded Ratio. This is the product of a series of calculations that reveals, at a given point in time, the relationship between a *pension fund's* assets and its liabilities.⁴³ A 100 percent funded ratio means that the plan is *fully funded*. The excess of these accrued liabilities over the actuarial value of assets is referred to as the “*unfunded liability*,” and the ratio of actuarial assets to liabilities is referred to as the “*funded ratio*.”

Funding Policy. The fundamental financial objective of a *defined benefit pension plan* is to fund the long-term cost of benefits promised to the plan members. Such resource accumulation typically occurs through *employee and employer contributions*, as well as investment earnings.⁴⁴ In addition, actuarial principles typically require that the total cost of employee services be recognized in the period in which those services are provided. This helps achieve intergenerational equity among those who are called upon to financially support the plan, thereby avoiding the transfer of costs to future generations.⁴⁵ A plan's funding policy reveals a plan's approach to these actuarial and funding issues⁴⁶. Related concepts: *entry-age normal funding method, funded ratio* and *prefunding*.

Governmental Accounting Standards Board (GASB). A nonprofit organization that develops accounting standards for various state and local governments (often referred to by the acronym “GASB” and pronounced “gaz-be”). This board establishes generally accepted accounting principles (sometimes referred to by the acronym “GAAP”) for state and local agencies.

The board operates independently and does not enforce the use of its standards but there are strong incentives to follow these standards. For instance, adherence to these standards are necessary to receive a “clean” audit opinion on an agency's financial statements.⁴⁷ In addition, bond rating firms consider whether or not an agency follows these standards when determining what credit rating to assign to a debt issuance.⁴⁸ Related concepts: *GASB Statements 43 and 45, GASB Statement 50, GASB Statement 63(Proposed)*, and *retirement system funding*.

GASB Statements 43 and 45. These are public agency financial statement and disclosure standards relating to “*other post-employment benefit*” commitments (sometimes referred to by the acronym OPEB) made by public agencies to their employees and retirees. Among other things, these accounting standards, adopted in 2004, state that government employers must report the cost of other post-employment benefits while the employee is working and earning those benefits, rather than in the period (often many years later) when the benefits

are paid or provided (sometimes referred to as “*pay-as-you-go*”).⁴⁹ This approach: 1) requires public agencies to measure and recognize these costs (expenses) over a period of time that approximates employees’ years of service, and 2) provides information about the anticipated financial costs associated with these benefits and whether or not a local agency has adequate resources on hand to pay for those future commitments.⁵⁰ Related concepts: *CAFR*, *GASB*, *GASB Statement 50*, *OPEB*, *pay-as-you-go*, and *retirement system funding*.

GASB Statement 50 (Amending GASB Statements 25 and 27).

A public agency financial statement and disclosure standard relating to *defined benefit pension plans*. Among other things, this accounting standard, adopted in 2007, aligns the financial reporting requirements for pensions with those for other postemployment benefits (see *GASB Statements 43 and 45*). GASB Statement 50 amends prior standards (GASB Statements 25 and 27) to require *defined benefit pension plans* to disclose various information regarding the plans’ funded status and the methodologies and assumptions used to determine that status. As with *GASB Statements 43 and 45*, the goal of the changes is to improve the transparency and usefulness of financial reporting by *pension systems* and public employers participating in such systems.⁵¹ Related concepts: *GASB*, *GASB Statements 43 and 45* and *retirement system funding*.

GASB Statement 63 (Proposed--Amending GASB Statement 34). This proposed financial statement and disclosure standard is intended to help those who review public agency financial reports understand how past transactions may impact an agency’s future financial statements.⁵²

Government Finance Officers Association (GFOA). This is a membership organization (sometimes referred to by the acronym “GFOA”), whose mission is to enhance and promote the professional management of governments for the benefit of the public. The association does this by identifying and developing financial policies and best practices and promoting their use through education, training, facilitation of member networking, and leadership.⁵³

Hybrid Pension Plans. These types of plans offer a combination of *defined benefit pension plans* and *defined contribution plans* to employees.⁵⁴ Related concepts: *defined benefit pension plans* and *defined contribution plan*.

Internal Revenue Code (IRC). The Internal Revenue Code is where federal tax law is found and codified with other federal law in the United States Code. These code books are divided into numbered “titles” or sections based on subject matter. The Internal Revenue Code is also known as Title 26 of the United States Code.

Investment Policies. California law requires public *pension systems* to diversify their investments to minimize the risk of loss and to maximize the rate of return, unless under the circumstances it is clearly not prudent to do so.⁵⁵ Because investments involve risk, the

Association of Public Pension Fund Auditors issued a report to *retirement system boards* and other pension *trust fund* managers so that they could better understand, categorize and manage the investment risks. A clear framework for understanding and categorizing risk is a fundamental step in managing pension funds effectively.⁵⁶

Related concept: *asset allocation*.

Investment Return Sensitivity Analysis. This analysis identifies potential pension costs to employers if investment returns fall below or rise above a targeted investment return threshold. The analysis provides additional information to employers about potential future costs of *defined benefit pension plans*.⁵⁷ Related concepts: *actuarial assumptions*, *actuary*, and *assumed rate of return*.

Life Expectancy. This is the length of time a person of a given age is expected to live. The period of time is a statistical average, based on mortality tables showing the rate of death at each age. Life expectancy assumptions factor into cost calculations for *defined benefit pension plans*, since the plan is committed to make payments for the balance of each retiree's post retirement life. Related concept: *actuary*.

Market Value of Assets. This is the cash value or the amount that a *pension fund's* assets could be sold for.. Related concepts: *actuary (assumed rate of return)*, *asset smoothing* and *investment policies*.

Matching Contributions. These are contributions made by an employer to a *defined contribution plan* on an employee's behalf when the employee makes elective or non-elective contributions.⁵⁸ Related concept: *employee/employer contribution*.

Member. *Pension systems* often refer to those who are participating in the plan as a "member" of the system. This term also is defined and used in most California public pension laws. A "member" can be active, inactive or retired; a survivor or beneficiary of an employee who is a plan member is also considered a member. Related concepts: *active member*, *miscellaneous employees*, *participant*, and *safety employees*.

Member Contributions. See *employee/employer contributions*.

Meyers-Milias-Brown Act. The California labor relations law⁵⁹ that requires local agency employers to negotiate in good faith with groups of employees to try to determine mutually agreeable employment conditions, including pension benefits and *other post-employment benefits*. Related concept: *collective bargaining*. For a glossary of terms relating to labor relations, please see the Institute's *A Local Official's Guide to Labor Relations Terminology* at www.ca-ilg.org/LaborRelationsGlossary.

Miscellaneous Employees. These are “non-safety” or general employee participants in public *pension systems*. “Safety” employees are involved in law enforcement, fire suppression, or the protection of public safety.⁶⁰ “Miscellaneous” employees are everyone else eligible to participate in a *pension system*. The reason underlying the distinction is that the *benefit formula* for safety employees typically yields higher pension benefits. Related concepts: *benefit formula* and *safety employees*.

Non-pooled Agency. This is a public agency that has more than the legally mandated number of employees necessary to establish an individual *pension fund*.⁶¹ These non-pooled agencies are large enough to allow them to spread the risks associated with *defined benefit pension plans* among a larger number of employees. Related concepts: *pooled agency* and *risk-sharing pool*.

Normal Cost. Computed differently under different funding methods, the employer’s annual “normal cost” represents the *present value* of benefits that *pension system members* earn during the valuation year. This term is sometimes also referred to as “current normal cost.” Related concepts: *actuary*, *assumed rate of return*, *employer/employee contribution*, *funding policy*, and *present value of future benefits*.

One-Year Final Compensation. In *defined benefit pension plans*, an approach to the *benefit formula*, in which the final average *pensionable wages* amount used to compute the employee’s retirement benefit, is based on the final or highest one year. An alternative approach is to use an average of the final or highest three years’ *pensionable wages*.

Other Post-Employment Benefits (OPEB). In addition to pensions, many state and local governmental employers provide other post-employment benefits (OPEB) as part of the overall compensation package a public agency offers to its employees. This includes employer-provided health insurance for retirees, as well as other forms of benefits that can be received after retirement (for example, life insurance).⁶² Related concepts: *GASB Statements 43 and 45*.

Over-Funded. See *excess assets*.

Participants. Often referred to as “members” of an agency’s *pension system*, this term refers to those that participate in an agency’s pension plan and include the following:

- Active members;
- Deferred members;
- Retired members; and
- Beneficiaries, former spouses and survivors of members.

Related concepts: *members*, *miscellaneous employees*, and *safety employees*.

Pay-As-You-Go Benefits. A situation in which agencies pay for the cost of benefits as those costs are incurred, as opposed to *pre-funding* such benefits (also known as the “current disbursement cost method”⁶³). Agencies sometimes use this approach for paying for *other post employment retirement benefits*. Related concepts: *GASB Statements 43 and 45*, *GASB Statement 50* and *retirement system funding*.

Pension Benefit. See *benefit formula* and *other post-employment benefits*.

Pension Cost Volatility. Volatility is the measure of the price of a financial instrument over time. These financial instruments may experience swings in value from year to year due to the fluctuating nature of financial markets. In an effort to minimize volatility in pension costs, some *pension systems* use a “smoothing” approach, in which investment gains and losses are recognized over an extended period allowing employer contributions to be more evenly allocated.⁶⁴ Related concept: *asset smoothing*.

Pension Fund. This is a pool of assets made up of the contributions to a *pension system* and investment earnings on those contributions that will be used to finance pension benefits. The *participants/members* have a legal or beneficial right to or some other contractual claim against the assets of the pension fund.⁶⁵ Related concepts: *pension system* and *trust fund*

Pension Obligation Bonds. When a public agency has an *unfunded liability*, it normally reduces that liability over time as part of its annual required pension contribution. Some agencies, however, have elected to incur debt through the issuance of pension obligation bonds in an effort to reduce their unfunded actuarial liability as a part of the overall strategy for managing pension costs. Finance professionals counsel caution in using this approach.⁶⁶

Pension Spiking. A practice of increasing an employee’s retirement benefits (without a change in the *benefit formula*) by dramatically increasing, just prior to retirement, the employee’s *base salary*; another way the increase can occur is by including special compensation or non-salary items (such as unused vacation pay, mileage pay, uniform allowance or other allowances) in the employee’s final *pensionable wages* used to calculate the employee’s retirement benefits.⁶⁷ Related concepts: *benefit formula* and *one-year final compensation*.

Pension System. In California, there are a number of kinds of entities through which public agency employers provide pension benefits: The *California Public Employees Retirement System*,⁶⁸ county plans adopted under the state law known as the *1937 Act*,⁶⁹ and the *State Teachers Retirement System*.⁷⁰ Some charter agencies have systems established under their charter authority. Related concept: *pension fund*.

Pensionable Wages. For purposes of retirement, this is an employee’s *base salary* plus any special compensation allowed to be counted as part of an employee’s overall compensation for purposes of calculating pension benefits under a *pension system’s benefit formula*. Special

compensation may include any payments for special skills as well as such items such as bonus pay, incentive pay, longevity pay, and value of *employer paid member contributions*.⁷¹ Related concepts: *base salary*, *benefit formulas*, *one-year final compensation* and *employer/employee contributions*.

Plan Governance. Generally refers to the systems and processes that *pension systems* use to administer pension benefits and manage the investment of retirement assets, with the objective of maximizing investment returns at an acceptable level of risk and reducing potential conflicts of interest. Governance systems and processes cover areas such as organizational transparency (including having clear, documented, and accessible policies) and commitment to knowledge and skill enhancement.⁷² Plans have begun to address increased organizational transparency and disclosures of potential and real conflicts of interest. There are a series of recommendations relating to governance practices.⁷³ Related concepts: *duty of reasonable care and diligence*, *fiduciary duty*, and *investment policies*.

Plan Sponsor. This is the agency or entity that contracts with a *pension system* to provide a vehicle for funding pension benefits. Beyond the public agency context, plan sponsors can include private businesses acting for their employees, unions acting on behalf of their members as well as state and local agencies operating on behalf of their employees.⁷⁴

Pooled Agency. A group of employers that join together because individually they do not have the required number of employees needed to establish an individual *pension fund*.⁷⁵ Pooling of agencies allows these agencies to combine investments and actuarial risks that are associated with *defined benefit pension plans*, and spread them among multiple agencies. This practice helps to reduce *pension cost volatility* for smaller agencies. Related concepts: *non-pooled agency* and *risk-sharing pool*.

Pre-Funding. This is a process of accumulating resources for future benefit payments during the active service life of employees.⁷⁶ Such resource accumulation typically occurs through *employer and employee contributions*, as well as investment earnings.⁷⁷ This also helps to achieve intergenerational equity among those who are called upon to financially support the plan, thereby avoiding the transfer of costs to future generations.⁷⁸ The *Government Finance Officers Association* recommends prefunding *other post-employment benefits*, for example health and life insurance.⁷⁹ This contrasts with the *pay-as-you-go* approach. Related concepts: *employer/employee contributions*, *funding policy*, *GASB Statements 43 and 45*, *GASB Statement 50*, *investment returns*, and *retirement system funding*.

Present Value. The key task for *defined benefit pension plan* administrators and their *actuaries* is to determine how much the *pension trust fund* needs to have on hand in order to meet current and future pension benefit obligations. The concept of “present value” is useful in calculating how much in *employer/employee contributions* a *pension fund* needs to receive and invest now in order to meet its projected obligations. The present value of a future payment is

what money is worth now in relation to what someone thinks it will be worth in the future based on expected earnings. For example, if one expects to make a 10 percent return on an investment, \$1,000 is the present value of the \$1,100 one expects to have a year from now. Related concepts: *actuary, assumed rate of return, employer/employee contribution, funding policy, investment policy, present value of future benefits, and unfunded liability.*

Present Value of Projected Benefits (PVB). This is a calculation in which future pension benefit payments (*actuarial accrued liability*) are expressed in today's dollars using *assumed rates of return*. This discounted value calculation of all future expected benefit payments is based on various *actuarial assumptions*. This concept is relevant to a *pension system's* effort to determine such things as a plan's *funded ratio* and whether *employer/employee contributions* need to be increased in order to satisfy the agency's *funding policy*. Related concept: *actuary, expected future benefits.*

Public Employees' Medical and Hospital Care Act (PEMHCA). This is the state law that governs the administration of CalPERS' health benefits program for those who participate in it.⁸⁰

Public Records and Pensions. Information given to the retirement system by a member, such as date of birth, social security number, is confidential member information. Information to or from the pension plan and the employer is general public information.⁸¹ An appellate court has held that, other non-confidential public information is subject to disclosure if requested including the name, date of retirement, department retired from, last position held, years of service, base allowance, cost of living adjustment, total health allowance and monthly pension benefit of each retiree.⁸²

Qualified Plan. This is a type of retirement plan established by an employer that meets the requirements of federal law.⁸³ A qualified plan may be a *defined benefit pension plan* or a *defined contribution plan*. Amounts contributed to the plan, and the interest earned on these investments, are not subject to income tax until the money is taken out during retirement or upon separation from the employer. An example of such a plan is a *401(k)*.

Reciprocity or Reciprocity Agreements. These agreements allow public employees to maintain *portability* when moving from one public employer to another. Depending on the specifics of the agreement or governing regulations, some systems may recognize a member's participation in each system when determining eligibility for benefits and when calculating retirement benefits.⁸⁴ Related concept: *portability.*

Replacement Benefit Plan (RBP). Federal tax law limits the annual benefit an individual can receive from a tax-qualified pension plan at a certain dollar amount per year,⁸⁵ which may be less than what an employee expects to receive under the agency's *benefit formula*. "Replacement benefit plans" are a mechanism to enable the employee to receive the full amount

promised. These amounts are subject to federal taxes to the extent the employee was subject to these taxes during duration of employment.⁸⁶ Employers pay for the benefit; CalPERS has a sheet that explains such plans further.⁸⁷ Note that there have been state legislative efforts to limit the availability of such benefits for future hires.⁸⁸

Retired Annuitant. This is an employee who has retired and is collecting pension benefits under a *defined benefit pension plan*.⁸⁹ Because of these employees' skills and expertise (or the employees' desire to transition more gradually into full retirement), agencies will sometimes hire them for limited periods. For those who are receiving benefits under the CalPERS' system, there are limits on: 1) how many hours such retirees may work, and 2) the duration of their tenure.⁹⁰

Retirement System Board. The group of individuals that, as a governing board, make decisions on behalf of a public *pension system* --sometimes referred to as a board of administration, board of trustees, or board of directors.⁹¹ The board has the sole and exclusive fiduciary responsibility over the *pension system's* assets.⁹² State law requires that the board administer the system in a manner that will assure prompt delivery of benefits and related services to the *members* and their beneficiaries.⁹³ The membership of a board is typically established by state law and cannot be changed without local voter approval.⁹⁴ Related concepts: *board of retirement, CalPERS Board, duty of care and diligence, fiduciary duty, and Teachers Retirement Board.*

Retirement System Funding. *Employee/employer contributions* are placed in a dedicated *trust fund* set up for the sole purpose of paying benefits. The contributions are invested and earn investment returns. Benefits and expenses associated with *the trust fund* are paid out of the fund. Any increase in the benefits and expenses will necessitate an increase in *employee/employer contributions*, a higher investment return or both. *Pension fund* assets are invested in a variety of investment vehicles including, but not limited to, stocks, bonds, and real estate.⁹⁵

Risk-Sharing Pools. This is a tool to moderate volatility in pension costs for smaller employers by spreading the risk of demographic gains and losses across small plans that offer the same *benefit formula*.⁹⁶ Related concepts: *non-pooled agency* and *pooled agency*.

Safety Employees. In pension benefit formulas, police, sheriffs, firefighters, and other public safety employees have their pension benefits calculated at a higher rate, with corresponding higher *employer/employee contributions*.⁹⁷ Some safety employees do not receive Social Security benefits. Related concepts: *benefit formula* and *miscellaneous employees*.

Second Tier Options. A "tier" refers to a group of employees whose retirement benefits are different from those of other colleagues at the agency. For example, a new benefit tier might apply to employees hired after a specific date, while those hired previously receive different (usually higher) benefits. Second tiers may combine *defined benefit pension plan* and *defined*

contribution plan designs (also referred to as a *hybrid pension plan*). Second tier options also include lowering benefit formulas or removing certain optional benefit upgrades from the employer's contract (for example: employer paid member contributions, post-retirement survivor allowance, *cost-of-living allowances* and *disability retirement*).⁹⁸

Sensitivity Analysis. See *Investment Sensitivity Analysis*.

Service Credit. Under a *defined benefit pension plan*, the length of an employee's employment or total years of service within the pension system is one element used to calculate the *benefit formula*. Public employees generally receive one year of service credit for each year worked. Related concepts: *air time*, *portability*, *benefit formula*, and *reciprocity*.

Social Security and Pension Plans. Some local agencies have elected to have their employees contribute to Social Security. Other agencies, however, do not and therefore are not part of the Social Security system. Employees who are not members therefore are not entitled to Social Security benefits upon retirement, death or disability.⁹⁹ Related concept: *three-legged stool*.

Super-Funded. This is a condition existing when the actuarial value of assets exceeds the present value of benefits. When this condition exists on a given valuation date for a given plan, *employee/employer contributions* for the rate year covered by that valuation may be waived.¹⁰⁰ A *pension trust fund* is considered to be "super-funded" when assets exceed the amounts necessary to meet the anticipated current and future demands on the fund. Related concept: *contribution holiday*.

Teachers Retirement Board. This board oversees the *CalSTRS retirement system* and associated programs. The board is comprised of 12 members:

- Three positions representing current educators elected by *members*;
- A retired CalSTRS member appointed by the Governor and confirmed by the Senate;
- Three public representatives appointed by the Governor and confirmed by the Senate;
- A school board representative appointed by the Governor and confirmed by the Senate; and
- Four board members who serve in an *ex-officio* capacity by virtue of their office: Director of Finance, State Controller, State Superintendent of Public Instruction, and State Treasurer.¹⁰¹

Related concepts: *California State Teachers' Retirement System*, *duty of care and diligence*, *fiduciary duty*, *plan governance*, *retirement system board*, and *third-party administrator*.

Three-Legged Stool. This is the theory that a combination of an individual's savings, Social Security, and pension will provide secure retirement income.¹⁰² Related concept: *Social Security and pensions*.

Total Compensation. See *pensionable wages*.

Trust Fund. Money and assets of a *pension system* are held in a separate fund, separate from other employer assets and are protected from third-party creditor claims. The fund may only be used to provide benefits to *pension system members* (and their beneficiaries) and to defray reasonable expenses of managing the *pension fund*.¹⁰³

Two-Tier Retirement Systems. See *second tier options*.

Under-Funded. When a *pension fund's* obligations to pension plan *members* exceed the fund's assets (in other words, the *actuary's* calculations indicate the fund has insufficient assets to pay all benefits that *members* have earned) the plan has *unfunded liabilities* (sometimes referred to by the technical term "unfunded actuarial accrued liability"). When this condition occurs, a pension plan is deemed under-funded.¹⁰⁴ Related concepts: *actuarial accrued liability, fully funded, funded ratio, funding policy, normal cost, present value of projected benefits, and unfunded liability*.

Unfunded Liability. This exists when the value of benefits estimated to be payable to plan *members* as a result of their service exceeds the projected value of plan assets available to pay those benefits. This phenomenon is sometimes referred to as "unfunded actuarial accrued liability" (sometimes referred to by the acronym UAAL). This amount changes over time as a result of changes in benefits, pay levels, rates of return on investments, changes in other actuarial assumptions, and changes in the demographics of the employee base.

Public entities typically reduce an unfunded pension liability over time as part of their annual *employer contribution*. Under standards set by the *Governmental Accounting Standards Board (GASB)*, unfunded liabilities should be addressed over a period of not more than 30 years in order to provide reasonable assurance of the payment of future benefits.¹⁰⁵ Related concepts: *actuary (actuarial assumptions), fully funded, funded ratio, funding policy, normal cost, pension obligation bonds, present value of projected benefits, and under-funded*.

Vested Benefits. In a *defined benefit pension plan*, vesting means the *pension plan participant* is eligible to receive pension benefits when he or she meets the length of service and age requirements. A *member's* vested benefits cannot be taken away even if:

- The member stops working for the employer; and
- Never works in covered employment again.

For example, in the *CalPERS* system, if the former employee is younger than the minimum age for retirement, they may leave their contributions on deposit with the system. After they reach or exceed the minimum age, they can apply for retirement benefits consistent with *service credit* earned before they left their employment.¹⁰⁶

When an employee becomes vested in a retirement account, it can also mean that the employee has a right to withdraw the money contributed to their agency's *pension fund* on their behalf.¹⁰⁷ Amounts distributed amounts may be subject to taxes and early withdrawal penalties.¹⁰⁸

Vested Rights. The legal concept that, once earned, the employee becomes entitled to the benefit promised. In California, this concept constrains public agencies from repealing or modifying their pension plans for those employees who have performed the necessary service to be entitled to benefits given that level of service.¹⁰⁹ However, under limited circumstances, certain kinds of changes to pension plans have been upheld.¹¹⁰ Whether and to what extent public employers are permitted to alter vested rights of their employees is a topic that is receiving a significant amount of attention and continues to be the subject of litigation. Close consultation with agency counsel should occur as part of any analysis relating to changing pension benefits.¹¹¹

Volatility. See *pension cost volatility*.

Caveats

This document is a service of the Institute for Local Government (ILG) whose mission is to promote good government at the local level with practical, impartial, and easy-to-use resources for California communities. ILG is the nonprofit 501(c)(3) research and education affiliate of the League of California Cities and the California State Association of Counties.

The Institute acknowledges the complexity of these issues. This glossary has attempted to translate these highly technical concepts into understandable terms that can be a starting point for elected officials, policy makers, the media and the general public to participate in conversations about pension issues. Readers should understand that the effort to be as clear as the subject allows has resulted in the omission of certain technical and legal nuances. . These materials should not be relied on as complete statements of the concepts described, nor should they be considered legal advice relating to pension issues. Officials are encouraged to consult with staff and other technical experts for up-to-date information and guidance on how these concepts apply in specific situations.

The Institute welcomes feedback on this resource:

- Email: info@ca-ilg.org Subject: A Local Officials Guide to Pension Terminology
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Endnotes, References and Additional Resources

¹ See State Association of County Retirement Systems, *New Trustee Handbook/CD*, available from <https://web.memberclicks.com/mc/quickForm/viewForm.do?orgId=slgs&formId=82555> (“SACRS Glossary”); CalPERS Glossary, available online at <http://www.calpers.ca.gov/index.jsp?bc=/utilities/glossary/home.xml>.

² SACRS Glossary at 276.

³ See Cal. Const. Art. XVI, § 17(e); see also Cal. Gov’t Code § 7504(a) (“(a) All state and local public retirement systems shall, not less than triennially, secure the services of an enrolled actuary. An enrolled actuary, for the purposes of this section, means an actuary enrolled under subtitle C of Title III of the federal Employee Retirement Income Security Act of 1974 (Public Law 93-406) and who has demonstrated experience in public retirement systems. The actuary shall perform a valuation of the system utilizing actuarial assumptions and techniques established by the agency that are, in the aggregate, reasonably related to the experience and the actuary’s best estimate of anticipated experience under the system. Any differences between the actuarial assumptions and techniques used by the actuary that differ significantly from those established by the agency shall be disclosed in the actuary’s report and the effect of the differences on the actuary’s statement of costs and obligations shall be shown.”)

⁴ SACRS Glossary at 275-294.

⁵ SACRS Glossary at 275-294.

⁶ SACRS Glossary at 275-294.

⁷ The *Government Finance Officers Association* publishes best practice recommendations for asset allocations for both defined benefit and defined contribution plans. See GFOA, *Asset Allocation Guidance for Defined Benefit Plans (1999 and 2009) (CORBA)*, available at http://www.gfoa.org/index.php?option=com_content&task=view&id=1605, *Asset Allocation Guidance for Defined Contribution Plans (1999 and 2009) (CORBA)*, available at http://www.gfoa.org/index.php?option=com_content&task=view&id=1606.

⁸ See *CalPERS Toolkit* at 19.

⁹ See Cal. Gov’t Code §§ 31520-31538.

¹⁰ See Cal. Gov’t Code §§ 31520.2.

¹¹ Cal. Gov’t Code §§ 20000 and following.

¹² CalPERS, *Facts at a Glance (June 2011)*, available online at <http://www.calpers.ca.gov/eip-docs/about/facts/general.pdf>.

¹³ SACRS Glossary at 278.

¹⁴ Cal. Gov’t Code § 20090.

¹⁵ See CalPERS website: <http://www.calpers.ca.gov/index.jsp?bc=/about/organization/board/structure-responsibilities.xml>.

¹⁶ SACRS Glossary at 278.

¹⁷ See CalSTRS at a Glance at <http://www.calstrs.com/About%20CalSTRS/atagance.aspx>.

¹⁸ See Cal. Gov’t Code §§ 22000-28101, available at http://www.calstrs.com/Help/forms_publications/printed/TeachersRetirementLaw.pdf.

¹⁹ Cal. Gov’t Code §§ 3500-3511.

²⁰ See GFOA, *General Purpose Checklist for [Comprehensive Annual Financial Report] Preparer*, available at <http://www.gfoa.org/downloads/GENERALPURPOSECHECKLIST.pdf>. See also GFOA, *Governmental Accounting, Auditing, and Financial Reporting Practices (1983, 1997, and 2006) (CAAFR)*, available at http://www.gfoa.org/index.php?option=com_content&task=view&id=1461, and GFOA, *Web Site Presentation of Official Financial Documents (2009)*, available at http://www.gfoa.org/index.php?option=com_content&task=view&id=1472.

²¹ See GFOA Advisory, *Responsible Management and Design Practices for Defined Benefit Pension Plans (2010)*, available at http://www.gfoa.org/index.php?option=com_content&task=view&id=1665.

²² See, for example, Cal. Gov’t Code §§ 21310 and following (cost of living provisions for CalPERS).

²³ See GFOA, *Developing a Policy for Retirement Plan Design Options (1999, 2007) (CORBA)*, available at http://www.gfoa.org/index.php?option=com_content&task=view&id=1608.

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- ²⁴ See GFOA, Essential Design Elements of Defined Benefit Retirement Plans (2008) (CORBA), available at http://www.gfoa.org/index.php?option=com_content&task=view&id=1611; Sustainable Funding Practices of Defined Benefit Pension Plans (1994, 2005, 2008 and 2009), available at http://www.gfoa.org/index.php?option=com_content&task=view&id=1627; Responsible Management and Design Practices for Defined Benefit Pension Plans (2010), available at http://www.gfoa.org/index.php?option=com_content&task=view&id=1665.
- ²⁵ *CalPERS Toolkit* at 11 and 14.
- ²⁶ See GFOA, Developing a Policy for Retirement Plan Design Options (1999, 2007) (CORBA), available at http://www.gfoa.org/index.php?option=com_content&task=view&id=1608.
- ²⁷ See GFOA, Essential Design Elements of Defined Contribution Plans as the Primary Retirement Plan (2008), available at <http://www.gfoa.org/downloads/DCPlansFINAL.pdf>.
- ²⁸ See Cal. Gov't Code §§ 21154-21176 (PERS), §§ 31720-31755.3 (1937 Act County Systems).
- ²⁹ Cal. Const. Art. XVI, § 17(c). See also Cal. Gov't Code §53216.6(b).
- ³⁰ See *SACRS Glossary* at 280.
- ³¹ See *SACRS Glossary* at 288.
- ³² California Education Code §§22950 and 22951
- ³³ See *SACRS Glossary* at 275-294.
- ³⁴ CalPERS Compensation Review, available at <http://www.calpers.ca.gov/eip-docs/employer/er-forms-pubs/pubs/manuals/pa-ret-manual/pm-compensation-review.pdf>
- ³⁵ See, for example, Cal. Gov't Code § 20691. See also 2 Cal. Code of Regs §569.
- ³⁶ SB 400, Chapter 555 of the Statutes of 1999, amended Government Code Sections 20391, 20392, 20393, 20395, 20397, 20398, 20405.1, 20405.3, 20407, 20409, 20677, 20683, 20687, 20822, 21070, 21071, 21072, 21073, 21073.5, 21077, 21130, 21337, 21353, 21353.5, 21362, 21363, 21363.5, 21369, 21372, 21373, 21374, 21403, 21407, 21572, 21573, and 21581; it added Government Code Sections 20035.5, 21070.5, 21070.6, 21073.1, 21073.7, 21251.13, 21328, 21354.1, 21362.2, 21363.1, and 21369.1; and repealed Government Code Sections 21363.6 and 21573.5; and added and repealed Government Code Section 21574.7. The bill is available online at http://info.sen.ca.gov/pub/99-00/bill/sen/sb_0351-0400/sb_400_bill_19990929_chaptered.html.
- ³⁷ AB 616, Chapter 782 of the Statutes of 2001, amended Government Code Sections 20677 and 31621.11; added Government Code Sections 21354.3, 21354.4, 21354.5, 31621.8, 31676.17, 31676.18, 31676.19, and 31808.9. It is available online at http://info.sen.ca.gov/pub/01-02/bill/asm/ab_0601-0650/ab_616_bill_20011013_chaptered.html.
- ³⁸ CalPERS On-line Glossary. Available online <http://www.calpers.ca.gov/index.jsp?bc=/utilities/glossary/home.xml#eg>
- ³⁹ See CalPERS Glossary, available at <http://webcache.googleusercontent.com/search?q=cache:LQCClmlt3ikJ:www.calpers.ca.gov/index.jsp%3Fbc%3D%2Futilities%2Fglossary%2Fhome.xml+calpers+and+%22excess+assets%22&cd=2&hl=en&ct=clnk&gl=us>.
- ⁴⁰ See *Hittle v. Santa Barbara County Employees Retirement*, 39 Cal. 3d 374, 392-93, 216 Cal. Rptr. 733, 743-44 (1985) (noting the fiduciary relationship between retirement system boards and participants).
- ⁴¹ Cal. Const. Art. XVI, § 17(b). See also Cal. Gov't Code §53216.6.
- ⁴² Cal. Const. Art. XVI, § 17(b).
- ⁴³ *SACRS Glossary* at 280.
- ⁴⁴ GFOA Best Practices Sustainable Funding Practices of Defined Benefit Pension Plans http://www.gfoa.org/index.php?option=com_content&task=view&id=1627
- ⁴⁵ GFOA Best Practices Sustainable Funding Practices of Defined Benefit Pension Plans http://www.gfoa.org/index.php?option=com_content&task=view&id=1627
- ⁴⁶ GFOA Best Practices Sustainable Funding Practices of Defined Benefit Pension Plans http://www.gfoa.org/index.php?option=com_content&task=view&id=1627
- ⁴⁷ Government Accountability Office, State and Local Government Pension Plans: Governance Practices and Long-term Investment Strategies Have Evolved Gradually as Plans Take On Increased Investment Risk (August 2010). Available at <http://www.gao.gov/new.items/d10754.pdf>

⁴⁸ Government Accountability Office, State and Local Government Pension Plans: Governance Practices and Long-term Investment Strategies Have Evolved Gradually as Plans Take On Increased Investment Risk (August 2010). Available at <http://www.gao.gov/new.items/d10754.pdf>

⁴⁹ Governmental Accounting Standards Board (GASB) Summary of Statement No. 45 *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* (Issued 6/04), available at <http://www.gasb.org/st/summary/gstsm45.html>; Governmental Accounting Standards Board (GASB) Summary of Statement No. 43 *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans* (Issued 4/04), available at <http://www.gasb.org/st/summary/gstsm43.html>. See also GASB 43 and 45 Resource Center: <http://www.gasb.org/jsp/GASB/Page/GASBSectionPage&cid=1175804831062>.

⁵⁰ Governmental Accounting Standards Board (GASB) Summary of Statement No. 45 *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* (Issued 6/04).

⁵¹ Governmental Accounting Standards Board (GASB) Summary of Statement No. 50 *Pension Disclosures—An Amendment of GASB Statements No. 25 and No. 27* (Issued 05/07), available at <http://www.gasb.org/st/summary/gstsm50.html>.

⁵² Governmental Accounting Standards Board (GASB) Summary of Statements No. 63 and 64 (Issued 7/11), available at http://gasb.org/cs/ContentServer?site=GASB&c=GASBContent_C&pagename=GASB%2FGASBContent_C%2FGASBNewsPage&cid=1176158736377

⁵³ See About GFOA, http://www.gfoa.org/index.php?option=com_content&task=view&id=76&Itemid=96.

⁵⁴ See, for example, GFOA, *Essential Design Elements of Hybrid Retirement Plans*, (2008), available at <http://www.gfoa.org/downloads/HybridPlansFINAL.pdf>

⁵⁵ Cal. Const. Art. XVI, § 17(d). See also Cal. Gov't Code §53216.6(c).

⁵⁶ GFOA, *Endorsing a Framework for Understanding Pension Fund Risk* (2001), available at http://www.gfoa.org/index.php?option=com_content&task=view&id=1609. The *Government Finance Officers Association* has issued a number of checklist and recommended practices for investment policies and choosing investment advisors. GFOA, *Investment Policies Governing Assets in a Deferred Compensation Plan* (2004), available at http://www.gfoa.org/index.php?option=com_content&task=view&id=1620, and Checklist, available at <http://www.gfoa.org/downloads/InvestmentPolicyChecklistforDCPlans.pdf>; *Pension Investment Policies* (2003), available at http://www.gfoa.org/index.php?option=com_content&task=view&id=1623, and Checklist available at <http://www.gfoa.org/downloads/PIPchecklist6.pdf>, *Public Employee Retirement System Investments* (1993, 1995, 1997 and 2009), available at http://www.gfoa.org/index.php?option=com_content&task=view&id=1624; GFOA Advisory, *Selection of Investment Advisers for Pension Fund Assets* (2000) (CORBA), available at http://www.gfoa.org/index.php?option=com_content&task=view&id=1666.

⁵⁷ *CalPERS Toolkit* at 17.

⁵⁸ *SACRS Glossary* at 282

⁵⁹ Cal. Gov't Code §§ 3500-3511.

⁶⁰ *CalPERS State Member Benefits* (February 2002) available at http://www.calstatela.edu/univ/hrm/docs/CalPERS_55.pdf

⁶¹ Cal. Gov't Code § 20000-2170.

⁶² The *Government Finance Officers Association* offers a set of recommended best practices relating to funding these benefits as well as a set of cautions concerning the use of bonds to finance them. GFOA, *Considerations for Prefunding OPEB Obligations* (2008) (BUDGET and CORBA), available at http://www.gfoa.org/index.php?option=com_content&task=view&id=1551. *Ensuring the Sustainability of Other Postemployment Benefits* (2007) (CORBA & BUDGET), available at http://www.gfoa.org/index.php?option=com_content&task=view&id=1610.

⁶³ *SACRS Glossary* at 285.

⁶⁴ *CalPERS Toolkit* at 20.

⁶⁵ OECD, *Private Pension: OECD Classification and Glossary* (2005) at 47.

⁶⁶ The *Government Finance Officers Association* has issued recommendations on the analytic factors that should be evaluated before an agency decides to issue pension obligation bonds. GFOA Advisory, *Evaluating the Use of*

Pension Obligation Bonds (1997 and 2005) (DEBT & CORBA), available at http://www.gfoa.org/index.php?option=com_content&task=view&id=1655.

⁶⁷ *SACRS Glossary* at 287.

⁶⁸ Cal. Gov't Code §20000-2170.

⁶⁹ Cal. Gov't Code § 31450 and following, which authorizes counties to create and operate retirement systems for county and other local agency employees. Twenty California counties operate retirement systems under the 1937 Act.

⁷⁰ *See generally*, Cal. Educ. Code § 22000 and following, available at

http://www.calstrs.com/Help/forms_publications/printed/TeachersRetirementLaw.pdf.

⁷¹ *See, for example*, Cal. Gov't Code § 20636; 2 Cal. Code of Regs. § 571(a) and (b); CalPERS Compensation Review, available at <http://www.calpers.ca.gov/eip-docs/employer/er-forms-pubs/pubs/manuals/pa-ret-manual/pm-compensation-review.pdf>.

⁷² Government Accountability Office, *State and Local Government Pension Plans: Governance Practices and Long-term Investment Strategies Have Evolved Gradually as Plans Take On Increased Investment Risk* (August 2010), available at <http://www.gao.gov/new.items/d10754.pdf>.

⁷³ GFOA, *Governance of Public Employee Post-Retirement Benefits Systems* (2010) (CORBA), available at http://www.gfoa.org/index.php?option=com_content&task=view&id=1628.

⁷⁴ *SACRS Glossary* at 285.

⁷⁵ Cal. Gov't Code §20000-2170

⁷⁶ GFOA, *Best Practices Sustainable Funding Practices of Defined Benefit Pension Plans*, available at http://www.gfoa.org/index.php?option=com_content&task=view&id=1627.

⁷⁷ GFOA, *Best Practices Sustainable Funding Practices of Defined Benefit Pension Plans*, available at http://www.gfoa.org/index.php?option=com_content&task=view&id=1627.

⁷⁸ GFOA, *Best Practices Sustainable Funding Practices of Defined Benefit Pension Plans*, available at http://www.gfoa.org/index.php?option=com_content&task=view&id=1627.

⁷⁹ *Considerations for Prefunding OPEB Obligations* (2008) (BUDGET and CORBA), available at http://www.gfoa.org/index.php?option=com_content&task=view&id=1551.

⁸⁰ Cal. Gov't Code § 22751-22948.

⁸¹ Cal. Gov't Code §6250-6270 (known as the California Public Records Act).

⁸² *Sacramento County Employees' Retirement System (SCERS) v. Superior Court*, 195 Cal. App. 4th 440 (2011).

⁸³ Specifically Internal Revenue Code Section 401(a), 26 U.S.C. § 401(a), and the Employee Retirement Income Security Act of 1974 (ERISA). Portions of ERISA are codified in various places of the United States Code, including 29 U.S.C. ch.18, and 26 U.S.C §§ 219, 408 (relating to the Individual Retirement Account), 410- 415, 4971, 4974, 4975.

⁸⁴ *CalPERS Toolkit* at 15. *See also* CalPERS, *When You Change Retirement Systems*, available at https://www.calpers.ca.gov/mss-publication/pdf/x3tUNJH0WDfG_pub16-booklet.pdf.

⁸⁵ *See* 26 U.S.C. § 415(b).

⁸⁶ *CalPERS IRC Section 415 & CalPERS Replacement Benefit Plan Fact Sheet*, available at <http://www.calpers.ca.gov/eip-docs/about/pubs/member/general/miscellaneous-information/internal-revenue-code-section415.pdf>

⁸⁷ *CalPERS IRC Section 415 & CalPERS Replacement Benefit Plan Fact Sheet*, available at <http://www.calpers.ca.gov/eip-docs/about/pubs/member/general/miscellaneous-information/internal-revenue-code-section415.pdf>

⁸⁸ AB 1184, introduced during the 2011-12 California Legislative Session.

⁸⁹ *See* Cal. Gov't Code § 20012.

⁹⁰ *See* Cal. Gov't Code § 21221(h) (annuitant cannot work more than 960 hours in any fiscal year, *and* an appointment under this section may not exceed 12 months total; governing body resolution required to “appoint” the annuitant); § 21224 (annuitant may provide specialized skills for a limited duration as long as the hourly rate paid is the same as paid by the employer to other employees performing the same or comparable duties; no governing body resolution required, annuitant is limited to 960 hours in a fiscal year, and position is supposed to be of “limited duration”).

⁹¹ Cal. Const. Art. XVI, § 17(h).

⁹² Cal. Const. Art. XVI, § 17(a).

⁹³ Cal. Const. Art. XVI, § 17(a).

⁹⁴ Cal. Const. Art. XVI, § 17(f).

⁹⁵ *CalPERS Toolkit* at 18.

⁹⁶ *CalPERS Toolkit* at 20.

⁹⁷ See Cal. Gov't Code § 20420 (CalPERS); *SACRS Glossary* at 275-294.

⁹⁸ The *Government Finance Officers Association* has a set of recommendations on creating multi-tier systems. See GFOA, *Designing and Implementing Sustainable Pension Benefit Tiers* (2011), available at http://www.gfoa.org/index.php?option=com_content&task=view&id=1887.

⁹⁹ *CalPERS Toolkit* at 15.

¹⁰⁰ *SACRS Glossary* at 287.

¹⁰¹ See <http://www.calstrs.com/About%20CalSTRS/Teachers%20Retirement%20Board/index.aspx>.

¹⁰² *SACRS Glossary* at 288.

¹⁰³ Cal. Const. Art. XVI, § 17(a). See also Cal. Gov't Code § 53216.6.

¹⁰⁴ *SACRS Glossary* at 288.

¹⁰⁵ Government Accountability Office, *State and Local Government Pension Plans: Governance Practices and Long-term Investment Strategies Have Evolved Gradually as Plans Take On Increased Investment Risk* (August 2010), available at <http://www.gao.gov/new.items/d10754.pdf>.

¹⁰⁶ CalPERS. (2008). *Refund Rollover Election*, available at https://www.calpers.ca.gov/mss-publication/pdf/xtA7O21Bave73_refund_rollover_election.pdf

¹⁰⁷ *CalPERS Toolkit* at 15; *SACRS Glossary* at 288.

¹⁰⁸ See CalPERS (2008). *Refund Tax Information*, available at https://www.calpers.ca.gov/mss-publication/pdf/xtA7O21Bave73_refund_rollover_election.pdf.

¹⁰⁹ *Kern v. Long Beach*, 29 Cal. 2d 848 (1947) and *Allen v. City of Long Beach*, 45 Cal. 2d 128 (1955).

¹¹⁰ *Packer v. Board of Retirement*, 35 Cal. 2d 212 (1950).

¹¹¹ CalPERS. (July 2011). *Vested Rights of CalPERS Members: Protecting the pension promises made to the public employees*, available at <http://www.calpers.ca.gov/eip-docs/about/press/news/vested-rights.pdf>.



AGENDA NO: C1
MEETING DATE: February 11, 2020

Staff Report

TO: Honorable Mayor and City Council **DATE:** February 4, 2020
FROM: Jennifer Callaway, Finance Director
SUBJECT: Presentation and Discussion of the Fiscal Year 2018/19 Comprehensive Annual Financial Report and recommendation to pay-off CalPERS liabilities for the Tier II and Tier III Unfunded Liabilities.

RECOMMENDATION

1. Council receive and provide feedback on the FY 2018/19 Comprehensive Annual Financial Report (CAFR) for the period July 1, 2018 through June 30, 2019; and
2. Adopt Resolution No. 12-20 approving allocation of \$486,504 in FY 2018/19 year-end revenues over expenditures to pay off the Tier II and Tier III (PEPRA) unfunded accrued liabilities for the Police, Fire and Miscellaneous classifications.

BACKGROUND

In the City's continued effort for increased transparency and fiscal accountability, in 2015 the City issued a Request for Proposal (RFP) for auditing services and the Pun Group was the selected as the most responsive proposer. The City entered into agreement with the Pun Group to perform auditing services for the fiscal years ending June 30, 2015, 2016, 2017 and 2018, with the option to renew for two additional fiscal years (2019 through 2020). The Auditors were onsite in October 2019 to review expenditures, revenues, contracts and general accounting processes for both accuracy and internal controls (fraud prevention). After the audit team collected its information, the issues discovered, if any, are presented as audit findings in the attached Comprehensive Annual Financial Report (CAFR). The City received no audit findings for FY 2018/19.

DISCUSSION

The Pun Group issued a Report on Internal Control Related Matters Identified in the Audit which highlights that the one outstanding Audit Finding from FY 2016/17 related to Accounting Policies and Procedures has been implemented and considered closed. Staff is pleased to report that there are no new findings for FY 2018/19.

Highlights of the CAFR results include:

Independent Auditor's Report (Financial Section Tab, page 1 last paragraph)

The auditors have given the City's financial statements a "clean" audit opinion for the year ended June 30, 2019, giving reasonable assurance that the financial statements are presented "fairly, in all material respects..."

Management's Discussion and Analysis (MD&A) (pages 5 through 15)

Page 5 of the CAFR begins the MD&A section of the report wherein summaries are presented

Prepared By: JC Dept Review: JC
City Manager Review: SC City Attorney Review: CFN
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for the City on an entity-wide basis. Information is provided in this section with a year-to-year view, explaining how fund balances have changed between fiscal years ending June 30, 2018 and June 30, 2019. Information is also presented on the adopted General Fund budget to actuals.

Statement of Net Position (page 20)

The Statement of Net Position serves as a useful indicator of a government's financial position. The City's government activities net position is \$115.3 million at fiscal year-end as compared to \$115.8 million the prior year, an overall decrease of \$500K over the prior fiscal year.

The City's business-type activities increased from \$32.8 million to \$38.7 million, an increase of \$5.9 million. The increase is largely attributable to the collection of utility service charges to fund construction of the City's new Water Reclamation Facility.

The largest portion of the net assets, \$119.9 million, represents the City's investment in its capital assets and infrastructure. Restricted assets of \$4.9 million are resources that are subject to external restrictions on how they may be used. As of June 30, 2019, net position of Government activities totaled \$115.3 million

Basic Financial Statements (pages 17 through 86, including footnotes)

This section contains basic financial statements, including the "Government-Wide" statement of Net Position and Statement of Activities, financial statements for the fund types including Governmental Funds, Proprietary Funds and Fiduciary Funds.

The footnotes section provides details on significant items such as the City's cash and investments (note 2 beginning on page 61), its long term obligations related to loan payables, pension related debt and compensated absences (note 7 page 68), the net pension liability for both the City's miscellaneous, Fire safety and Police safety pension plans (note 8 on page 71), and a discussion of the City's other post-employment benefit plans (note 9 on page 78).

Required Supplementary Information (pages 87 through 93)

The schedules of Budgetary Comparison Schedules and Pension Plan Contributions are provided in this section.

Supplementary Information (pages 95 through 133)

This section provides budget to actual information for "non-major" funds which represent less than 10% of the City's total assets/liabilities/revenues or expenditures.

Statistical Section (pages 135 through 185)

This section presents demographic statistics and ten-year historical financial data for the City, including information on assessed valuations, fund balances, debt, property tax rates, personnel (full-time equivalent) history, principle employers, and other financial and demographic disclosures.

General Fund Year-End Revenues Over Expenditures

Through prudent spending and receipt of higher than expected property tax, sales tax, and Transient Occupancy Tax revenues, the City's General Fund closed FY 2108/19 with \$727,820 of revenues over expenditures. This savings is largely attributable to personnel savings due to vacancies, lower than expected legal fees and other contractual services costs. Lastly, approximately \$167,000 of the savings was due to the early payment of the City's Fire Safety Side fund (CalPERS) in FY 2017/18. Staff expected this CalPERS savings for FY 2018/19 with funds due back to the General Fund Emergency Reserve which funded the prepayment. The vacancies that contributed to this savings have currently been filled and we do not anticipate significant savings for FY 2019/20 at this time.

Staff recommends that the City Council adopt resolution No. 12-20 to appropriate \$486,504 from the FY 2018/19 year-end savings to pay off the unfunded liabilities for the City's Tier II and Tier III-PEPRA (Public Employee Pension Reform Act) CalPERS retirements formulas for the Miscellaneous, Fire and Police plans. The payments are broken down as follows:

Classification	Tier II UAL	Tier III UAL	Tier II Interest Savings	Tier III Interest Savings
Fire	\$ 49,270	\$ 27,881	\$ 20,020	\$ 5,224
Police	\$ 174,554	\$ 54,194	\$ 96,856	\$ 10,154
Miscellaneous	\$ 102,759	\$ 77,846	\$ 19,254	\$ 8,477
Total by Tier	\$ 326,583	\$ 159,921	\$ 136,130	\$ 23,855
Total	\$ 486,504		\$ 159,985	

There are three benefits to payoff of these unfunded liabilities which are as follows:

1. Result in a savings to the City of approximately \$160,000 in total interest that the City will not have to pay over the next two to eleven years (depending on the retirement plan).
2. This will help to prevent the Tier II and PEPRA formulas from accruing significantly larger unfunded liabilities (as has occurred with the Tier I formulas), saving the city money in the long-term and proactively managing liabilities.
3. Prepayment will result in reduced expenditures for FY 2020/21 of approximately \$100,000 which will assist in budget balancing efforts.

It should be noted that City staff will be recommending that the General Fund year-end revenues over expenditures be used to pay off the unfunded accrued liabilities for all City employees, including employees funded in the Utilities, Harbor and Transit enterprise funds. This will yield savings to the enterprise funds over the next two to eleven years which translates to reduced operating costs for enterprise fund customers.

By policy, the City's General Fund Emergency Reserve is to maintain a target funding level of 28% of annual, on-going operating expenditures based on the most recent adopted budget and a minimum target funding level of 25% of annual on-going operating expenditures based on the most recent adopted budget.

Based on the adopted FY 2019/20 adopted budget, the City's target and minimum funding levels for the General Fund Emergency Reserve are outlined below:

FY 2019/20 Adopted Budget (on-going expenditures)	\$ 13,682,443
GFER Target Funding Level - 28%	\$ 3,831,084
GFER Minimum Funding Level - 25%	\$ 3,420,611

The General Fund Emergency Reserve (GFER) balance as of 6/30/2019 (including the \$727,820 in FY 2018/19 revenues over expenditures) totals \$3,808,577. With staff's recommendation to allocate \$486,504 of the GFER balance to prepay the Tier II and Tier III UAL's for the Police, Safety and Miscellaneous classifications, the GFER balance would fall below the minimum funding level as outlined below:

GFER Funding Level 6/30/2019	\$ 3,808,577
Use of \$486,504 for UAL Payoff	\$ (486,504.00)
GFER Funding Level 12/31/2019	\$ 3,322,073

However, per policy, Council has three years to bring the GFER balance within the minimum and target funding levels. The Measure Q fund owes the GFER \$168,750 for the City's Fire Engine purchase that occurred in FY 2018/19. This repayment was committed over the next three years (FY 2109/20 included). Therefore, when taking into account this commitment, the GFER would fall within the minimum funding level as outlined below:

FY 2019/20 Adopted Budget (on-going expenditures)	\$ 13,682,443
GFER Target Funding Level - 28%	\$ 3,831,084
GFER Minimum Funding Level - 25%	\$ 3,420,611
GFER Funding Level 6/30/2019	\$ 3,808,577
Use of \$486,504 for UAL Payoff	\$ (486,504.00)
GFER Funding Level 12/31/2019	\$ 3,322,073
Measure Q Fire Truck Payback to GFER	\$ 168,750
GFER Funding Level	\$ 3,490,823

Staff would also note that the Citizen's Finance Advisory Committee (CFAC) provided valuable feedback in response the draft FY 2018/19 CAFR, including several recommendations to improve the final CAFR. CFAC formed a subcommittee to review the CAFR and Staff appreciates this thorough review and collaboration to make the City's CAFR the best reflection the city. The Subcommittee's report is provided as Attachment 2 for Council review.

Once again, the CAFR was submitted for consideration of the Government Finance Officers Association (GFOA) Award for excellence in Financial Reporting.

CONCLUSION

Kenneth Pun from The Pun Group will present the FY 2018/19 audit reports to the City Council. There are six reports in total as follows:

- City's 2018/19 Comprehensive Annual Financial Report
- Report on Internal Controls
- Communication Letter
- Transit Audit
- Bike Pathways Audit
- Roads Audit

Documents Available for Review at City Hall and on the City Website:

1. [FY 2018/19 Comprehensive Annual Financial Report](#)
2. [Report on Internal Controls](#)
3. [Communication Letter](#)
4. [Transit Report](#)
5. [Bike Pathways Report](#)
6. [Roads Audit](#)

ATTACHMENTS

1. Resolution No. 12-20
2. CFAC Sub Committee Report
3. Staff Presentation

RESOLUTION NO. 12-20

RESOLUTION OF THE CITY COUNCIL
OF THE CITY OF MORRO BAY, CALIFORNIA,
APPROVING AMENDMENTS TO THE CITY'S FISCAL YEAR 19/20 BUDGET
TO AUTHORIZE USE OF FISCAL YEAR 18/19 REVENUES OVER EXPENDITURES TO PAY
OFF THE CITY'S TIER II AND TIER III CALPERS UNFUNDED ACCRUED LIABILITIES FOR THE
FIRE, POLICE AND MISCELLANEOUS RETIREMENT CLASSIFICATIONS

THE CITY COUNCIL
City of Morro Bay, California

WHEREAS, the City closed Fiscal Year (FY) 18/19 with \$727,820 in year end revenues over expenditures; and

WHEREAS, the City Council has prioritized fiscal sustainability and addressing the City's CalPERS pension issue; and

WHEREAS, the City staff recommends that the City Council appropriate \$486,504 from the FY 18/19 year-end revenues over expenditures to pay off the City's Tier II and Tier III CalPERS unfunded accrued liabilities for the City's Fire, Police and Miscellaneous classifications; and

WHEREAS, the pay-off of the City's unfunded liabilities for Tier II and Tier III Fire, Police and Miscellaneous classifications will result in interest savings of \$160,000 over the next two to eleven years; and

WHEREAS, pay-off of the City's unfunded liabilities for Tier II and Tier III Fire, Police and Miscellaneous classifications will prevent the Tier II and Tier III formulas from accruing significantly larger unfunded liabilities such as has occurred with the Tier I formulas, saving the City money in the long-term and proactively managing liabilities; and

NOW, THEREFORE, BE IT RESOLVED by the City Council of the City of Morro Bay, California, amend the operating budget of the City, by the additional revenues over expenditures from FY 18/19 of \$486,504, to pay-off the City's Tier II and Tier III CalPERS unfunded liabilities for the City's Fire, Police and Miscellaneous pension plans.

PASSED AND ADOPTED by the City Council of the City of Morro Bay, at a regular meeting thereof held on the 11th day of February 2020, by the following vote:

AYES: Heading, Addis, Davis, Heller, McPherson
NOES: None
ABSENT: None



John Heading, Mayor

ATTEST:



Dana Swanson, City Clerk