

I. CALL MEETING TO ORDER

The meeting was called to order at 3:01 p.m. by Mayor Pro Tem/Chair Stapleton.

II. ROLL CALL

PRESENT: Joe Stapleton, Mayor Pro Tem/Chair
Will O'Neill, Mayor (excused at 3:32 p.m.)
Allen Cashion, Committee Member
Keith Curry, Committee Member
Nancy Scarbrough, Committee Member
William Collopy, Committee Member

ABSENT: Noah Blom, Councilmember (excused)

STAFF PRESENT: Grace K. Leung, City Manager
Jason Al-Imam, Finance Director/Treasurer
Shelby Burguan, Deputy Finance Director
Marlene Burns, Buyer
Raymund Reyes, Administrative Manager
Abigail Marin, Budget Analyst
Trevor Power, Accounting Manager
Vicky Nguyen, Senior Fiscal Clerk
Jessica Kan, Finance Manager
Jennifer Anderson, Purchasing and Contracts Administrator
Jessica Nguyen, Senior Budget Analyst
Theresa Schweitzer, Finance Administrator Manager
Jeff Boyles, Chief of Fire
Sabrina Mesropian, Management Fellow

MEMBERS OF THE PUBLIC: Jim Mosher
Larry Tucker

III. PLEDGE OF ALLEGIANCE

Committee Member Nancy Scarbrough led the Pledge of Allegiance.

IV. PUBLIC COMMENTS

A. ADDITIONAL MATERIALS RECEIVED

Mayor Pro Tem/Chair Stapleton opened public comments.

Mayor Pro Tem/Chair Stapleton closed public comments.

V. CONSENT CALENDAR

A. MINUTES OF OCTOBER 10, 2024

Recommended Action: Approve and file.

MOTION: Committee Member Keith Curry moved to approve the minutes of October 10, 2024, as amended, seconded by Committee Member Nancy Scarbrough. The motion carried as follows:

AYES: Cashion, Collopy, Curry, Scarbrough, Stapleton
NOES: None

ABSENT: Blom (excused)
ABSTAIN: O'Neill

VI. CURRENT BUSINESS

A. INTERNAL AUDIT PROGRAM UPDATE

Recommended Action: Receive and file.

Finance Director/Treasurer Jason Al-Imam provided a presentation describing the Internal Audit Program findings by the Pun Group.

The policy regarding payroll is nearing completion and it is recommended that there be a policy update to address the timeliness and improve the manual journal entry process, chart of account maintenance, and the timeliness and accuracy of bank reconciliations. The objective of the audit included an assessment of the year end close process.

Committee Member William Collopy inquired if a policy update is needed versus a desk procedure.

Finance Director/Treasurer Al-Imam explained that a policy would ensure the journal entries are approved and entered in a timelier manner. The City agreed with the three findings regarding the journal entries process, account maintenance, timeliness and accuracy of bank reconciliations and is preparing a formal procedure to include timelines.

Eide Bailly was retained to examine the budgeting function, which involved a comprehensive assessment of all aspects of the budget process. Four findings were related to budget development efficiencies, long-range financial forecasting, budget validation and accounts payable processing, and performance measurement. The City agreed with all four findings.

Additionally, regarding performance management, it was recognized that this was the first year the City implemented performance measures, and Newport Beach received the GFOA award for its effort. The City is working to fine-tune those performance measures.

The recommendation for the Long-Range Financial Forecast (LRFF) is that the Tidelands Fund include more detailed analysis and be incorporated into the LRFF to better reflect the fiscal impact on the General Fund due to the significant transfers made each year to cover Tidelands operations.

Eide Bailly also examined the customer service activity of the Revenue Division within the Finance Department. This assessment involved a comprehensive review of the division's structure, resource allocation, staffing levels, and documented or undocumented policies and procedures. The assessment recommended improvements in performance measures, documentation, manual processing, and utility and general billing. The City agreed with all four findings.

The current internal audit program was initiated in 2020 with an enterprise risk assessment and an initial evaluation of internal control risks. These processes served as the primary building blocks to inform and develop an internal audit work plan. Since the final remaining item on the 2020 internal audit work plan will be completed by a consultant specializing in business continuity and disaster planning assessments, it is recommended that a new enterprise risk assessment and evaluation of internal control risks be performed in 2025.

Finance Director Jason Al-Imam indicated that if the Finance Committee supports embarking on a new internal audit risk assessment and evaluation of internal control risks, an informal request for proposals will be sent to Eide Bailly and The Pun Group in 2025.

Committee Member William Collopy requested that staff provide an enterprise risk assessment matrix to the Committee for review and consideration, which will assist in developing an internal audit work plan.

Finance Director/Treasurer Al-Imam responded that staff could do that.

Committee Member Allen Cashion questioned who manages cash offsite and what the largest cash transaction is.

Finance Manager Jessica Kan reported a large amount of utility is collected at City Hall as a lot of the offsite locations won't take large transactions, such as classes and citations, a lot of which are credit card transactions. Whittier is the third-party lockbox for payments. There is also a post office box in Newport Beach that receives checks.

Mayor Pro Tem/Chair Stapleton opened public comments.

Mr. Jim Mosher, Newport Beach resident, commented about the policies and procedures being revised and asked if they were part of the City Manager's administrative policy manual or something separate, and inquired why the policies are not posted on the website to provide more transparency.

Finance Director/Treasurer Al-Imam responded that certain policies are already embedded in the Administrative Manual; others are more nuanced such as manual journal entry preparation, which is more of a Finance Department desk procedure and not necessarily required in the manual. The Administrative Manual policies and documents are available upon request.

Mayor Pro Tem/Chair Stapleton closed public comment.

Mayor Pro Tem/Chair Stapleton thanked Finance Director/Treasurer Al-Imam and filed and received the report.

B. OPEB ACTUARIAL VALUATION REPORT UPDATE

Recommended Action: Receive and file.

Finance Director/Treasurer Jason Al-Imam provided a presentation to the Committee, which included an update on the Other Post-Employment Benefits (OPEB) for the city. The discussion included a review of the most recent actuarial valuation and the status of funding the OPEB liability, which is currently fully funded. Key highlights include a description of retiree medical benefits offered through three categories: the Legacy Defined Benefit Plan (closed to new employees after 2005), the Defined Contribution Retiree Health Savings Plan (for employees hired from 2006 onward), and the CalPERS Minimum Required Contribution (MRC). A portion of the City's OPEB liability is in the form of an implicit rate subsidy, which results from the pooling of non-Medicare retirees and active employees for premium purposes. Although retirees are solely responsible for the cost of their health insurance, retirees receive the benefit of a lower rate. The difference between these amounts is the implicit rate subsidy. The accounting standards require that the value of the implicit subsidy be included in the City's OPEB liability, even though these costs will be paid on a pay-as-you-go basis in the future in the form of higher premiums for active employees. However, the cost associated with the implicit subsidy is covered by the City's cafeteria plan contribution and is paid from the City's operating budget. Therefore, the targeted funding level is based on the value of the explicit subsidy associated with the legacy defined benefit plan and the CalPERS MRC.

In 2008, the City established a Section 115 OPEB Trust with California Employers' Retiree Benefit Trust (CERBT), which is managed by CalPERS. However, in March of 2022, CalPERS approved changes to the asset class allocations for CERBT, which resulted in lower returns and an increase in volatility. The additional risk did not appear to be commensurate with the

expected return. Therefore, the City evaluated other alternatives. Public Agency Retirement Services or PARS manages \$6 billion of pension & OPEB assets for 500 public agencies throughout the U.S. A distinctive benefit to PARS is that public agencies are permitted to create a customized investment strategy for their PARS OPEB Trust, which allows for greater control of investment risk.

In January 2024, the Finance Committee directed staff to bring an item forward for City Council consideration to establish an OPEB Trust with PARS. It was recommended that PARS Trust assets be invested in the “balanced” strategy, which has an expected return of 6.27% (compared to 6.0% for CERBT) net of fees and has lower volatility. In March of 2024, the City Council approved establishing an OPEB Trust with PARS, and therefore, funds were transferred from CERBT to PARS in May 2024.

Committee Member William Collopy inquired if there was any private equity in the City’s PARS OPEB Trust. Keith Stribling from PARS confirmed the City’s OPEB Trust does not include any private equity, and currently there is no intention to invest in private equity.

Finance Director/Treasurer Al-Imam reported the annualized net rate of return of 5.6% from 2008-2024. The City has contributed nearly \$28 million to the trust which has earned just over \$18 million in investment income. The OPEB Trust reserve balance was \$46 million dollars as of June 30, 2024, which exceeded the explicit portion OPEB liability currently valued at \$39.7 million. An actuarial valuation is completed once every two years. The most recent actuarial report was completed in 2024, which had a measurement date of June 30, 2023 and reflected a long-term expected rate of return of 6.0%. It was pointed out that the next valuation report will use a higher discount rate of 6.27%, which is consistent with the long-term expected return for the City’s OPEB Trust, which is invested in the balanced strategy.

Finance Director/Treasurer Al-Imam explained further that City Council Policy F-2 (Reserve Policy) requires the “new plan” be 100% funded and that the explicit portion of the “old plan” be funded over a 20-year amortization period (or less) based on the annual required contribution determined by a biennial actuarial review. The explicit liability is comprised of the CalPERS required minimum contribution and Legacy Liability which is a closed plan and is split 50/50 between the Legacy Liability Plan and the CalPERS minimum required contribution. Council Policy F-2 does not directly address whether funds should be set aside for the implicit subsidy. However, since the cost associated with the implicit subsidy is covered by the City’s cafeteria plan contribution and is paid from the City’s operating budget, the targeted funding level has been based on the value of the explicit subsidy associated with the legacy defined benefit plan and the CalPERS MRC.

In October 2023, the City Council approved allocating \$5.8 million of the General Fund’s operating surplus for Fiscal Year 2022-23 towards paying down the City’s OPEB liability. The explicit subsidy is fully funded as of June 30, 2024. Council Policy F-2 does not directly address funding for the explicit subsidy; however, it is recommended that the City not fund the explicit subsidy for the reasons already mentioned, which is consistent with predominant practices. Since the OPEB liability is fully funded, it results in annual savings totaling approximately \$4 million are expected to accrue due to the elimination of the OPEB liability.

Mayor O’Neill congratulated staff and stated this was something he was really quite proud of the City for accomplishing.

Mayor Pro Tem/Chair Stapleton opened public comments, there were none.

C. CALPERS UPDATE

Recommended Action: Receive and file.

Finance Director/Treasurer Al-Imam moved into the CalPERS update and reported that in July the net return on investments was 9.3% for the fiscal year 2023-2024. The funded status jumped from 72% funded to 75% funded, but it is not an apples-to-apples comparison, as not all agencies across California are a full service City like Newport Beach. The 2023 valuation reports set the contribution rates for FY2025-26. Fiscal Year 2022-23 investment return was 6.1%, underperforming the 6.8% target. Total unfunded liability decreased from \$348 million to \$341 million whereas the total funded ratio increased from 70.9% to 72.5%. The funded status improved due to the City's aggressive pension paydown strategy, despite investment returns falling short of the 6.8% target.

In 2015, CalPERS approved the Funding Risk Mitigation Policy, which included a provision that automatically triggered a decrease in the discount rate when the actual investment return for a fiscal year exceeded the assumed rate of return by at least 2%. The two percent trigger intended to use a portion of unexpected gains to de-risk the portfolio. However, in April 2024, CalPERS approved a change to the policy, which eliminated the automatic change in the discount rate and instead requires board discussion on the discount rate when investment returns exceed 6.8% by 2% or more in a given year. The return for FY 23-24 exceeded the expected rate of return by 2.5%, which prompted board discussion. However, the board decided to leave the discount rate at 6.8%. However, it was pointed out that CalPERS will embark on a new Asset Liability Management study next year, which will include a review of the discount rate, which happens once every four years.

Committee Member Collopy inquired if the discount rate changed other than every four years. Finance Director/Treasurer Al-Imam explained that every two years they review the discount rate, but the four year review does a deeper dive and showed the comparison chart for other Orange County cities.

Finance Director/Treasurer Al-Imam explained that the funded status for all agencies in Orange County increased in 2024 due to the investment return of 9.3%. It was pointed out that the comparison of the funded status for agencies in Orange County is not an apples-to-apples comparison since not every city is a full-service city like Newport Beach. For example, cities like Tustin, Irvine and Santa Ana contract with the County for fire services. Therefore, the pension liability for fire services is on the balance sheet of the County. Nonetheless, the cost associated with pensions for fire services is charged to each contract city. In addition, some agencies have issued pension obligation bonds in prior years. However, the debt for those bonds is not reflected in the funded status.

Committee Member Curry noted the other thing that's not considered is a city's ability to pay their liability.

Finance Director/Treasurer Al-Imam continued and explained the pension paydown strategy is revisited annually. In 2024, the Finance Committee and City Council approved the continuation of an aggressive pension paydown strategy, and approved staff's recommendation to make a payment of \$40 million to CalPERS as part of the budget with the intent to allocate an additional \$5 million from the FY 2024-25 budget surplus.

Committee Member Collopy inquired if the same pension paydown strategy would be used in the upcoming year. City Manager Grace Leung responded that the City would continue to include \$40 million in the baseline for paying down the pension liability. In addition, at fiscal year-end, half of the surplus would be allocated towards paying down the pension liability, which would bring the total paid to CalPERS up to \$45 million.

Finance Director/Treasurer Al-Imam indicated that the Actuarial Valuation for the year ending June 30, 2024 will not be available until August 2025. However, the CalPERS Pension Outlook tool has been utilized to estimate the City's projected funded status as of June 30, 2024, which reflects the impact associated with the 9.3% investment gain. The previous forecast projected

the City's pension liability being paid off in FY 2032-33, which was dependent on CalPERS earning 6.8% over the long-term. The impact of the 9.3% return in 23-24 resulted in a projection that shows the City paying off the pension liability a few months sooner than previously projected.

Finance Director/Treasurer Al-Imam indicated that the City's pension funded status is projected to be 90% funded in the next four to five years and fully funded within the next eight years.

Committee Member Collopy asked if they were using a different discount rate than CalPERS for the City's contribution, and for an estimate for the total unfunded balance. Finance Director/Treasurer Al-Imam stated they use the same discount rate as CalPERS for forecasting purposes.

Mayor Pro Tem/Chair Stapleton opened public comments.

Seeing none, Mayor Pro Tem/Chair Stapleton closed public comments and received and filed the report.

D. FIRST QUARTER BUDGET UPDATE

Recommended Action: Review and discuss the report on the first quarter of Fiscal Year 2024-25 and provide any recommendations for consideration by the City Manager and City Council.

Deputy Finance Director Shelby Burguan provided the presentation of the first quarter budget update for 2024-2025. The revised General Fund Expenditure budget totals 325.8 million dollars and the projected year end expenses are estimated at \$323.4 million which reflects an expenditure budget savings of \$2.5 million dollars. Savings are in the salary and benefits category, largely due to vacancies. There are also a few proposed budget amendments described in the staff report that impact both the revenue and expenditure budget by minor amounts. It is currently projected that unrestricted General Fund resources will total \$5.0 million at the end of FY 2024-25. As is the case each year, staff anticipate that additional budget savings will be realized, and the final year-end budget surplus will grow in future quarters. Staff recommend that the Finance Committee review and discuss this report and provide any recommendations for city manager and City Council consideration.

Committee Member Collopy inquired if the savings were only based on vacancies to-date and whether they assumed full-staffing going forward. Deputy Finance Director Shelby Burguan confirmed that was correct.

Mayor Pro Tem/Chair Stapleton opened public comments.

Seeing none, Mayor Pro Tem/Chair Stapleton closed public comments and received and filed the report.

E. WORK PLAN REVIEW

Recommended Action: Receive and file.

Mayor Pro Tem/Chair Stapleton reported that looking at the Work Plan and January 9, 2025 will not have the current Council seated.

City Manager Leung stated that the mayor's appointment takes place on January 14. There would be one vacancy, the suggestion is to move the Finance committee meeting date past the mayoral appointment. Current suggested date is January 23, 2025, which is a Thursday.

Mayor Pro Tem/Chair Stapleton summarized that January 23rd will be the overview of the utility department, financial statement audit results, long range financial forecast budget amendments and another workplan review. Feb will have FFP, and March will begin the budget.

Mayor Pro Tem/Chair Stapleton opening public comments.

Mr. Larry Tucker commented on the City’s reserve levels and indicated that it might be advantageous for the Committee to review what is actually needed in the reserves.

Finance Director/Treasurer Al-Imam responded they have a Contingency reserve policy that is 25% of operating expenses. It was further pointed out that the FFP reserve and utilities reserves are set based on fiscal policy and reserve targets.

Committee Member Collopy stated that years ago the Finance Committee performed a comprehensive analysis that found they have a very good handle on how the reserves are established.

Mayor Pro Tem/Chair Stapleton opened public comments.

Seeing none, Mayor Pro Tem/Chair Stapleton closed public comments and received and filed the report.

VII. ADJOURNMENT

The Finance Committee meeting adjourned at meeting at 4:06 p.m.

Attest:

Joe Stapleton, Mayor Pro Tem/Chair
Finance Committee

Date