MOFD Finance Subcommittee
Steve Anderson and Brad Barber

Sirs:

Attached is the 2015 version of my "revised" (executive summary) balance sheet which reformats the GASB balance sheet and compares it to prior years going back to 2009. In my opinion, this is what the CAFR should have; not a reiteration of the GASB balance sheet seven times.

There are four main topics this balance sheet addresses which separate it from the one in the CAFR:

A) It states MOFD's true financial condition: A net liability of $50 million; not $23 million.

B) It shows MOFD's assets, liabilities and net condition (currently a net $50 million liability) separately. It does not understate liabilities by netting them against uncertain assets "behind the curtain".

C) It bifurcates Operations from Employee Benefits. The reason for this is that employee benefit assets and liabilities are the tail that wags the dog. The employee benefit assets are seven times the operations assets and the employee benefit liabilities are over 100 times the operation liabilities. It also includes a consolidated statement of the two.

D) Most of MOFD's liabilities are future employee benefit liabilities. These liabilities are simply projections of what the future holds and not determinate. On top of this uncertainty, these liabilities, which can occur as far out as 60 or more years in the future, are then discounted back to the present at an assumed discount rate. This rate is the District's best guess of what the assets set aside to fund these liabilities will be but, in reality, this rate is also an unknown. The pension plan is currently underfunded because its assets have not earned what they were projected to earn in the past and OPEB is virtually unfunded so its asset performance history is even a larger unknown. It would be prudent for the District to put as much relevant data for significant elements of its finances in its annual financial report as possible. This would include not only the discounted present value of its Pension ($171 million) and its OPEB ($13 million) liabilities, but their non-discounted amounts also. The executive summary balance sheet includes estimates of these values.

A) True Financial Condition

The "bottom line" is a net liability of $50 million; not the $23 million the CAFR shows. The $27 million difference results from two items:

1) Prepaid items. The CAFR shows $21.76 million in pre-paid assets. However, only about $150,000 of these are real. The $21.6mm of "Prepaid Pension Assets" is a myth (or a lie depending on how pissed off you are). If there is some $21.6mm asset out there, where is it? Does CCCERA holding it for MOFD's account but is not aggregating it with MOFD's other assets? Is it in some MOFD fund not otherwise identified? The answer to these question is no; it does not exist anywhere but on paper in the CAFR balance sheet. MOFD has $143 in assets managed by CCCERA, and netted against $171 million in liabilities and that is it. There is not another $21.6 million in assets. This was a vestige of accounting "sleight of hand" back when MOFD borrowed $28 million in 2005 to fully fund the pension. The$28 million loan went on the balance sheet as a

liability; a $28 million asset was added to the balance sheet so the net would not be impacted; and (here's the sleight of hand) the footnoted $28 million pension liability also disappeared. A $28 million asset was added above the line and below the line. The below-the-line assets and liabilities have now been moved to above the line so now the double accounting is all above the line. I don't know if this is a structural flaw in the new GASB reporting rules for pensions or an error by the people who created the CAFR but it is an error which the executive summary balance sheet reverses.

2) There is also an additional $5.9 million in OPEB liabilities. In Bartel's last OPEB report (9/26/14), he said the gross OPEB liabilities, using a (in my opinion too high) 7.25% discount rate were $11.9 million as of 6/30/2013. Escalate that for two years at inflation (2.5%) and you get to $12.5 million by 6/30/2015. Net out the meager $84,000 put into the "OBEB TRUST FUND" last year and you get $12.5 million. But the CAFR only accounts for $6.6 million; $5.9 million short of the real number. While there is a 2.5 page footnote (#11) in the CAFR regarding OPEB, the $11.9 million total liability from the Bartel report is never mentioned; much less increased for two years of inflation.

The sum of those two is $27.5 million and there's the difference. A significant difference. The first is an error on someone's part. If it is GASB's, then this is one more reason a GASB balance sheet should not be relied upon to manage the District. If it is not GASB's, this $22 million error, which has existed since the Pension Bond was put on the balance sheet, needs some explanation by someone. The second is just another case of smoke and mirrors on behalf of the District. Everyone knows that the OPEB liability is over $12 million. To only show part of it on the balance sheet is providing no useful knowledge. This practice needs to be stopped.

B) Displaying MOFD's total assets and liabilities

The "big lie" of the newly instituted GASB 68 for pension accounting is the "need" to only show a net liability. In 2007 MOFD's pension plan was fully funded (in fact, slightly overfunded). Then in one year its assets lost 28% of their value. I don't recall what the district's total liabilities (and assets) were at that point (since they were not reported), but if MOFD was fully funded today a zero net liability would turn into $48 million net liability with no indication as to whether this was due to liabilities going up or assets going down. What benefit is it to the District and the community to shield itself from the facts that would point to the reason for such a drastic event?

The CAFR shows $63 million in liabilities. If all of the OPEB liability was included that would increase to $70 million. But MOFD's real liabilities are $213 million. That is not a minor adjustment and it results in understating reality by a factor of three. How can rational decisions be made when the facts are so warped? On the asset side the difference is worse. Removing the bogus $22 million Prepaid Pension asset, the CAFR shows $19 million in assets. In reality, MOFD has $162 million in assets; over eight times what the CAFR indicates. And 90% of those are rather volatile pension assets. This is valuable information which should not be hidden from the District itself or the community.

C) Bifurcating Operations from Employee Benefits.

One of the reasons pension and OPEB reporting was kept in a footnote, and now GASB 68 only shows the net pension condition and not its true value of assets and liabilities, is that these assets and liabilities overwhelm the numbers of the District's core business. They are the tail that wags the dog but they can also take down the entire operation if they are not fully understood and dealt with properly. There executive summary balance sheet deals with this by segregating the core business assets and liabilities from the employee benefits, and then consolidating them at the top. There is can be seen that 88% of the Districts assets are attached to employee benefits and 99% of the District's liabilities. While in total the District has $50 million in net liabilities, its core business is quite healthy with assets 12 times liabilities and net assets ($17 million) almost 75% of the annual revenue. Further segregation might identify "indispensable" assets (such as the capital assets and restricted cash), but that is fine tuning.

D) Non Discounted Liabilities

Many, including economists, might question the value of knowing what the District's long term (pension and OPEB) liabilities are. Currently the District does not know what these are. Its pension plan does not report them nor does its OPEB actuary. But not knowing them is akin to a home owner knowing the balance of his home mortgage but not knowing what his monthly payments are or how long he needs to make them (the product of the two being the total un-discounted liability). Only could say "but he can just pay off the balance". But what if he cannot pay it off in a lump sum. What if he is a retiree and on a fixed income that is not growing with inflation or growing only at inflation. He needs to be able to manage his cash.

This is not really the case for the District and its long term liabilities but it has other issues that might make it very wise to know, no matter how painful that knowledge might be, what its total liabilities really are. First, unlike a homeowner, the District cannot pre-pay the discounted value of its liabilities. It can invest sums which it hopes will grow with earnings and cover the future liabilities but, at least with the current investment pool, very few of those are guaranteed investments. But the payments to the retirees are guaranteed by the District. Shouldn't the District know how big a guarantee it has made?

The true elephant in the room are the pension liabilities and with the latest report from CCCERA, the GASB 68 accounting, a little bit of the curtain hiding the truth was pulled aside. In that report, on page 8, CCCERA's consultant Segal showed the sensitivity to discount rate of MOFD's net liability (at 6.25%, 7.25% and 8.25%). Since MOFD's asset value is known, adding that to the resulting net value produces the discounted gross liability. It can then be estimated, by measuring the impact on present value from a change in discount rate, approximately what the average life is of the un-discounted stream of liabilities. I have done this by creating an approximate annual liability stream stretching out 60 years. It increases at a rate of 4.73% for 16 years and then steadily declines. The discounted present value for this estimated liability stream is within a couple hundred thousand dollars of what CCCERA reports for the three separate discount rates. The total liabilities are $615 million; almost two thirds of a billion dollars. That is one heck of tail that dog is wagging. Why would the District not want to know this number? It should be a wakeup call for what we have obligated future generations to pay. So the executive summary balance sheet reports it.

This describes the format and elements of the Executive Summary Balance Sheet. With this, the changes from last year to this year can be noted. They are:

1) The change in Assets and Liabilities on the operations side are small partially because operation assets and liabilities are a small portion of the District's total. There was actually a 10% increase in net assets; $1.6 million resulting from a $1.9 million increase in the reserve accounts.

2) And there was a $12 million decrease in net liability on the Employee benefit side. This was the result of a $17 million increase in assets offset by a $5 million increase in liabilities. Much of the asset increase ($11.4 million) was from the recognition of deferred gain in pension assets (GASB 68's move from Valuation Value of assets to Market Value.) But there was also a real gain in pension assets of $5.4 million. On the liability side the $5 million increase came from four factors: (a) A $1.6 decrease in the pension bond balance. (b) A $4.4 million decrease in OPEB liability because the discounted liability is now using a 7.25% discount rate instead of a 4% discount rate. The reason is that there is now an OPEB funding plan but it should be questioned. The total OPEB liability is $12.5 million. If that increases with inflation (2.5%) over 15 years it will increase to $18 million. For MOFD to have $18 million in offsetting assets in 15 years, even if they earn at a rate of 7.25% (which is questionable), the District would have to contribute $700,000 per year to the trust for 15 years. Last year it contributed $84,000. Whether the District really has a plan to fund OPEB in anyone's lifetime is questionable. (c) A $5.4 million increase in pension liabilities (which was offset by $5.4 million in asset gains so the net was unchanged but this is an example of why assets and liabilities should be separated and not netted; so it can be understood what is happening). (d) A new item "Deferred Pension Inflows" of $6 million. It is unclear to me if this is a real liability or just an accounting entry to "smooth large movements in the net pension liability" as was stated in the CAFR (in which case it should be ignored). Currently it is included and is the entire reason liabilities increased.

3) The net result is a $13.5 million decrease in net liabilities although when the adjustment for market value of pension assets had been previously taken into account, the decrease was only $2 million. But it was a decrease and if the $6 million "Deferred Pension Inflows" item is just "accounting trickery", the net decrease will be closer to $8 million (half from a change in OPEB discount rate; $1.6mm from paying down the pension bond; $2 million in operating reserves).

As always, I hope you find this information, and the executive summary balance sheet, useful. I certainly hope you repair the CAFR's errors. Attached is a PDF printout of the Executive Summary Balance Sheet and the underlying Excel spreadsheet, which also includes an Executive Summary Budget Comparison comparing the current budget to budgets going back to 2007 and the "proof" that we have over $600 million in pension liabilities. I believe this document should also be part of a truly informative financial reporting package.

Sincerely,

Steve Cohn
Orinda Emergency Services Task Force