THE IMPACT OF YESTERDAY'S PROMISES

June 27, 2006

Summary

In the forefront of every budget planning session and every collective bargaining negotiation procedure, whether in the smallest government entities or the largest private industries, the main concerns affecting the process were the high cost of employee health care and retirement benefits.

The grand jury in the same way found that private companies going bankrupt blamed employee benefit costs consistently for their failure to make a profit. When private companies go bankrupt and leave badly under-funded pension plans, a federal agency partially bails them out. The Pension Benefit Guarantee Corporation steps in to insure continued pensions at a reduced benefit in most cases. The status of this federal agency has gone from a surplus of 7.7 billion in 2001 to a 23 billion dollar negative position in 2006. They do not recognize any promised health benefits.

In the public sector, if a municipality faces financial ruin, the taxpayers are on the hook to pay the full benefits promised to government employees by government employees.

Where do Sonoma County taxpayers stand? Are we deferring too much benefit liability to future taxpayers? Taxpayers are entitled to full disclosure of their obligation and by what means these benefit promises are secured.

The Financial Accounting and Standards Board, the authority recognized by the Securities and Exchange Commission as the maker of the nation's accounting rules, has set new standards of accounting for public and private companies' employee benefit reporting. Effective for fiscal years ending after December 2006, a new requirement to measure plan assets and obligations on their financial balance sheets, making them fully transparent, is proposed. Threats have been made for the past year, that this disclosure would be "eye popping" and a "double whammy" for pension systems.

This governing board states that over the next three years regulatory accounting methods for pension and retiree health benefits will have three new components to correct flaws:

- Strengthening plan funding rules to ensure that benefit promises made to employees are properly secured
- Pricing premium allowances fairly to discourage risky behavior
- Provide a clearer picture to taxpayers and recipients.

This disclosure of over-funding or under-funding should be made public.

Reason for Investigation

The grand jury was concerned with the fact that health care costs are the fastest growing expenditure in county budgets. This coupled with already high pension contributions amounts to a figure between 17 and 20% on average of the total expenditures of private and public sector budgets.

Last year, 71 of the nation's largest private companies froze or terminated pension plans. Almost no employers offer Defined Benefit Plans (a set amount per month). New employees and recent hires were switched to Individual Retirement Accounts (IRA). Less than 20% of all workers in the private sector now have a traditional pension plan. Health plan coverage is not there for 60% of the employees in the private sector.

Reform is the word most often used to describe necessary changes by health care analysts. Cost sharing by employees and putting the responsibility back on employees for their own coverage, is the trend in large companies today. The belief that employers are responsible to provide these benefits is in serious jeopardy, according to experts.

This was a self-initiated investigation to see how Sonoma county cities and the county entity will cope with escalating health care costs and proposed liability funding to reserve accounts. This should be made public information. Present and future retirees should be aware of the stability of their pensions and benefit expectations.

Background

Current accounting standards do not provide for complete information about benefit obligations. Consequently, to comply with these federal standards by showing over-funded or under-funded pension and health care liabilities, we should have a clear and useful picture that should be published.

Investigative Procedures

The grand jury requested data through correspondence addressed to the chief financial managers of each of the nine municipalities: Cloverdale, Cotati, Healdsburg, Petaluma, Rohnert Park, Santa Rosa, Sebastopol, Sonoma, Town of Windsor, as well as the County of Sonoma. Further we requested specific data on the costs of employee benefits and budget figures for the past five years. It was a rather broad request. Information requested had to be clarified by follow-up telephone and e-mails. We further:

- Interviewed either City Managers or Financial Officers in each municipality and in most incidences we met more than one person, often on multiple occasions
- Examined the budgets of each city
- Met with the North Coast Builders Exchange for private sector input
- Met with representative of the Redwood Empire Municipal Insurance Fund
- Sent representatives to the Conference on Health Care sponsored by medical executives and local businesses along with representatives from Sutter Health Care, St. Joseph's Hospital Foundation and Kaiser Foundation
- Met with the California Forensic Medical Group under contract with the county jail.

Researched the following publications:

- The Business Journal
- The Press Democrat's publications on the subject of benefits
- The New York Times Digests
- Reviewed Insurance company newsletters
- We researched material entitled "The Crippling Financial Impact of Public Pensions and Healthcare Obligations on Municipal and County Budgets."
- Researched the Bureau of Labor Statistics website
- Researched US Government congressional website
- Interviewed a respected CPA in private practice
- Researched Pension Benefit Guarantee Act Director's Report to the American Institute of Certified Public Accountants
- Researched the Financial Accounting Standards Board website
- Researched Pension Benefit Guarantee Corporation website.

It became apparent in our meetings with the various entities and scanning of the information they forwarded that benefits were scattered amongst departments and categorized differently. Separating health care and pension benefits was not practical because they were intertwined. Retiree benefits were so convoluted with special circumstances and explanations, it became clear that there was no consistency in benefits promised. It depended on who was promising what at the time.

Budget information was not comparable because some cities furnished us with budget projections and some with actual expenditures. What impact continued increases in benefit costs would have on these budgets could not be determined.

Findings

Fl What the grand jury was able to interpret from the piles of financial information provided, was that health care benefits alone indicated no extreme differences between cities. These health care premiums averaged about 3% of the budgets.
The premiums had a broad range of $5,400 to $11,500 per employee per year, taking into consideration, single verses family coverage and risk factors. Adding all the other contributions: pensions, dental, vision and/or life insurance to the equation, employee benefit costs are close to the normal range of 17 to 20% of the budgets.

F2 California Public Employees Retirement System (CalPers) is the pension plan of choice. During our interviews it became apparent, that actuarial expertise and plan management were highly respected.

F3 Health care coverage costs have doubled in the past five years and are projected to double again in the next five years. Insurance providers blame this on the costs of new technology.

F4 The State of California, as quoted in the Sacramental Bee, sees the way out of this situation of unsustainable health care promises: the solution, "just quit promising health care for life. That's what the Medicare system is for."

F5 Reserve funding will be mandatory for all employing entities offering benefits for life. This is nothing new to pension providers, however, it will be new for health care, dental care, life insurance or any other promises for life. A mismatch between assets and liabilities has to be addressed. Full disclosure will provide this information.

F6 Both current employees and retired employees will benefit from the security of knowing that what they expect and have been promised is not dependent on the whims of the future.

Conclusions

In the past, employees in the private sector set the standards for the public sector employees in wages, hours and working conditions. In order to attract the most qualified workers, employers often competed with generous benefit offerings. In addition, upon retirement benefits were maintained for life as a way of showing appreciation for their loyalty. These generous offerings have collapsed in the private sector.

Public municipalities will have to raise taxes, cut other services and layoff workers, if there are not enough assets or reserves to meet the requirements of the new accounting laws. Reportedly, this has happened in other states.

Private sector employees have had to experience sacrifices in companies including, but not limited to Hewlett-Packard, General Motors, IBM, United Airlines, Verizon, etc. Perhaps public employees would not be subject to this, if the problem were addressed now and not deferred to future taxpayers.

The grand jury found a bleak outlook for the continuance of generous promises. Actuarial information is that future costs will continue to rise and securing already made promises will likely include higher deductibles from the employee for care along with cost sharing premiums. The impact would be less take home pay.

Figures furnished to the jury by providers indicated that driving up these costs are early retirements without Medicare eligibility. Boomers and the age group between 50 and 65 out-spend health care premiums by 164% and the figure for all retirees out-spending health care premiums is 131%. Overhead for insurance companies has tripled since 1993 according to the data furnished to us. This is also a reason for escalating health care benefit costs.

Commendations

The grand jury would like to acknowledge the City of Rohnert Park for publicly disclosing the findings of a recent actuarial study regarding the City's financial status. Reports are that the City is currently $52 million short of what is needed to cover health care promises now on the books. They are looking for ways to address this deficit by cutting services and/or asking for an additional sales tax.

Recommendations

R1 The grand jury recommends that Supervisors, Council members and financial officers should verify that health or other lifetime benefit promises are secured properly and in compliance with reserve funding standards.

R2 The grand jury recommends that the Board of Supervisors and/or City Councils enlist actuarial expertise to audit this asset/obligation disclosure.

R3 The grand jury recommends that the advice of an expert should be solicited to consider the fairest most equitable way to offer health care benefits to public employees. This should be disclosed.

R4 The grand jury recommends to build a secure structure for maintenance of employee benefits should not be deferred.

R5 The grand jury recommends full disclosure of each entities total benefit obligations along with information describing provisions to secure them. We are requesting this information between the end of each entities current fiscal year and December 31, 2006:

- Number of employees eligible for pension premiums
- Number of retired employees receiving pension benefits
- Financial obligation
- What reserves are in place to insure these pension obligations
- Obligation for health care coverage
- Reserve amount in place
- Amount required by federal authorities to secure these health care benefits.

Required Responses to Recommendations

Sonoma County Board of Supervisors
R1, R2, R3, R4, R5

Sonoma County Comptroller and Chief Financial Officer
R1, R2, R3, R4, R5

Cloverdale City Council
R1, R2, R3, R4, R5

Cloverdale City Manager and Chief Financial Officer
R1, R2, R3, R4, R5

Cotati City Council
R1, R2, R3, R4, R5

Cotati City Manager and Chief Financial Officer
R1, R2, R3, R4, R5

Healdsburg City Council
R1, R2, R3, R4, R5

Healdsburg City Manager and Chief Financial Officer
R1, R2, R3, R4, R5

Petaluma City Council
R1, R2, R3, R4, R5

Petaluma City Manager and Chief Financial Officer
R1, R2, R3, R4, R5

Rohnert Park City Council
R1, R2, R3, R4, R5

Rohnert Park City Manager and Chief Financial Officer
R1, R2, R3, R4, R5,

Santa Rosa City Council
R1, R2, R3, R4, R5

Santa Rosa City Manager and Chief Financial Officer
R1, R2, R3, R4, R5

Sebastopol City Council
R1, R2, R3, R4, R5

Sebastopol City Manager and Chief Financial Officer
R1, R2, R3, R4, R5,

Sonoma City Council
R1, R2, R3, R4, R5

Sonoma City Manager and Chief Financial Officer
R1, R2, R3, R4, R5,

Town of Windsor City Council
R1, R2, R3, R4, R5

Town of Windsor City Manager and Chief Financial Officer
R1, R2, R3, R4, R5