

**CITY OF NEWPORT BEACH  
FINANCE COMMITTEE  
JANUARY 16, 2020 MEETING MINUTES**

**I. CALL MEETING TO ORDER**

The meeting was called to order at 3:01 p.m. in the Crystal Cove Conference Room, Bay 2D, 100 Civic Center Drive, Newport Beach, California 92660.

**II. ROLL CALL**

**PRESENT:** Mayor /Chair Will O'Neill, Council Member Diane Dixon, Council Member Joy Brenner, Committee Member William Collopy, Committee Member John Reed, Committee Member Joe Stapleton, and Committee Member Larry Tucker

**ABSENT:** None

**STAFF PRESENT:** City Manager Grace K. Leung, Finance Director/Treasurer Dan Matusiewicz, Deputy Director/Finance Steve Montano, Revenue Auditor Antonio Velasco, Budget Analyst Amy Mayfield, Administrative Manager Angela Crespi, Purchasing Agent Anthony Nguyen, and Administrative Specialist to the Finance Director, Marlene Burns

**OTHER ENTITIES:** Luis Murillo (Nyhart) and James Burns (Nyhart)

**MEMBER OF THE PUBLIC:** Jim Mosher

**III. PUBLIC COMMENTS**

None

**IV. CONSENT CALENDAR**

**MINUTES OF NOVEMBER 14, 2019**

**Recommended Action:**  
Approve and file.

Chair O'Neill noted Mr. Mosher's requested modifications. Committee Member Collopy noted corrections of his title and Chair O'Neill's title.

**MOTION:** Committee Member Stapleton moved to approve the minutes with the modifications and, Council Member Brenner seconded. The motion carried 7 ayes – 0 noes.

**V. CURRENT BUSINESS**

**A. OPEB ACTUARIAL VALUATION**

**Summary:**

Review of OPEB Actuarial Valuation.

**Recommended Action:**

Receive and file.

Luis Murillo, representing Nyhart, noted the purpose of the presentation is to review the updated valuation of the retiree health program that is offered to City employees. He advised a valuation needs to be performed every two (2) years and the last valuation performed was June 30, 2019.

Mr. Murillo advised the two purposes for performing a valuation. He noted one is to identify the recommended contributions for the program to have enough money in assets in the trust to meet the obligation. He noted the second purpose is the Governmental Accounting Standards Board (GASB) 75 requirement, which requires the City to state the liability for the benefit on its financial statements. He noted there is no requirement to pre-fund this liability; however, the City has a policy to fund the Actuarially Determined Contribution (ADC), and those numbers will be identified to make the contributions to the trust.

Chair O'Neill noted failure to pre-fund the liability leads to additional interest in the future. Mr. Murillo clarified the sooner the contributions are placed in the trust; the more earnings accumulate to pay-off the future benefits, which is the goal of pre-funding.

Mr. Murillo noted some retirees were "grandfathered" into the plan and continue to receive a fixed dollar contribution from the City. He noted effective January 1, 2006, the City implemented a Retiree Health Savings program (RHS) for all new full-time employees and the contribution is placed in the RHS. He advised while it is not an Other Post-Employment Benefits (OPEB) liability, those employees are being included in the valuation due to the City's participation in CalPERS for its retiree health plans. These require the City to have a minimum contribution for each employee at retirement, a portion of which is an OPEB liability.

Mr. Murillo reported 607 full-time and 123 part-time employees are in the RHS plan and are included in the valuation due to the minimum required contribution to CalPERS for retiree health plans. He also noted 60 active employees are eligible for the City's fixed dollar contribution under the prior defined benefit plan; however, it is paid into their RHS account. He noted 553 retirees receive the \$400 or \$450 fixed dollar contribution and 52 retirees who only receive the \$139 minimum required employer contribution benefit.

Finance Director/Treasurer Matusiewicz noted the City is slowly converting from a Defined Benefit Plan (DB) to mostly a Defined Contribution Plan (DC). In response to Council Member Dixon's inquiry, Mr. Murillo reported the City has 605 retired employees. He noted there are an additional 125 who have waived coverage with CalPERS so there is no liability; however, they are eligible to return to the plan at any time. Finance Director/Treasurer Matusiewicz clarified there are more retirees but they are not included in the valuation, as they have elected non-CalPERS medical coverage such as Medicare.

In response to Chair O'Neill's inquiry, Mr. Murillo advised CalPERS offers Medicare so employees who are receiving the defined benefit are likely to stay on this plan. Chair O'Neill noted the City is paying down its OPEB liability over the next 10 years, so this should not be an issue for future City Councils.

Mr. Murillo explained CalPERS medical is a community-rated plan that means an implicit rate subsidy can exist when the non-Medicare rates for retirees are the same as for active employees. The implied rate subsidy is the differential between what the retiree is costing and the premium that is being paid and is required by GASB. In response to Committee Member Collopy's inquiry, Mr. Murillo explained while the contribution is capped at \$400/\$450, there is a cost shift between the premium and the City's contribution which GASB requires the City to accrue the difference as a liability. Finance Director/Treasurer Matusiewicz clarified the City is required to accrue the difference as a liability; however, it is not required to fund it. He noted GASB effectively does not trust cities would not bend to the pressure if employees were paying a higher premium than they otherwise would if they did not include the retirees. They could start to negotiate for higher health benefits. City Manager Grace Leung advised it does not

mean anything from a real-world perspective and it is simply a bookkeeping issue. Mr. Murillo clarified the \$200 differential in the example is applied to the City as a liability. In response to Committee Member Collopy's inquiry, Finance Director/Treasurer Matusiewicz stated it should be reclassified from an active employee expense to a retiree expense. He further clarified the City is funding the full ADC to the Trust but the Trust is not paying it out to anyone. Chair O'Neill believes it is a savings issue that lowers the City's OPEB liability.

Mr. Murillo advised census and premium rate information is collected during the valuation process from the City to help determine the expected annual benefit payment, which is also called cash flows. He noted the number is derived by estimating the number of retirees and their expected costs to the City and noted they discount all of the future cash flows to today's dollars to derive the liability. He also stated they allocate the total liability to the past, present, and future. In response to Committee Member Collopy's inquiry, Mr. Murillo clarified the past information is required because employees have accrued the benefit based on past service.

Mr. Murillo explained that at the end of the FY19-20, \$2.9 million is expected to be paid in benefit payments, which is the additional cost for allowing retirees to be on this plan. He noted it is a cost-shifting from the active employees to the retirees. He advised the City is funding for the amount and the City can reimburse itself for the benefit as long as an actuary has calculated the implied subsidy. If so, the City is allowed to take that amount from the Trust.

In response to Chair O'Neill's inquiry, Finance Director/Treasurer Matusiewicz advised the City can reimburse itself but instead of sending the entire amount to the Trust, the City nets the amount needed to make cash distributions.

Mr. Murillo noted they project out over several decades what the benefits would be each year, and when summed, it is \$115.4 million over all years based on all the assumptions. In today's dollars, it is \$39.4 million. He explained if the \$39.4 million was placed in the Trust earning 6.5% interest there would be enough funds to not make a contribution in the future and all the benefits would be paid from the Trust. He also noted if the implied subsidy is an additional \$11.9 million; the total amount would be \$51.3 million including future service.

In response to Chair O'Neill's inquiry, Finance Director/Treasurer Matusiewicz clarified the City reduced the interest rate from 7.5 % to 6.5% because it is a maturing plan and the City is de-risking its portfolio.

Mr. Murillo reported the total liability, including future service, is \$51.3 million and the amount accrued by employees through the valuation date is \$56.6 million. He reported the total OPEB liability is \$46.6 million, with \$23.2 million funded and \$23.5 million unfunded. He advised the normal cost is what employees are expected to earn in the next year, which is \$520,000. He reported \$4.2 million would be covered by the City contributing to the normal costs annually.

Mr. Murillo clarified the manner by which the City is paying down the \$23.5 million in unfunded liability through an amortization payment over 10 years. He summarized the process by which the City becomes 100% funded by contributing amortization payments over the next 10 years and simply the normal cost thereafter.

Mr. Murillo noted for the next nine (9) years, the City has a \$3.5 million contribution to help pay down the \$23.5 million unfunded liability. As long as the City is also paying the normal costs, the City will pick up every year's future accruals.

In response to Council Member Dixon's inquiry, Mr. Murillo explained the valuation was based on retirees and existing and future employees; however, does not include any employees hired after the valuation. In response to Committee Member Collopy's inquiry, Mr. Murillo confirmed the valuation assumes all employees will work until retirement and how many will leave.

Mr. Murillo presented a sensitivity analysis that showed the impact of a 1% decrease and increase in the discount (interest) rate, which would change the recommended contribution from \$4.1 million to \$4.9 million. He noted the City is contributing through the California Employers' Retiree Benefit Trust (CERBT) under investment Strategy 1, with the expected return being 7.6%. He noted in the near-term, which is 10 years, CalPERS expects 5.9%, and they are using a discount rate of 6.5%, but after the first 10 years, CalPERS expects 8%.

In response to Council Member Dixon's inquiry, Finance Director/Treasurer Matusiewicz clarified that the Public Employees Retirement Fund (PERF) does not allow the City to choose investment strategies.

In response to Committee Member Reed's inquiry, Mr. Murillo noted the 1% increase in health care costs in the sensitivity analysis is based on CalPERS' assumption. He also noted they expect the City's CalPERS minimum costs to increase by 4% so they demonstrated the sensitivity analysis at 5% for the valuation.

Mr. Murillo noted the long-term rate of return is 7.6% and they are being more conservative by using a 6.5% rate of return. He noted CERBT leaves the number to the employer's discretion for purposes of valuation. He presented a variety of investment strategies to the Committee.

In response to Committee Member Collopy's inquiry, Mr. Murillo clarified the different assumptions in determining how the fund has performed in the past. He advised when looking at the 4%, they expect the CalPERS minimum contribution to increase every year, which is based historically on anticipated future trends and is currently hovering at the high 3% range. He advised if a high percentage is predicted when calculating health care costs, the costs would be prohibitive and unsustainable. He noted the ultimate trend in increased health care costs is 4-5%, which includes inflation and medical costs.

Mr. Murillo further explained a second cost component has to do with income offset based on investment returns. They look to the City and its investment advisors for the input regarding strategy. Lastly, he noted the medical inflation assumption is what the actuarial focuses on, and the City has more input into the investment return assumption.

Mr. Murillo presented projections and recommended contributions by projecting assets for the next 20 years and the correlating OPEB liability. He noted that after 10 years the City would be 100% funded.

In response to Council Member Dixon's inquiry, Mr. Murillo advised after the first 10 years there would be \$41.8 million in assets and \$41.2 million in liability so there would be money in the Trust to continue making the benefit payments. He noted the City would continue to have a liability however the unfunded liability would be zero. Finance Director/Treasurer Matusiewicz noted that eventually it would just be the Public Employees' Medical & Hospital Care Act (PEMHCA) minimum required funding.

Finance Director/Treasurer Matusiewicz presented the preliminary staff recommendations. He is advising the ADC be funded at 5.5%, which is an extra \$815,000 per year. He also recommends when making the ADC contribution to the Trust, the City net out any benefit payments so it is only paying the amount it wants to accumulate due to a heavy outflow required for making benefit payments. He recommends reducing the discount rate to 5.5% during the next 2-year valuation depending on the Capital Market Assumption (CMA) outlook. He recommends transitioning Strategy 1 assets to Strategy 3 gradually over the next nine (9) years. Lastly, he recommends eventually reducing the discount rate to 4.5% or future expected return commensurate with the portfolio mix.

In response to Committee Member Stapleton's inquiry, Finance Director/Treasurer Matusiewicz clarified the fourth Strategy would be to keep the money in the City's fixed-income

portfolio. Committee Member Stapleton noted the approach was very conservative. Finance Director/Treasurer Matusiewicz stated the question is whether the City is willing to take a volatility risk after it is fully funded.

In response to Committee Member Stapleton's inquiry, Finance Director/Treasurer Matusiewicz clarified in two (2) years he would like to reduce the discount rate, but would start putting money today into Strategy 3 to start changing the mix, which will reduce the assumed rate of return. In response to Committee Member Stapleton's inquiry, Chair O'Neill clarified Finance Director/Treasurer Matusiewicz is asking for more funding to backfill the liability so it does not extend from 9 years to 12 years.

Finance Director/Treasurer Matusiewicz noted the recommendations are a road map and are subject to change. Chair O'Neill stated the recommendation does play into this year's budget to the tune of \$800,000. In response to Council Member Dixon's inquiry, Finance Director/Treasurer Matusiewicz clarified the \$800,000 would come from the General Fund.

Chair O'Neill stated he would not ask the Committee to make the recommendation today and suggests the \$800,000 become a discussion between the City Manager and the Finance Director/Treasurer as part of the City Manager's overall budget recommendation.

Chair O'Neil called for public comments and hearing none, closed the public comment period.

There was no further action taken on this item.

## **B. INTERNAL AUDIT PROGRAM UPDATE**

### **Summary:**

Staff will provide an oral update of plans to implement a robust internal audit and performance audit program.

### **Recommended Action:**

Receive and file.

Deputy Director/Finance Steve Montano advised the City has retained the accounting firm, Moss Adams, to serve as the City's Internal Auditor and will execute an ongoing Internal Auditing Program. In response to Committee Member Collopy's inquiry, Deputy Director/Finance Montano clarified Moss Adams will be acting as the Internal Auditor on behalf of the City.

Committee Member Collopy expressed concern about the terminology and noted an External Auditor should give guidance and help develop procedures; however, by definition, is not an Internal Auditor. Finance Director/Treasurer Matusiewicz clarified the City is effectively outsourcing this role as the staff has limitations on resources. City Manager Leung clarified that she and the Finance Director/Treasurer are responsible for the Internal Audit Program and need outside resources to complete the work.

Deputy Director/Finance Montano reported the first step would be to complete an Enterprise Risk Assessment of internal controls that will focus on the City's operating environment. He noted they would deploy a team that will conduct fact-finding and interviews of City staff. He advised there would then be an internal controls review that will be more specific in nature. He reported the first phase will be to develop the work plan and the schedule, the second phase will involve fact-finding of relevant documents and interviewing and surveying staff, the third phase will be to compare current practices to best industry practices, and the fourth phase will be to prepare a draft report, which focuses on how to take identified opportunities for improvement. He also noted there would be an ongoing audit program focused on reducing risk, strengthening controls, and enhancing performance.

Deputy Director/Finance Montano advised the work would begin this month with the final audit plan issued in June 2020. He advised the contract is \$120,000; however, Moss Adams believes the work will be completed at \$100,000.

In response to Chair O'Neill's inquiry, Deputy Director/Finance Montano advised the end result would be the City's Internal Risk Assessment, which will identify areas of risk. He further clarified the risk will include identifying errors, ensuring there is no employee theft, and assessment of the City's operating performance. He also advised the work plan would be presented to the Finance Committee when it is received.

Committee Member Collopy expressed his passion for the subject and volunteered to assist with the process. Chair O'Neill thanked him for volunteering.

Finance Director/Treasurer Matusiewicz noted he looks at this process, as a road map and noted future phases will be more narrowly focused. Deputy Director/Finance Montano feels this will be beneficial to the organization and its various operations.

In response to Council Member Dixon's inquiry, City Manager Leung believes the outcome will be a very robust system and stated this is a good method to start evaluating the performance process in the long run. She also feels the outcome will lead to good control measures and performance tied to resource allocations. Council Member Dixon expressed her support for the item.

Committee Member Tucker expressed his support for the item.

Chair O'Neill opened public comments.

Jim Mosher stated he reviewed the contract and noted it was a one (1) year contract. He inquired if the firm will have a new contract for future years. He referenced the 11 points of work that Moss Adams might do for the City this year, but the actual work will be agreed to through their proposals. He recommends those letter proposals be made publicly available along with the contract for transparency.

In response to Mr. Mosher's inquiry, Deputy Director/Finance Montano advised the results of the first phase would go back to City Council for review and along with approval to execute the subsequent year's contract. He feels it is highly likely they will continue with Moss Adams and equated this to a Public Works' project where the design phase is completed prior to moving to the construction phase.

In response to Mr. Mosher's suggestion, Purchasing Agent Anthony Nguyen advised RFPs have been posted publically since October 2019. He noted any engagement over \$10,000 is live on the system and available for public review.

There was no further action taken on this item.

#### **C. TOT, CHARTER TAX AND OTHER AUDITS UPDATE**

##### **Summary:**

Staff will update the committee on the TOT, charter tax and other audit findings performed to date.

##### **Recommended Action:**

Receive and file.

Chair O'Neill noted there was no need for a staff presentation as the staff report was very thorough.

In response to Council Member Dixon's inquiry, City Manager Leung noted she is finalizing the audit and there have been some discussions with various hotels.

In response to Committee Member Tucker's inquiry, Finance Director/Treasurer Matusiewicz advised some hotels misinterpreted the code. Council Member Dixon advised at least one (1) hotel inquired regarding the cleaning fee in the Code.

Revenue Auditor Antonio Velasco reported during his site visits he felt some hotels simply do not understand the Code requirements and require education from the City.

In response to Council Member Dixon's inquiry, Revenue Auditor Velasco advised the Charter Tax is still on the honor code in terms of passenger receipts. He advised they also do not understand the Code requirements and require education from the City.

In response to Council Member Dixon's inquiry, Finance Director/Treasurer Matusiewicz clarified the tax is either \$1.00 per head or \$1.75 per head depending on the price of the ticket.

Chair O'Neill advised in order to change the tax into a fee, there would need to be a substantial rate study and the City would get a lot less money.

Chair O'Neill called for public comments.

Mr. Mosher noted the Charter Tax is \$0.50 if the ticket is between \$25 and \$30. He noted the two auditors were engaged and inquired if any discrepancies were found.

Revenue Auditor Velasco explained there were actually three firms who conducted the audits and no major differences were found.

There was no further action taken on this item.

**D. BUDGET AMENDMENTS FOR QUARTER ENDING DECEMBER 31, 2019**

**Summary:**

Staff will report on the budget amendments from the prior quarter

**Recommended Action:**

Receive and file.

There was consensus that no further action was needed on this item.

**E. WORK PLAN REVIEW**

**Summary:**

Staff and Finance Committee to review the proposed work plan and adjust as necessary.

**Recommended Action:**

Receive and file.

City Manager Leung reported the Economic presentation is cancelled.

Chair O'Neill noted the Finance Committee would be reviewing the Public Works budget, the Facilities Financial Plan (FFP), Harbor and Beaches Master Plan updates and the Fee Study update.

Chair O'Neill reported on January 25, 2020, there would be a special meeting of the City Council that will be a planning session. He also noted on February 10, 2020, City Council would be discussing the Capital Improvement Program.

**VI. FINANCE COMMITTEE ANNOUNCEMENTS ON MATTERS WHICH MEMBERS WOULD LIKE PLACED ON A FUTURE AGENDA FOR DISCUSSION, ACTION OR REPORT (NON-DISCUSSION ITEM)**

None

**VII. ADJOURNMENT**

The Finance Committee adjourned at 4:12 p.m. to the next regular meeting of the Finance Committee.

Filed with these minutes are copies of all materials distributed at the meeting.

The agenda for the Regular Meeting was posted on January 10, 2020, at 11:10 a.m., in the binder and on the City Hall Electronic Board located in the entrance of the Council Chambers at 100 Civic Center Drive.

Attest:

\_\_\_\_\_  
Will O'Neill, Chair  
Finance Committee

\_\_\_\_\_  
Date