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May 31, 2016

CONFIDENTIAL/ATTORNEY-CLIENT COMMUNICATION

Charlotte Addington
Sonoma County Grand Jury
P.O. Box 5109
Santa Rosa, CA 95402

RE: Public Library

Dear Ms. Addington:

I have reviewed the above-entitled Grand Jury Report and in my opinion it:

Does not contain defamatory material. *Brooks v. Binderup* (1995) 39 Cal.App.4th 1289;

Meets the witness secrecy requirements. *McClatchy Newspapers v. Superior Court* (1988) 44 Cal.3d 1162, 1172-1178;

Is within the subject matter and geographic jurisdiction of the Grand Jury. *People v. Superior Court* (1973 Grand Jury) (1975) 13 Cal.3d 430, 437-438; *Board of Trustees v. Leach* (1968) 258 Cal.App.2d 281, 285; and,

Meets the requirement that "raw evidentiary material" not be disclosed, except as authorized by statute. *McClatchy Newspapers v. Superior Court* (1988) 44 Cal.3d 1162, 1178-1183; *Daily Journal Corp. v. Superior Court* (1999) 20 Cal.4th 1117. Please note, the prohibition in McClatchy does not extend to selective paraphrasing of testimony in findings that do not disclose the identity of the witness nor does it extend to quoting statements from public documents.

Please let me know if you have any questions or would like to discuss this further.

Very truly yours,

Jeffrey L. Berk
Deputy County Counsel

JLB:ao
cc: Judge Raima Ballinger

Raina Ballenger
June 7, 2016

PUBLIC LIBRARY

SUMMARY

The Sonoma County Library (Library) is a joint venture between the County and major cities in the County. Public libraries have served the residents of Sonoma County for over one hundred years. The Library is considered an asset to the community and provides a wide variety of services. Recently, new management has assumed responsibility and has instituted improvements to the Library's management and governance structure.

The financial health of the Library, however, is a cause of great concern. It has accumulated a $17 million unfunded employee benefits liability. This has caused the net position (net worth) to go negative and has left the Library with liabilities exceeding assets by more than $4 million. This deficit consists principally of unfunded liabilities in funds for its pension benefits, its retiree health benefits and its compensated absences benefits.

Because the Library is not fully funding its current employee benefit costs, this problem continues to grow. Essentially the Library has been deficit-financing its current operations.

The Grand Jury recommends that the Library develop a prudent financial plan that covers the cost of operations as well as the accumulation of funds to pay for future benefit liabilities. This plan would match current spending to current revenue. Ideally, the liabilities would be reduced over time. Active efforts to identify new funding sources will be required.

GLOSSARY

Actuary: A business professional who analyzes the financial consequences of risk. Actuaries use probability, statistics, and financial theory to study uncertain events, especially those of concern to insurance and pension programs, and periodically issue actuarial reports projecting future liabilities and assets.

Amortization: The gradual write-off of an asset or liability. In the context of this report it refers to the write-down of unfunded liabilities for pension, health benefits, or compensated absences.

CalPERS: The State agency that administers most of the municipal, county, school and state pension programs.

Compensated Absences: A labor expense primarily pertaining to employee sick leave and other excused days. These terms are usually negotiated with labor unions.

JPA: A Joint Powers Authority is an entity permitted under California law whereby two or more public authorities may jointly exercise any power common to all. In the context

of this report, it refers to the consolidation of all separate Sonoma County libraries into a common organization.

MOU: A Memorandum of Understanding is typically an agreement between two or more parties. In the context of this report, MOU refers to the agreement between the Sonoma County Library and its employees'union.

Net Position: An accounting term used in governmental or not-for-profit accounting. Net position is the difference between total assets and total liabilities. In accounting for private organizations, this term is referred to as net worth.

OPEB: Other Post-Employment Benefits usually refers to both current and retired employee health benefits and compensated absences.

UAAL: Unfunded Actuarial Accrued Liability is an actuarial term that refers to the difference between the actuarial values of assets (AVA) and the actuarial accrued liabilities (AAL) of a plan. Essentially, the UAAL is the amount of retirement benefits owed to an employee in future years that exceeds current assets and their projected growth.

BACKGROUND

This is a self-initiated report. No specific complaints against the Sonoma County Library were received by the Grand Jury during the present term. The Grand Jury became aware of the Library's financial stresses after reviewing financial audits of Sonoma County's Independent Special Districts.

METHODOLOGY

The Grand Jury conducted interviews with the Sonoma County Library staff and representatives from the Sonoma County Library Commission. The Grand Jury also reviewed pertinent financial data, labor union MOU's and recent actuarial reports.

DISCUSSION

History of the Sonoma County Library

The Sonoma County Library, the fourteenth public library in California, is a free public library system established pursuant to the California Education Code. Since its creation in 1859, the Library has been successful in providing free library services including community education and literacy programs. Based on a 2012 Grand Jury recommendation, in 2014 cities in Sonoma County revised the JPA for the purpose of improving public library services. Currently, library services are provided through the Central Santa Rosa Library, eight regional libraries, and rural stations in Occidental and Forestville. Roseland, which is being annexed by Santa Rosa, also has a small library. In addition, Mendocino County's Bookmobile provides service for the far northwest corner of Sonoma County.

A countywide library system saves the public money by eliminating the need for administrative services at each library, while offering access to the resources of every library across the United States. The County and its cities provide the buildings that house libraries in their communities. Administratively the Library is organized as follows:

- The Library is governed by an independent eleven-member **Library Commission** as specified in the revised JPA. The City Councils of Cloverdale, Cotati, Healdsburg, Petaluma, Rohnert Park, Santa Rosa, Sebastopol, Sonoma, and Windsor, along with the Sonoma County Board of Supervisors, each appoint a Library Commissioner. The City of Santa Rosa and the Sonoma County Board of Supervisors also jointly appoint one additional Commissioner.
- Nine **Library Advisory Boards** serve as links to each branch library's community. They advocate for the Library in each community and advise the Library Commission and Library Director on ways to provide the best possible service.

Additional nonprofit groups that support the library system include:

- **Friends of the Library** groups support each of the nine regional libraries — raising funds and volunteering in the libraries.
- The **Sonoma County Public Library Foundation** raises funds for countywide library services.

The Library has nearly 200 employees to serve the people of Sonoma County. Patrons borrow over 2.5 million items a year, including books, e-books, audiobooks, CDs, DVDs and periodicals. The Library estimates that nearly half the County population has a library card. Reference librarians answer nearly a quarter of a million questions annually for individuals, businesses and government agencies. During the school year, hundreds of classes either visit a library or are visited by a children's librarian. The Library also operates an adult literacy program that trains volunteers to tutor individuals who lack basic reading skills.

Impending Financial Issues

Operating a library requires more than promoting literacy and providing a venue for media access and research. A successful library includes a business component that raises revenue and manages expenses to achieve financial stability. Balancing revenues with expenses is the hallmark of a well-run enterprise.

The Grand Jury found that the liabilities of the Library exceeded its assets, resulting in a negative net position. At the close of the most recent fiscal year this deficit was $4,558,443. Our investigation found that the deficit occurred due to the failure to adequately fund pension and health benefits in prior years. Current staff indicates that former management did not recognize the financial danger of allowing these liabilities to increase to current levels.

These liabilities are composed of three employee-related expenses that have been allowed to accrue without setting aside sufficient funds to pay for them in the future:

- **Compensated Absences (employee excused absences, funded by operating expenses as they incur):** *$ 803,935*
- **Net Pension Liability (annual cash payments by the Library to a pension plan and the earnings thereon):** *$ 9,378,768*
- **Net obligation for post-retirement health benefits (recently funded by a cash payment of $1.1 million):** *$ 6,661,872*

Total Unfunded Liabilities as of June 30, 2015 *$16,844,575*

Based on an Actuarial Valuation prepared for the Library, as of June 30, 2014, its pension plan had a present value of projected liabilities of $65,743,630, of which $49,239,539 was paid-up trust fund assets and $7,958,585 was unfunded liabilities. The Library's contribution to the plan was 15.919 percent of payroll and the employees' contribution was 6.99 percent of wages. The total annual payroll of employees covered by the plan was $7,532,252. The plan had 147 retired members, whose average age was 69.2 years and who received an average annual retirement benefit of $18,467. There were 148 active members, whose average age was 54.67 years and whose average annual wages were $50,894.

These liabilities (a form of debt) do not have to be paid immediately but are expected to be paid over the next twenty to twenty-five years, similar to a home mortgage. Unlike mortgage payments, these amounts can fluctuate because of changes in employee salaries, life expectancies, investment returns and other factors. Pension benefit payments start as the Library employees retire. These payments are not optional, and failing to pay them is a form of insolvency. Failing to set aside funds to pay these employee benefit liabilities as they are incurred is a form of debt financing. In a sense, the Library is funding some of its current operations with deficit spending. If this practice is allowed to continue, the unfunded liability grows. Evidence that the Library already finds itself in a cash bind can be seen in reduced operating hours and failed efforts to enact a County sales tax.

The Library's total unfunded liability of $16,844,575 is more than double its current annual payroll of $7,953,750, an amount equal to 2015's total revenue. Not only is this unfunded liability seriously high, it is increasing. In FY 2013-14, the Library's unfunded health benefits liabilities increased by more than $800,000. That deficiency improved in FY 2014-15, but the unfunded liability still increased by $230,000. Current Library plans are to contribute additional funds to narrow this gap. However, these plans are subject to funds being available after normal operational expenses are paid and thus have been considered discretionary by current management.

These financial difficulties are complicated by the fact that the average age of the Library's employees is fifty-four. This suggests that a large part of the staff will be retiring in the next ten to fifteen years, meaning they will no longer be contributing to the benefit plans but, instead, will be recipients of plan funds. This difficulty is not as severe in the pension fund because the existing trust fund currently provides 86 percent of future benefits.

The more serious problem is the unfunded retiree health care benefits. These stand at $6.6 million, against which there is only $1.1 million in reserves, invested with CalPERS, which represents only 16 percent of future benefits. Paying down this deficit will be difficult. Some of the more common approaches to reducing deficits are raising revenues, reducing expenses, and establishing and funding a trust fund. All options are effective and all are painful. The long-term goal should be clear: Do not increase the unfunded liabilities for the current year and begin to pay down long-term liabilities for the prior year's expenses. Simply put, pay your expenses as they are incurred.

Addressing the Fiscal Challenge

The Library has added to its staff a new Executive Director and a new Finance Director, both of whom appear to be bringing improved management practices to the Library. Further, the Library has taken some important steps to broaden its revenue base. Each "Friends" group conducts modest fund-raising activities, such as book and cake sales, for their respective library branches. In addition, a new Library Foundation Director has been charged with identifying significant additional funding. Finally, the Library Commission is in the process of forming a Revenue Generation Committee.

A tax increase remains an option. In 2014, an effort was made through an election to ask voters for a quarter-cent increase in the sales tax. The measure was narrowly defeated. Sales tax revenue is dependable, it can be predicted and it can produce a significant amount of increased revenue that can generally be devoted to any Library purpose. In addition, the Library can seek financial grants for specific needs. Grants tend to be onetime events and would need to be applied for repeatedly. As such, they would not be as dependable and flexible a source of funding as sales taxes.

While adding new revenue is part of any solution to the Library's fiscal challenge, controlling expenses is the flip side of good financial management. Unfortunately, the Grand Jury did not learn of any specific initiatives aimed at reducing expenses. It is important to note that 79 percent of the Library's operating expenses are employee-related. Thus, hiring policies have an outsized impact on annual budgets. Every time an employee is hired, not only is the employee's salary added to the expense structure, but also the retirement benefits (e.g., for pensions, health benefits and compensated absences) are increased.

Although identifying cost savings was beyond the scope of our investigation, we did note that the Library serves as the repository of Sonoma County's historical archives at its own expense. Furthermore, when any County agency needs to access documents from the archives, the Library delivers them free of charge. Considering the Library's financial situation, it may be more equitable for Sonoma County to pay for this service.

During our investigation we were unable to ascertain whether the Library management had recently conducted rigorous financial planning. Staff demonstrated awareness of the fiscal challenges confronting the Library but, as far as we could discern, did not have a carefully thought-out plan to get from deficit financing to adopting a budget which insures that expenses will be paid for as they are incurred. Financial planning is a necessary first step to a healthy financial structure. Creating a financial plan would permit management and Library Commissioners to establish operating priorities and corresponding budgets that maintain valued library services and begin to reduce unfunded liabilities.

FINDINGS

F1. The Library's pension fund appears to be stabilized and the Library is making current payments. However the unfunded liability is still excessive in relation to the Library's total revenue.

F2. The Library's OPEB (health and absences) obligation is seriously underfunded. The Library fails to completely fund its costs for current benefits as well as costs for its future unfunded liabilities.

F3. The $1.1 million fund for future OPEB costs, invested with CalPERS, does not appear in the Library's financial reports.

F4. New management is aware of the Library's financial difficulties and is developing new programs for revenue building. However, revenue for these programs will compete with Library operating needs as well as paying down unfunded liabilities.

RECOMMENDATIONS

The Grand Jury recommends that:

R1. Library management draft a business plan that projects future revenues and expenses and provides for liability reduction.

R2. The Library Commission review the current financial status at least quarterly to verify that the unfunded liability is decreasing, and annually report to the public on the progress being made towards solvency.

R3. The Library fund its current OPEB costs and not allow its unfunded liability to increase. Monies set aside for these benefits should be placed in a non-revocable trust fund similar to the one created for pension benefits.

R4. The Library allocate any new revenue to ensure that all the Library's current expenses are paid as they are incurred and that its pension and OPEB liabilities are not allowed to grow.

R5. The Library include a summary of its pension reform progress in the Management and Discussion Analysis section of its annual financial report. This summary should

discuss the identification of the OPEB, past and future contributions to the Health and Compensated Absences trust funds, and their status and change in value.

REQUIRED RESPONSES

Pursuant to Penal Code Section 933.05, the Grand Jury requires responses as follows:

- R1, R2, R3, R4, and R5: The Sonoma County Library Commission

BIBLIOGRAPHY

CalPERS Actuarial Valuation as of June 30, 2014 for the Miscellaneous Plan of the Sonoma County Library, (CalPERS ID: 6462278835) (Rate Plan ID: 1137)

Library Commission Regular Meeting Draft Minutes, January 11, 2016

Memorandum of Understanding between the Sonoma County Library and SEIU Local 1021, CTW, CLC 2013 - 2016

Required Contributions for Fiscal Year July 1, 2016 – June 30, 2017

Sonoma County Library Commission Bylaws, Revised January 2, 2016

Sonoma County Library Monthly Financial Report, December 2015

Sonoma County Library Basic Financial Statements, Year Ended June 30, 2015

Sonoma County Library Basic Financial Statements, Year Ended June 30, 2014

Sonoma County Library Strategic Plan 2015-2020

Reports issued by the Civil Grand Jury do not identify individuals interviewed. Penal Code Section 929 requires that reports of the Grand Jury not contain the name of any person or facts leading to the identity of any person who provides information to the Civil Grand Jury.