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Date: October 28, 2015

To: Board of Directors

From: Paige Meyer, Fire Chief
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Subject: Adoption of Other Post-Employment Benefits (OPEB) Funding Policy and Revision of Fund Balance/Reserve Policy

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OPEB Funding Policy

The purpose of this OPEB Funding Policy (OPEB Policy) is to incorporate the District's current funding strategy for retiree medical benefits into a formal Board approved policy, as well as provide for additional contributions to the OPEB trust fund beyond the annual required contributions (ARC) if financial conditions warrant. The OPEB Policy is intended to reflect a reasonable, conservative approach to funding retiree medical benefits which, to the greatest extent possible, funds the cost of the benefits as they are earned and ensures funds are available to pay benefits when an employee retires. In essence, the OPEB funding policy would mirror the manner in which the District funds retirement benefits administered by CCCERA. The additional payment beyond the ARC is intended to accelerate the pay down of the unfunded OPEB liability.

The 2015-16 budget included full funding of the ARC in the amount of $5.5 million; part of which is offset by contributions from current employees and retirees equivalent to 8% of their monthly medical premiums. The proposed OPEB funding policy would limit such contributions to active employees only.

Fund Balance/Reserve Policy

The Fund Balance and Reserve Policy serves to strengthen the long-term fiscal stability of the District. The existing policy is made up of two components:

> *Dry Period Funding* – maintaining a minimum reserve requirement of 50% of General Fund revenues to cover the timeframe from April property tax payments to December property tax payments.
>
> *Budget Stabilization Fund* – operational reserve of 20% of General Fund expenses to withstand unanticipated revenue declines or expenditure increases, as well as an unanticipated capital expenditure; plus a contingency for future payments

related to open claims under the District's self-insured workers' compensation program.

Staff recommends the workers' compensation reserve amount be increased from $1,000,000 to $3,000,000 based on an independent, actuarial review of the District's self-insured workers' compensation program, which estimated the discounted present value of future expected loss costs at June 30, 2015 to be $4,100,000.

Recommended Board Action:

Staff recommends the Board adopt the Other Post-Employment Benefits (OPEB) Funding Policy and the revision to the Fund Balance/Reserve Policy providing an additional $2,000,000 to the workers' compensation reserve amount.

Financial Impacts:

This action would further strengthen the long-term fiscal stability of the District without impacting current operations.

Attachments: Other Post-Employment Benefits (OPEB) Funding Policy
Revised Fund Balance/Reserve Policy

**DISTRICT – POLICY AND PROCEDURE**

**OTHER POST EMPLOYMENT BENEFITS (OPEB) FUNDING POLICY**

## INTRODUCTION

The purpose of this OPEB Funding Policy ("Policy") is to establish a methodology for funding current and future costs associated with the District's contractual obligation to provide retiree medical benefits as set forth in District labor agreements. It is anticipated that current assets, plus future assets from employer contributions, employee contributions, and investment earnings will be sufficient to fund the retiree medical benefits when due. The Policy is intended to reflect a reasonable, conservative approach to funding which, to the greatest extent possible, funds the cost of the benefits as they are earned. This Policy recognizes that there will be investment market place volatility and that actual economic and demographic experience will differ from assumed experience. Accordingly, this Policy is intended to provide flexibility to smooth such volatility and experience in a reasonable, systematic, and financially sound manner. Further, it is the intent that this Policy comply with Governmental Accounting Standard No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions ("GASB 45").*

It is the policy of the Board that the OPEB liability associated with retiree medical benefits, along with the annual contributions required to both fully fund the cost of retiree medical benefits as they are earned on a going forward basis and fully amortize any unfunded liability, be determined through an actuarial valuation, performed biannually, in accordance with GASB 45. This annual funding concept is the same as that utilized to fund CCCERA pension obligations on an ongoing basis.

## NORMAL COSTS

The District incurs an annual OPEB retirement obligation for current employees. The on-going service cost for retiree medical benefits earned by current employees during the current year is referred to as the "normal" cost. In order to keep the District's OPEB obligations current, the normal cost for service will be paid for on an annual basis and included as part of the overall District budget. The payment of these funds will be made to the OPEB retirement trust fund.

## UNFUNDED ACTUARIAL ACCRUED LIABILITY (UAAL)

The actuarial valuation calculates an Unfunded Actuarial Accrued Liability (UAAL) as of the valuation date. The UAAL represents the difference between OPEB assets available in the trust fund and the OPEB liability related to prior employment service for former and existing employees. The UAAL (or funding shortfall) is amortized as a level dollar amount over a closed period (23 years as of July 1, 2015), and is also paid annually along with the normal cost into the OPEB retirement trust fund.

Also, the assumptions used in the actuarial valuations may vary from actual results. Significant assumptions include the discount rate (or assumed annual investment earnings rate; currently 7.25%) and health care costs increases ranging from 8.5% in 2015 to 4.50% in 2024 and beyond. To the extent these assumptions vary from the actual results, the District could incur additional liabilities resulting from these differences.

**ANNUAL REQUIRED CONTRIBUTIONS (ARC)**

The annual required contributions (ARC) to fund retiree medical benefits, as determined by the actuarial valuation, reflect the normal costs plus amortization of the UAAL, until such time as the UAAL is fully amortized.

Active employees have agreed to contribute toward the cost of medical benefits through a monthly, pre-tax payroll deduction. In exchange, the District has committed to use such amount paid by employees to help fund the District's obligation to provide retiree medical benefits. It is the District's policy, through a combination of employee and District contributions, to fully fund the annual ARC into an irrevocable trust fund.

**ADDITIONAL CONTRIBUTION**

If financial conditions warrant, and until such time as the UAAL is fully amortized, it is the District's policy to make an additional contribution to the OPEB trust fund to further pay down the UAAL. When the General Fund budget projects an operating surplus (i.e., operating revenues exceed expenditures and transfers), the Districts shall make an additional contribution into the OPEB trust fund equal to 10% of the projected surplus amount, but not to exceed $200,000 during the budget year.

**INVESTMENT/TRUST VEHICLE**

In order to maximize the earnings rate of the OPEB deposits, the District will utilize an irrevocable trust fund. Once the funds are invested into the trust, they can only be used to fund ongoing OPEB retirement obligations.

The Board of Directors approved using the California Employers' Retiree Benefits Trust (CERBT), which is managed by CalPERS. From time to time, the Board may evaluate this trust advisor/organization to determine if the service and safety goals are being met for these funds.

## DISTRICT – POLICY AND PROCEDURE

## FUND BALANCE/RESERVE POLICY

### INTRODUCTION

Responsible financial practices necessitate adoption of specific procedures for reporting fund balance classifications, minimum reserve requirements and hierarchy of fund balance expenditures in conformance with Governmental Accounting Standards Board guidelines.

### PURPOSE

To provide procedures for reporting fund balance classifications, establish prudent reserve requirements, and establish a hierarchy of fund balance expenditures.

### DEFINITIONS

Fund balance - The difference between assets and liabilities.

Dry Period Funding – 50% of the operating revenues (excluding grant and one-time revenues) in the General Fund at fiscal year-end.

Budget Stabilization Fund – 20% of General Fund operating expenditures (excluding capital contributions) and debt service expenditures; plus a contingency for future payments related to open claims under the District's self-insured workers' compensation program.

### POLICY

The District will report fund balance in accordance with Governmental Accounting Standards Board Statement No. 54. The following five components will be used:

1. *Non-Spendable Fund Balance* – Fund Balance amounts set aside for items that do not represent available, spendable resources such as prepaid expenses or inventory amounts.
2. *Restricted Fund Balance* - Fund Balance amounts that have external restrictions imposed by creditors, grantors, contributors, laws, regulations, or enabling legislation which requires the funds to be used only for a specific purpose.
3. *Committed Fund Balance* - Fund Balance amounts that have constraints imposed by formal action of the Board. Once adopted, the limitation imposed by the resolution remains in place until a similar action is taken (the adoption of another resolution) to remove or reverse the limitation.
4. *Assigned Fund Balance* - Fund Balance amounts that are constrained by the

District's intent to be used for a specific purpose, but are neither restricted nor committed.

5. *Unassigned Fund Balance* - represents residual amounts that have not been restricted, committed or assigned.

The District will maintain in the General Fund at fiscal year-end a Dry Period Funding balance equivalent to at least 50% of General Fund operating revenues, excluding grant and other one-time revenues, for the current fiscal year. Such amount establishes the minimum Fund Balance for the General Fund.

The District will maintain a Budget Stabilization Fund separate from the General Fund with a minimum Fund Balance equivalent to 20% of General Fund operating expenditures (excluding capital contributions) and debt service expenditures, plus an amount equal to the District's excess workers' compensation insurance deductible (or self-insured retention; which is currently $1,000,000).

The District will report the following amounts as Committed Fund Balance at fiscal year- end:

1. *Dry Period Funding* – Fund Balance committed to covering operational costs during the "dry period" between the receipt of property taxes in April and the receipt of property taxes in December, when expenditures typically far outpace revenues. The amount will be equal to 50% of General Fund operating revenues (excluding grant and other one-time revenues, for the current fiscal year) and will be maintained in the General Fund.
2. *Workers' Compensation Claims* - Fund Balance committed to pay for catastrophic workers' compensation claims that exceed the District's regular workers' compensation expenditures or excess workers' compensation insurance deductible. The amount will be maintained in the Budget Stabilization Fund and is to be based upon the estimated liability for unpaid losses as determined by an independent actuarial review of the District's Self-Insured Workers' Compensation Program; with such amount currently set at $3,000,000.
3. *Budget Stabilization* – Fund Balance committed to provide a source of funds to mitigate the effects to the General Fund during a prolonged economic downturn or fund an unanticipated major expenditure, and can only be used pursuant to action taken by the Board of the Directors. The amount will be equal to 20% of General Fund operating expenditures (excluding capital contributions) and debt service expenditures for the current fiscal year, and will be maintained in the Budget Stabilization Fund.

The Fire Chief or Chief Financial Officer is designated to determine and define the amounts of those components of fund balance that are classified as "Assigned Fund Balance". The District will report the following amounts as Assigned Fund Balance:

1. *Budgetary Deficit* – Fund balance committed to pay for the subsequent year's budget deficit, if any. The amount is equal to the projected excess of budgeted expenditures over budgeted revenues by fund.
2. *Other Assigned Fund Balance* categories as determined by the Fire Chief or Chief Financial Officer.

The District considers restricted amounts to have been spent prior to unrestricted amounts when an expenditure is incurred for purposes for which both are available. Committed, assigned and unassigned amounts, in this order, are considered to be spent when an expenditure is incurred for purposes for which either is available.