

Unfunded Liabilities for Retiree Health Benefits

A School District Fiscal Time Bomb!

Summary

The school districts in Sacramento County have an unfunded liability for retiree health benefits approaching \$1 billion. While the districts owe retiring or retired teachers and other employees that sum, many districts do not have the money to pay their obligations. Districts and employees negotiated the benefits when times were good, but no funds were ever set aside to pay for them. Apparently districts thought they could pay from each year's budget. However, that is not a realistic expectation. Sacramento City Unified School District alone owes \$560,000,000 and is trying to put aside \$1 million each year to pay the obligation. The liabilities are so large that school districts may go bankrupt or retired teachers may not receive health benefits. Yet many districts admit they have no plan to deal with their unfunded liability.

The attached table reflects self-reported information from each school district in Sacramento County and the Sacramento County Office of Education regarding the unfunded liabilities for retired employees' health benefits. This table includes the adopted budgets, shows whether or not the districts have discussed this issue at a board of education public meeting in the last three years, and if there is a plan to fund its debts. The notes represent some of the detailed information given to the grand jury.

Definitions

For purposes of this report the following definitions are provided:

“Pre-funding” is setting aside funds to pay for future benefits while the employee is working.

“Pay-as-you-go” is meeting the employers' OPEB²⁰ cost obligation on a year to year basis with current revenue.

“Unfunded liability” is the actuarial value of anticipated future financial obligations that is not covered by similar value of assets and anticipated revenues.

Background

The history of collective bargaining by teachers dates from the 1960s. Prior to this, school districts and administrators had virtually unrestricted power to establish working conditions and compensation for teachers. Pensions were generally awarded to retired teachers at age 65, with 35 years of service.

²⁰ OPEB includes post employment healthcare, as well as other forms of post employment benefits (for example, life insurance) when provided separately from a pension plan. (Governmental Accounting Standards Board, summary of Statement 45, June, 2004.)

In the early 1960s, various states granted school employees the right to “meet and confer”, a form of collective bargaining. Resulting agreements offered salary stability, guaranteed benefits, and modifications of terms and conditions of employment for school employees.

Retiree health benefits were initially granted to school district employees from generous and well-to-do school districts. Some of these health benefits were lifetime and some included family coverage. The school districts often bore the entire cost of these benefits. These benefits became the subject of meet and confer sessions and went on to be a very important part of collective bargaining between boards of education and employees.

Since 1985, the California State Legislature has taken several actions to enhance health benefits of retired teachers. Districts that provide health and/or dental benefits for current teachers must permit retired teachers and their spouses to enroll in the same plan. The law also allows plans to set higher premiums for retired members as compared to current employees. This is based on retirees' typically higher utilization of medical services. However, state law does not include a requirement for districts to contribute to retirees' coverage. Thus many districts have obligated themselves contractually to fund these benefits but never set aside any money for them.

Approach

In gathering data for this study, the grand jury conducted interviews and took sworn testimony from school board members, superintendents, district personnel, and an actuary with a public entity; reviewed collective bargaining agreements and the minutes of school board meetings; reviewed district policies and administrative procedures; and attended school board meetings. A self-reported survey was completed and submitted by each school district and the county office of education.

Disclaimer

Sacramento County school districts were asked to self-report the dollar amount of unfunded liability for retiree health care costs. The cost of these future benefits is part of the total obligation of each district. The attached table contains the amounts reported. The accounting/actuarial methods used by each district for arriving at the amounts may not be the same. Some districts chose the Other Post Employment Benefits (OPEB) amount while other districts used actual retiree health care benefits costs. Reported amounts require numerous inputs and assumptions and these vary widely among the districts. Some districts only report their cash outlays for OPEB benefits in a given year, rather than reporting employer costs of accrued OPEB benefits earned by employees in that year--and these two amounts may differ. In this study it was not possible to examine the details of each reported unfunded liability or to bring these amounts to a common definition with common assumptions. As a result, the districts' actual unfunded liability amounts could vary significantly from the self-reported unfunded health liability amounts in the table.

Nevertheless, these potential variations do not change county school districts' financial obligations for retiree benefits in addition to pensions. The results of this survey should be viewed as point-in-time, self-reported data that provides insight into the magnitude of these unfunded liabilities. The grand jury is not pointing out the exact amount of the debt so much as the fact of a largely ignored obligation.

School District Responses for Information on Unfunded Liabilities for Retired Employee Health Benefits

School District	Superintendent	Adopted 2009-10 Budget (General Fund) as per SCOE	Self-Reported Unfunded Health Liability	Has the issue of unfunded liability for retired employee health benefits been discussed with your Board of Education within the last three years?	Is there a payment plan currently in place or currently being negotiated regarding this unfunded liability?	Notes from information by school districts.
Arcohe (K-8)	Mark Cornfield	\$3,570,366	\$568,000	No	No	See note 1
Center (K-12)	Scott Lochr	\$37,348,171	\$5,898,425	No	No	
Elk Grove (K-12) (LT)	Steven Ladd	\$482,902,748	\$33,329,761	Yes	Yes	See note 2
Elverta (K-8)	Elizabeth Golchert	\$2,172,541	\$139,962	No	Yes	See note 3
Folsom Cordova (K-12)	Patriek Godwin	\$144,043,900	\$18,700,000	Yes	Yes	See note 4
Galt (K-8)	Karen Schauer	\$31,545,743	\$5,104,307	Yes	No	See note 5
Galt (9-12)	Daisy Lee	\$19,440,693	\$0	n/a	n/a	
Natomas (K-12)	General Davie, Jr.	\$76,196,471	\$5,440,225	Yes	No	See note 6
River Delta (K-12)	Richard Hennes	\$18,191,190	\$3,313,242	Yes	Yes	See note 7
Robla (K-6)	Ralph Friend	\$16,294,184	\$130,969	Yes	No	See note 8
SCUSD (K-12) (LT)	Jonathan Raymond	\$366,069,730	\$560,100,000	Yes	Yes	See note 9
San Juan (K-12)	Pat Jaurequi	\$360,293,651	\$74,785,897 (OPEB)	Yes	Yes	See note 10
Twin Rivers (K-12)	Frank Porter	\$252,719,433	\$8,161,958	Yes	Yes	See note 11
SCOE (LT)	David Gordon	\$120,201,816	\$67,139,320	Yes	Yes	See note 12
Totals		\$1,930,990,637	\$816,178,434			

(LT) = Lifetime Benefits

The following notes are highlights of *verbatim* information provided by the school districts within Sacramento County and the Sacramento County Office of Education.

Notes from School District Responses for Information on Unfunded Liabilities for Retired Employee Health Benefits

1. Arcohe Union School District – GASB 45 is a requirement for our district this year. During this year Arcohe will be putting our plan and trust in place.

2. Elk Grove Unified School District – Liability for retiree health care is broken into two different groups. Eligible employees that retired prior to July 1, 2000 receive their retiree health benefits through the District. The District pays the premiums for retirees to participate in the lowest cost plan that is offered to current employees. All eligible employees retiring after July 1, 2000, do not receive any post-retirement health benefits from the District. Rather, this second group of retirees is the responsibility of the Elk Grove Benefit Employee Retirement Trust (“EGBERT”). EGBERT has its own separate Board of Directors which sets benefit levels and manages the EGBERT trust assets . . . As of June 1, 2007 the District unfunded liabilities dollar amount was \$33,329,761 . . . As of October 15, 2008 the unfunded liabilities dollar amount for EGBERT was \$214,022,367.

The District’s liability for pre-July 1, 2000 retirees is funded on a pay-as-you-go basis. Due to the July 1, 2000 cut off date, the number of District retirees in this group and the corresponding liability for benefits is steadily decreasing over time. The cost of this pay-as-you-go model is built into the District’s budget and reviewed each year.

3. Elverta Joint School District – Pay-as-you-go is the current practice.

4. Folsom Cordova Unified School District – (Minutes of Board meeting of 02-15-07) . . . approve the establishment of a Fund 71 (irrevocable trust) to meet the District’s negotiated obligations for retiree benefits according to Governmental Accounting Standards (GASB) 45 . . . Contributions are made annually. Approximately \$1.6M annually is deposited into irrevocable trust. 2010-11 deposit will be less due to significant budget cuts from the State.

5. Galt Joint Union Elementary School District – The District had an actuarial study performed in 2008 that was presented to and approved by the Galt School Board . . . A payment plan is not currently in place for this liability. However, the District maintains a Retiree Benefit Fund that maintains a fund balance capable of funding current year plus the following 2-3 years out.

6. Natomas Unified School District – (Minutes of December 12, 2007 Regular Board Meeting) . . . [presentation of] actuarial Study of Retired Health Liabilities prepared by Total Compensation System, Inc. . . . GASB 45 requires the District book this long-term liability starting in 2008-09.

7. River Delta Unified School District – (Board meeting minutes of February 17, 2009) . . . [Adoption of] Resolutions #603 to 606 giving approval to provide post-retirement vesting conditions for [all] employees and satisfy CalPERS vesting requirements.

8. Robla School District – (Board minutes of September 17, 2009) . . . approval of Actuarial Report for Robla School District’s financial obligations for post retirement.

9. Sacramento City Unified School District – (Board agenda item October 2, 2008) . . . \$560.1 million as of 12/2008 actuarial report received December 2009 and will be presented to Board of Education at future meeting . . . \$1.0 million has been set aside to start funding this liability. There is no on-going funding stream identified for this purpose at this time.

10. San Juan Unified School District – (Board budget presentation of June10, 2008) . . . Administration was recommending funding the annual OPEB obligation at \$2.8 million for GASB 45 compliance after completion of PARS payments. However, due to the State budget plan, SJUSD administration is recommending delaying the OPEB contribution indefinitely . . . (On December 16, 2008) . . . Due to continued reductions in funding from the State, there are no current plans to fund this liability.

11. Twin Rivers Unified School District - \$8,161,958 is the amount of unfunded liability as of June 30, 2009. \$67,139,320 is the amount on our actuarial study for current and future retirees as of June 30, 2009. Currently, it is a pay-as-you-go plan.

12. Sacramento County Office of Education (SCOE) – (Memo from superintendent indicates SCOE has a funding mechanism in place through an irrevocable trust to eventually fully fund the liability for lifetime retiree health benefits.)

Discussion

With pension plans, a school district knows what the costs are going to be. With health care, the actual costs are not under a school district's control. A school district has no ability to affect health care costs or premiums. It is at the mercy of providers and insurers. While these costs have increased exponentially, school districts, boards and superintendents have either been unaware of or ignored their growing liability for retiree health care benefits. Few responsible parties have acknowledged the fact that obligations are growing rapidly but no funds are being set aside to pay the obligations. In the past this has not been a cause for alarm heard by (or from) school boards, superintendents, state regulators, state legislature or unions. Many districts have used a pay-as-you-go approach to meet their financial obligations for these retirement benefits. They appeared to believe that they would always have sufficient money to pay for them. The problem with pay-as-you-go is that districts may not have sufficient funds to pay the current year’s retiree health benefits and also pay for necessary school programs. The size of the unfunded liability has increased substantially but the school districts’ income has not.

The self-reported data collected from the 13 school districts in Sacramento County and the Sacramento County Office of Education indicate that four school districts have not discussed the topic of unfunded health care liabilities for retirees in the last three years. Seven school districts have developed plans to make payments toward their unfunded liabilities but six of these school districts have not funded these plans due to state budget cuts. However, six school districts have made no plans and continue to pay-

as-they-go. The self-reported data of some districts simply addressed the Governmental Accounting Standards Board (GASB) standard, which is only an accounting statement, and not a plan to pay the obligation.

In June 2004, GASB released Statement 45 and Statement 43, which detail accounting and financial reporting duties by employers for OPEB. “This Statement establishes standards for the measurement, recognition, and display of OPEB expense/expenditures and related liabilities (assets), note disclosures, and if applicable, required supplementary information (RSI) in the financial reports of state and local governmental employers.”²¹ Therefore, school districts that offer post employment health care to their employees should follow the GASB regulations and report their obligations.

However, it is not enough for a school district to follow GASB and report its unfunded liability. If a school district has long-term fiscal obligations for OPEB due to collective bargaining agreements with employees, the district should develop a plan for meeting such obligations. The district may apply to the state for reimbursement up to \$15,000 for activities related to developing a plan to meet its OPEB obligations. The plan should include the OPEB review of the financial obligations determined by the actuary and the strategy for funding the obligation.

In recent years some districts became alarmed at the trend of increased annual costs for retiree health benefits. To meet ever-growing unfunded liability amounts, some districts developed trust funds to buffer these exceedingly high costs, which must be paid out of the districts' general funds. Others made plans to gradually pay down their unfunded liability but have stopped these payments due to current budget shortages. Some districts simply have ignored the problem.

One of the difficulties in resolving the problem is the relationship between school boards and school unions. The unions have enormous influence on both school boards and administrators. School boards consist of locally elected community members. Basic qualifications usually include that the members live in the school district, are registered voters, and are at least 18 years old. Many people who run for school boards are parents of children who attend schools in their district. These parents have been active in their child's school and want to become “more involved” or want to “move up,” some with political aspirations and some with single-issue concerns. A school board candidate campaigns for a short time, to a limited audience, and frequently demonstrates a limited knowledge of school district governance but expresses a willingness to learn, a “grass roots” profile. School board members generally serve a three or four year term. Elections historically have a very low voter turnout.

School boards are often regarded as relatively weak governing bodies composed of part-time members with limited amounts of time to dedicate to the position, a limited knowledge of school district responsibilities and procedures, a limited interest in serious or strained negotiations with employees, and a dependence on the superintendent for information and guidance. School board members typically receive packets of agenda items a few days before the school board meeting. They have a limited amount of time to devote to the study of the agenda items, and a limited amount of time to

²¹ Governmental Accounting Standards Board, Summary of Statement 45, June 2004.

confer with the superintendent or appropriate school district staff. Board members talk on the phone and use e-mail with district staff but must be ever mindful of following the Brown Act²² regulations regarding talking with other school board members. It should be noted that some school boards often combine closed session agenda items such as labor negotiations or disciplinary actions so they fall outside of the guidelines of the Brown Act thereby holding sessions that are closed to the public. Many school board members apparently only scan the summary pages to agenda packets and generally follow staff recommendations. Most have limited knowledge about school budgets, finance, and their own responsibilities as elected officials. Often board members know little or nothing about unfunded retiree health care liabilities.

Typically teacher unions are most interested in identifying and endorsing school board candidates who have philosophies and goals that align with those of the teachers and teacher unions. Because of the size of their membership and their financial resources, unions have an enormous impact on school board elections.

As well as influencing school board elections, teacher unions and other employee groups can greatly influence the hiring and the tenure of superintendents. The result is a political tension for superintendents trying to please school board members and to develop positive relationships with staff and their union representatives. Historically, many superintendents are former classroom teachers who have moved from being site administrators, to district level administrators to superintendents. Most superintendents have additional degrees in educational administration and some have participated in short-term superintendent skill development programs offered by professional associations. There is now a growing interest in large districts in hiring superintendents with corporate, military or business experiences, along with knowledge of finance and labor negotiations. The school board usually selects a superintendent who matches the perceived needs of current school board members.

The issue of retiree unfunded health liabilities shows the impact of board members who can be short-term elected officials and superintendents who serve at the fragile pleasure of school boards. In summary, school boards and school district superintendents can easily assume the unfunded liability costs will occur in the future, under someone else's leadership.

The focus of this Sacramento County Grand Jury study has been to identify unfunded retiree health care costs for school districts within the county. School districts have promised benefits that may not be paid or that can ultimately bankrupt the district, especially during the current economic climate. The financial obligation of school districts is overwhelming, especially for those who have adopted a pay-as-you-go plan. The information supplied to the grand jury indicates the total unfunded liability for retiree health care costs in Sacramento County school districts is approaching \$1 billion.

²² See California Government Code section 54950 or follow the link: www.leginfo.ca.gov/

Conclusion

While employers, employees, and retirees seem to consider an employer-sponsored health plan a desirable benefit, the continuing escalation of health care and premium costs places enormous fiscal pressure on school districts that try to maintain the benefits. Unless union contracts are renegotiated so that benefits are reduced or employees contribute to the payment of healthcare costs, the consequences will be devastating.

Health care costs will continue to escalate. If school districts fail to plan for funding of negotiated obligations for retiree health benefits, and employees and/or unions fail to assume some of the costs of the benefits, school districts will be unable to provide a quality education for students and may become bankrupt. In order to avoid these dismal prospects the Sacramento County Grand Jury makes the following findings and recommendations:

Findings and Recommendations

Finding 1 Sacramento County school district boards are not knowledgeable about the ultimate long-term fiscal impacts the unfunded liability for retiree health benefits will have on their districts.

Recommendation 1.1 Sacramento County school district boards and superintendents, with advice from actuaries and accountants, should immediately assess and quantify their long-term OPEB obligations and ramifications.

Finding 2 Sacramento County school districts have a variety of approaches in addressing the unfunded liabilities for contracted retiree health benefits. Some of those approaches include:

- Creating trust funds or other funding plans but stopping all contributions to them due to current economic conditions
- Creating trust funds and contributing to them
- Ignoring the problem
- Regarding the GASB standards as a “plan” when in fact it is only an accounting statement
- Utilizing an annual pay-as-you-go approach to these obligations, relying on their general funds for retiree health benefits.

Recommendation 2.1 All school districts should have a funding plan and a schedule of contributions in their 2011-2012 budgets.

Recommendation 2.2 School district boards must find means other than pay-as-you-go for funding these ongoing and increasing expenses.

Recommendation 2.3 All school boards should begin serious negotiations with their employee unions to reduce benefits or increase contributions.

Response Requirements

Penal Code sections 933 and 933.05 require that specific responses to both the findings and recommendations contained in this report be submitted to the Presiding Judge of the Sacramento County Superior Court by August 9, 2010 from:

- **Mark Cornfield, Superintendent, Arcohe Union School District**
- **Scott Loehr, Superintendent, Center Joint Unified School District**
- **Steven Ladd, Superintendent, Elk Grove Unified School District**
- **Elizabeth Golchert, Superintendent, Elverta Joint School District**
- **Patrick Goodwin, Superintendent, Folsom Cordova Unified School District**
- **Karen Schauer, Superintendent, Galt Joint Union School District**
- **Daisy Lee, Superintendent, Galt Joint Union High School District**
- **General Davie, Jr., Superintendent, Natomas Unified School District**
- **Richard Hennes, Superintendent, River Delta Unified School District**
- **Ralph Friend, Superintendent, Robla School District**
- **Jonathan Raymond, Superintendent, Sacramento City Unified School District**
- **Pat Jaurequi, Superintendent, San Juan Unified School District**
- **Frank Porter, Superintendent, Twin Rivers Unified School District**
- **David Gordon, Superintendent, Sacramento County Office of Education**

Mail or hand-deliver a hard copy of the response to:

**Hon. Steve White, Presiding Judge
Sacramento County Superior Court
720 9th Street, Dept. 47
Sacramento, CA 95814**

In addition, e-mail the response to Becky Castaneda, Grand Jury Coordinator, at castanb@saccourt.com