September 23, 2014

The Honorable Glenda Sanders
Presiding Judge of the Superior Court
700 Civic Center Drive West
Santa Ana, CA 92701

RE: “Orange County City Pension Liabilities: Budget Transparency Critically Needed”

This letter is in response to the Orange County Grand Jury’s report entitled “Orange County City Pension Liabilities - Budget Transparency Critically Needed”, with requisite responses provided below. The City understands the importance of financial planning, with a critical component being a clear, understandable budget document that provides thorough and relevant financial information.

The City appreciates and agrees with the Grand Jury’s desire to include detailed information regarding unfunded pension liabilities in budget documents. The City does want to point out that significant information regarding the City’s pension, including its funded status, is and has been available to the public, in a number of ways for many years. The City’s audited Comprehensive Annual Financial Report (“CAFR”) details pension information as required under Generally Accepted Accounting Principles, including its funding policy and annual pension costs (“APC”). The CAFR’s for the County of Orange and the Orange County Fire Authority also include this information. The Orange County Employees Retirement System (“OCERS”) also issues an annual CAFR and publishes another user friendly document “OCERS by the Numbers” on an annual basis with a great deal of information on their entire pension system. In addition, all public agency CalPERS annual valuation reports are available online on the CalPERS website.

Again, there has been transparency in regards to the availability of detailed information to the public for public agency pensions and unfunded liabilities. That being said, the Grand Jury makes some good recommendations to improve dissemination of the information in regards to the City’s budgeting process.

We fully support the Grand Jury’s effort in addressing this issue and provide our responses to their Recommendations and associated findings below:

**Recommendation #1:** Each city should post its current and at least three most recent prior year budgets on the city’s web site, and these budgets should be easily located. Each city’s web site should have a search engine and single search on the word “budget” should immediately link to the current budget. (F.1) (F.4)
Response to Recommendation #1:
The City agrees with Recommendation #1. A search field is already conveniently located on the City of Dana Point web-site at www.danapoint.org in the upper right corner. A simple search using the word “budget” links to the City’s web page where a link to the current two-year budget is located, along with links to three prior two-year budgets. Together this provides eight years of budget information.

In addition, and because this recommendation also references Finding #1, the City will include information in its next two-year budget that reports the absolute dollar value of any unfunded pension liability, along with that liability per capita and as a percent of City revenue.

Recommendation #2: Each city’s budget information should contain not only this year/next year budget projections, but should show at least five years of projected revenues and expenditures. Projections should be at the same level of detail and use the same line item structure as information for the current budget. (F.1)(F.2)(F.3)(F.5)(F.8)(F.10)

Response to Recommendation #2:
The City partially agrees with Recommendation #2. At the Dana Point City Council’s June 17, 2014 public meeting, City staff was directed to develop a five-year financial model.

The City’s current budget stands at 250 pages in length, and providing five-years of projections at the same level of detail and line item structure as the current budget would result in an incredibly lengthy document that we believe would degrade the usefulness of it as a decision-making tool. When presenting information, consideration needs to be given to the complexity of the format and readability for the public.

The five-year financial model being developed by Staff will provide personnel cost details, including those specific to pension costs. The detail that will be provided in the five-year forecast will be vetted by the City Council’s appointed Investment Review Committee, incorporated in the next two-year proposed budget, and thus reviewed by the City Council.

Recommendation #3: Each city’s budget should show separate line items for predicted employee and predicted employer contributions for the city pension system (F.8)(F.9)

Response to Recommendation #3:
The City agrees with Recommendation #3. The City will detail the City’s contribution for the Employer-portion of pension costs in the next two-year budget, and will do so separate from any Employee-portion of pension costs paid by the City.

Recommendation #4: Each city’s budget should provide trend data on the accumulation/drawdown of reserves and provide details on the city’s policy for the size of its reserves and on the intended uses of such reserves. In particular any discussion
Response to Recommendation #4:
The City agrees with Recommendation #4. The City has reported in the footnotes to its audited CAFR the detailed amounts in its reserve accounts, along with explanations on how their respective amounts are derived. The City has also previously included a discussion in its prior two-year budgets regarding its reserve accounts, including their intended use and how the their amounts are established.

In response to this Recommendation #4, the City will add a table to the new five-year financial model section of the upcoming budget to show the history and projection for its reserve accounts. A discussion regarding addressing any unfunded status of the City's pension plan will also be clearly delineated in the financial model section of the budget.

Recommendation #5: Each city using CalPERS for one or more of its pension plans should identify the names and dates of the CalPERS Annual Valuation Report(s) which call out Annual Required Contributions (ARCs) for these plans and should provide a separate expenditure line item for predicted city catch-up contributions for the city pension systems based on these ARCs. A discussion of the risks associated with these CalPERS projections should also be provided by the city. (F.1) (F.2) (F.8) (F.9)

Response to Recommendation #5:
The City agrees with Recommendation #5. The City has provided information specific to its Annual Required Contribution to CalPERS in its annually audited CAFR. In direct response to Recommendation #5, in its next two-year budget the City will identify the CalPERS report that shows the Annual Required Contribution, and when applicable will provide information on any predicted catch-up contributions. A discussion will also be presented regarding financial risks to the City associated with CalPERS projections.

The City will also provide access to the CalPERS actuarial reports on the City’s website, in addition to them already being available on CalPERS website.

Recommendation #6: Each city which outsources fire or police services to OCFA and/or OCSD should require them to provide projections of future costs of service out at least five years into the future and require that these projected costs explicitly show the relationship of projected pension costs including amortization of unfunded liabilities. This level of pension costs information should be provided in budgeted expenditures for outsourced services. A discussion of the risks associated with these projections should also be provided by the agencies and incorporated in the city’s budgets. (F.6) (F.12)

Response to Recommendation #6:
The City partially agrees with Recommendation #6. Due to the complexity of the recommendation and the City's relationship with the various entities involved, this recommendation can best be addressed by dealing with OCSD and OCFA separately.
Pertaining to OCSD, Recommendation #6 will be partially implemented. The OCSD has provided projections of future costs of service five years out, including costs related to the amortization of its unfunded liability. This information will be incorporated into the City’s next two-year budget, and further into the five-year financial model currently being developed. However, the actual unfunded liabilities of OCSD are not the direct responsibility of the City; therefore, the City will provide readers with information on how to obtain OCSD unfunded liability information from the County of Orange.

Pertaining to OCFA, the recommendation will not be implemented because it is not warranted or is not reasonable. At the time of incorporation in 1989, the City of Dana Point was required to allocate a defined percentage of its 1% Basic Property Tax Levy revenue to the Orange County Structural Fire Fund, which is exclusively utilized for the provision of fire protection services. The City does not outsource to or contract with OCFA for these services, and cannot independently decide to have OCFA provide fire services differently.

Consequently, the City does not include the cost of fire protection services in its budget. Also, as is the case with OCSD, the unfunded liabilities of the OCFA are the direct responsibility of OCFA, but the City will provide readers with information on how to obtain OCFA unfunded liability information directly from OCFA.

**Recommendation #7:** Each city that has CalPERS as a provider for pensions should include a provision in their agreements with CalPERS that CalPERS will post their Annual Valuation Reports online. (F.11)

**Response to Recommendation #7:**
The City agrees with Recommendation #7. In fact, CalPERS currently provides the reports at: [http://www.calpers.ca.gov/index.jsp?bc=/about/forms-pubs/calpers-reports/actuarial-reports/home.xml](http://www.calpers.ca.gov/index.jsp?bc=/about/forms-pubs/calpers-reports/actuarial-reports/home.xml)

In addition, the City will load the most recent reports on its website and make them searchable using the word “pension”.

Respectfully,

Douglas C. Chotkevys
City Manager

Michael A. Killebrew
Assistant City Manager/
Director of Administrative Services

Cc: Dana Point City Council
Dana Point City Attorney