

**Los Angeles County Policies and Practices  
Governing Retirement**

***Eligible Salary and Benefits***

November 4, 1992

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Honorable Deane Dana, Chair  
Los Angeles County Board of Supervisors  
500 West Temple  
Room 822 Hall of Administration  
Los Angeles CA 90012

Dear Chairman Dana,

On March 3, 1992, the Board of Supervisors of Los County requested the Economy and Efficiency Commission and the Productivity Commission "to conduct a study of the County's policies and practices retirement-eligible salary and benefits, and report to the Board as soon as possible". The requested study included "a detailed background on the development of these programs and their retirement impact, examination of all relevant legal requirements, and a with comparable private and public plans. As a result of the division of work between the two commissions, the Economy and Efficiency Commission took responsibility for providing to your Board both an independent legal opinion on the question of constituted compensation earnable for retirement purposes. and for that portion of the project comparing comparable private and public retirement-eligible salary

On July 21, 1992, we transmitted to your Board the legal opinion of independent counsel. Following this Executive Director accomplishment, on August 18, 1992 we sent to your a letter expressing a strong concern for taking immediate action to prevent incurring any additional liability prior to resolution of this issue. Specifically, this recommended "that your Board take interim action to avoid incurring additional liability and consider giving notice to new employees, and to the extent legally permissible, current employees, regarding potential changes in the pension system." Subsequent to these actions the Productivity Commission completed and submitted to your Board their portion of this assignment entitled "Productivity Commission Retirement Study". In addition, the Los Angeles County Employees Retirement Association (LACERA) has also submitted to your Board a legal opinion on the issues of this matter.

We have now concluded the remainder of our assignment. This includes completing an assignment with WF Corroon on the comparison of comparable private and public retirement plans. Using the WF Corroon study and other available materials, we have prepared a set of recommendations we feel will meaningfully assist your Board in taking those actions necessary to improve the policy and operations of the current Los Angeles County Retirement System. To the extent possible, this Commission has attempted to identify all of the ramifications of its recommendations, but the recommendations made within this report, as with the recommendations of other agencies considering these issues, should be reviewed and implemented within the context of the entire retirement system and the policy direction issued by your Board.

Sincerely,

Gunther W. Buerk  
Chairperson

cc: Each Supervisor  
Each Economy and Efficiency Commissioner  
Donald Landis, Chair Productivity Commission  
Richard Dixon, Chief Administrative Officer  
Daniel Ikemoto, Auditor Controller  
DeWitt Clinton, County Counsel  
Charles Conrad, Chief Executive Officer, LACERA  
Bruce J. Staniforth, Executive Director

**Los Angeles County Policies and Practices Governing Retirement-  
Eligible Salary and Benefits**

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November 1992

**LOS ANGELES COUNTY POLICIES AND PRACTICES GOVERNING  
RETIREMENT ELIGIBLE  
SALARY & BENEFITS**

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**Appendix C:** Interim Recommendations of the Commission to Board of Supervisors, dated August 18, 1992.

**Appendix D:** Letter to the Board of Supervisors, dated September 11, 1992, summarizing the Opinion of Independent Counsel (Morgan, Lewis and Bockius opinion submitted July 21, 1992)

**Appendix E:** Executive Summary, Comparability Analysis, Los Angeles County Employee's Retirement Benefits, WF Corroon (Complete report submitted to Supervisors, October 16, 1992)



## **EXECUTIVE SUMMARY**

This report considers the issues raised pertaining to both the decision making process of retirement system design and the appropriateness of the inclusion of a number of specific items within the current benefit structure. The conclusions of our study indicate that the County must be governed by a stated Board policy and written procedures. The lack thereof has resulted in a broad, and at times conflicting, interpretation of unstated policy. As a consequence, flexible benefits, deferred salary, and transportation allowances have all been included within the definition of compensation earnable. This report considers the inclusion of each of these benefits, as well as the operation of the entire retirement system, in making the following recommendations:

### **LOS ANGELES COUNTY RETIREMENT POLICY**

1. Direct the Chief Administrative Officer, with the written support of the Los Angeles County Employees Retirement Association (LACERA), to submit to your Board a retirement policy that provides a basis for compensation and benefit design and administration under existing County ordinances.
2. Direct that, in conjunction with the policy developed in recommendation #1, a study of compensation and benefit issues for all employees within Los Angeles County Government be undertaken

### **FLEXIBLE BENEFIT PLAN DESIGN**

3. Direct the Chief Administrative Officer to seek legislation that will allow the Board of Supervisors to determine whether or not to include flexible benefits within the definition of compensation earnable for all new hires.
4. Direct the Chief Administrative Officer to take those actions necessary to insure that new hires are notified of any revised actions concerning the inclusion of flexible benefits in compensation earnable and any resulting procedures for implementing these actions.

5. Direct the Chief Administrative Officer, after obtaining legal advice from County Counsel, to implement a freeze on the MegaFlex plan cash options as provided in the present plan for each employee until a final policy on benefit levels can be established as suggested in recommendations #1 & #2.
6. Direct the Chief Administrative Officer to develop and submit a plan to your Board on how to address any additional retirement liability, as determined by the Retirement Board actuary, that will occur when flexible benefit cash options attributable to the Options plan, first effective in 1992, are included in actuarial calculations.
7. Direct the Chief Administrative Officer to explore postponing implementation of the Options plan until the terms can be renegotiated to exclude flexible benefits from compensation earnable.
8. Direct the Chief Administrative Officer, after obtaining legal advice from County Counsel, to insure that any future increases in County contributions are used only for the purpose of buying benefits and are not available as a cash option within the constraints of the collective bargaining process.
9. Direct the Chief Administrative Officer, after obtaining legal advice from County Counsel, to prepare an analysis of the possibility of offsetting future cost-of-living pay increases granted to employees in the MegaFlex Plan by reducing the amount of the cash back option available under MegFlex, relative to recommendations #1 & #2.
10. Direct the Chief Administrative Officer that, consistent with the policy developed in recommendation #1, any future increases in cash options under all flexible benefit plans be carefully considered, controlled or possibly eliminated and that current employees whose contracts may be renegotiated be notified of any such changes.
11. Direct the County Counsel to submit to your Board a report identifying the specific contractual obligations of the county to those employees currently included in flexible benefit as "compensation earnable".



12. Direct the Chief Administrative Officer to identify for your Board the fiscal impacts of any contractual obligation identified in recommendation #10 as it relates to the current flexible benefit plans and to identify options through which any such obligation can be met.

**TREATMENT OF DEFERRED SALARY**

13. That your Board reaffirm the action taken on September 8, 1992 by the Los Angeles County Employees Retirement Association (LACERA) stating that "delayed salary or merit increases shall constitute Compensation Earnable within the meaning of the Government Code Section 31461 when deferred, not when received."
14. Direct the Chief Administrative Officer, after obtaining legal advice from County Counsel, to present a plan to discontinue the use of the deferred salary program and to submit to your Board an analysis of the value of such a program prior to any future implementation.
15. Direct the County Counsel to submit to your Board an opinion identifying the specific contractual obligations of the County to those employees currently involved in salary deferral arrangements as well as the County's aggregate accrued liability for deferred salary.
16. Direct the Chief Administrative Officer to identify to your Board the fiscal impact of any identified contractual obligations of the deferred salary program and to identify options through which any such obligations can be met.

**TREATMENT OF TRANSPORTATION ALLOWANCE**

17. Direct the Chief Administrative Officer to develop procedures that properly consider transportation expenses as reimbursement to individuals for those transportation expenses incurred in the conduct of county business and that these expense be adequately documented. These revised procedures should be communicated to all employees.

18. Direct the Chief Administrative Officer to submit to your Board a report identify any contractual obligations of the county to those employees allowed to include transportation allowances in pensionable compensation.
19. Direct the Chief Administrative Officer to identify to your Board the fiscal impact of any identified contractual obligations as a result of including a transportation allowance in "compensation earnable" and to identify options through which any such obligations can be met

**OPERATION OF THE RETIREMENT SYSTEM**

20. Direct the Chief Administrative Officer to provide an analysis of impacts to your Board, with the input of the LACERA, prior to the implementation of any proposed action that affects retirement benefits. This analysis must consider all issues such as: compliance with. policy, fiscal impacts. recruiting, retention, and any additional relevant information. In cases where a conflict of interest appears to exist from the implementation of any proposed changes in retirement benefits, an independent analysis should be obtained.
21. Direct the Chief Administrative Officer to review the existing substantial financial commitment of fully paid medical coverage for some retirees and, in coordination with LACERA, to explore methods for financing this commitment in the future.22.
22. Request that LACERA consider reviewing retirement member compensation for compliance with the law and the policies established by \*s Angeles County if compensation increases beyond "normal" expectations, particularly during the final compensation period.
23. Request LACERA and the chief Administrative Officer to investigate options for simplifying the retirement system and to return to your Board with recommendations.

## INTRODUCTION

A retirement system has two basic objectives: to provide benefits that will attract and retain outstanding employees and to provide an ample retirement income. It is also an objective to accomplish both in as efficient and as cost effective manner possible. This Commission acknowledges that Los Angeles County has in the past recognized these objectives and has taken steps in an attempt to improve the efficiency and effectiveness of the retirement system. In its efforts to reduce retirement liability, the County has substituted three successively less generous retirement plans for its costly basic plan. These substitutions have had the effect of reducing millions in unfunded liability. (The operation of the Los Angeles County Retirement System and a description of the current retirement plans is contained in Attachment A.)

Recent actions impacting retirement plan design have raised serious questions as to the adequacy of the oversight process in this area. It appears that a lack of basic system management by staff has incurred an unfunded liability in excess of \$265 million. It is a lack of attention to fiscal impacts and the perception of having assumed this liability without adequate public exposure that has caused the public uproar and resulting lawsuits. The failure of the County staff to include LACERA as an administrative body in the decision making process, a failure to inform the public, through the Board of Supervisors, of the fiscal impacts of proposed actions, and a potential conflict of interest on the part of the individuals making the decisions on this matter are often cited as issues of prime concern. As a consequence of this lack of process, the State legislature recently passed Assembly Bill 2721 (Appendix B) which requires public notice of all salary and benefit increases with an explanation of the financial impact that any proposed increases will have on the funding status of the retirement systems.

The objective of the Commission in the conduct of its review has been to identify significant opportunities for the improvement in both the policy and operational structure of the retirement system. On August 18, 1992 this Commission sent to your Board a letter expressing a strong concern for training immediate action to prevent incurring any additional liability prior to resolution of this issue (Appendix C). Although recommendations are made to seek improvements and arrive at a satisfactory resolution of this matter, it is critical to understand that this understanding should be considered one phase of an ongoing review process. As a further assistance to your Board in its deliberations, this report includes as Appendix D a letter to your Board dated September 11, 1992 that summarizes the opinion of the independent counsel on the questions raised.

## LOS ANGELES COUNTY RETIREMENT POLICY

The Comparability Analysis of the Los Angeles County Employees' Retirement Benefits (Appendix E) produced by WF Corroon states that the retirement income for the typical employee group within Los Angeles County is "generally adequate" (p.8) and that the benefits are not "overly generous"(p.10). It also states that the funded Status of the system remain sound" and that "the actuarial assumptions used by the Retirement System [are]reasonable and consistent with those used by other 1937 Act county retirement Systems" (".9). However, it appears from an interpretation of the equity tests presented within this document that "the typical employees in the Choices and the Options flexible benefits plans receive a less adequate retirement benefit than the typical employees who participate in the MegaFlex Plan". This is a direct result of the level of flexible benefit cash options included as pension able earnings In addition, of those who participate in the MegaFlex Plan, there appears to be a benefits bias towards the "highly compensated employees"(". 31). This bias is generally due to the inclusion of the flexible benefit cash options and the transportation allowance in pensionable earnings (".33).

In establishing future retirement plan benefits the Board of Supervisors should be aware of the potential comparative intra-county impacts to the retirement plan design It should also use these impacts in defining a retirement policy and in structuring retirement plans.

There are valid reasons for developing a plan structure that includes some benefits. Certainly, it is difficult to attract and retain highly qualified executive level employees for public entities due to the strict limitations on the types of executive compensation and benefit programs available to governmental employees. Executives in the private sector are likely to be provided with other types of compensation, ie. nonqualified tax deferred savings plans and supplemental retirement programs. A retirement plan structure that includes specific and identified `benefits" would be proper to institute if the Board feels that such an action is necessary to accomplish the retirement policy objectives it sets for itself. Without a statement of the Board's policy on compensation and benefits, a determination as to whether any plans accomplish the desired objectives cannot be made.

It is beyond the scope of this effort to investigate all the elements, e.g., fiscal, legal, labor relations, involved in the formulation of an appropriate retirement plan policy. Such a policy should be developed to ensure a fiscally sound, equitable and effective plan structure

**RECOMMENDATIONS :**

That your Board:

1. *Direct the chief Administrative Officer with the written support of the Los Angeles County Employees Retirement Association (LACERA), to submit to your Board a Retirement policy that provides a basis for compensation and benefits design and administration under existing County ordinances.*
2. *Direct that in conjunction with the policy developed in recommendation #1, a study of compensation and benefit issues for all employees within Los Angeles County Government be undertaken.*

## **FLEXIBLE BENEFIT PLAN DESIGN**

County Counsel, LACERA Counsel, and independent counsel agree that cash paid to an employee under a flexible benefit program and cash used under such a program to purchase benefits for an employee are "pensionable compensation". As was discussed above, it is not clear from the documentation provided to the Commission that the Board's original intent in modifying the Flexible Benefit Plan was to increase the pension benefit. There are many tax and personal benefits to be gained from the implementation of a flexible benefit program, but there does not appear to have been any examination given to the issues of retirement costs or the inequities that may have been created by taking this action. It appears, that retirement benefit increases came about as an unintended side effect of the flexible benefit plan design.

In a September 25, 1990 Board Letter, the Chief Administrative Office presented the cost impact of modifications to the Flexible Benefit Plan on the county cost of fringe benefits as a percent of payroll. The ultimate impact as indicated in Attachment B of that document was a savings of 0.11% of a payroll base of \$526.9 million or approximately \$5.7 million annually. Neither the resulting increase in Retirement System unfunded liability of \$265 million (not including the effect of the Options flexible benefit plan implemented for Local 660 members earlier this year nor the increase in ongoing Retirement System costs appear to have been considered in this analysis. The implementation of these modifications appears to have resulted in a significant net annual cost.

The legal opinions submitted on this issue indicate that these benefits may now have become a vested right of the employee to whom these benefits have been granted. Thus, the existence of flexible benefits in its present configuration appears to have created an obligation for the county. In analyzing the inclusion of flexible benefits in the definition pensionable compensation, W F Corroon states that "the mere existence of a flexible benefits plan does not create the need for additional retirement income. The County contributions to the flexible benefit plans resulted from a conversion of employee benefits into cash equivalents. Once these benefit values are incorporated into the pension formula, the retirement program begins replacing both income and benefits" (pp. 55-56, underlining added).

Serious fiscal ramification to the retirement system of the actions that we retake, apparently, were neither identified or quantified for the Board of Supervisors. Granting higher pension benefits in this manner is neither an effective utilization of funds nor essential from a retirement benefit design perspective. The elimination of these benefits from "compensation earnable" will require changes to the law.

RECOMMENDATIONS:

That your Board:

3. *Direct the Chief Administrator to seek legislation that will allow the Board of Supervisors to determine whether or not to include flexible benefits within the definition of compensation earnable for all new hires.*
4. *Direct the Chief Administrator to take those actions necessary to insure that new are notified of any revised actions concerning the inclusion of flexible in compensation earnable and any resulting procedures for implementing these actions.*
5. *Direct the Chief Administrator Officer, after obtaining legal advise from County Counsel, to implement a freeze on the MegaFlex plan cash options as provided in the present plan for each employee until a final policy on benefit levels can be established as suggested in recommendations #1 & #2*
6. *Direct the Chief Administrator to develop and submit a plan to your Board on how to address any additional retirement liability, as determined by the Board actuary, that will occur when flexible benefit cash options attributable to the Options plan, first effective in 1992 are in actuarial calculations.*
7. *Direct the Chief Administrative Officer to explore postponing implementation of the Options plan until the terms can be renegotiated to exclude benefits from compensation earnable.*
8. *Direct the Chief Administrative Officer, after obtaining legal advice from County Counsel, to issue that any future increases in County contributions are used only for the purpose of buying benefits and are not available as a cash option within the constrains of the collective bargaining process.*

9. *Direct the Chief Administrative Officer, after obtaining legal advice from County Counsel, to prepare an analysis of the possibility of offsetting future cost-of-living pay increases to employees in the MegaFlex Plan by reducing the amount of the cash back option available under MegFlex, relative to recommendations #1 & #2*
10. *Direct the Chief Administrative Officer that consistent with the policy developed in recommendation #1, any future increases cash options under all flexible benefit plans be carefully controlled or possibly eliminated and that current employees whose contracts may be renegotiated be notified of any such changes.*
11. *Direct the County Counsel to submit your Board a report identifying the specific contractual obligations of the county to those employees currently included in flexible benefit as "compensation able".*
12. *Direct the Chief Administrative Officer to identify for your Board the fiscal impacts contractual obligation identified in recommendation #10 as it relates to the current flexible benefit plans and to identify options through which arty such obligation can be met.*



### TREATMENT OF DIFFERED SALARY

The opinion of independent counsel concludes that deferred compensation in the form of delayed salary and delayed merit increases, although pensionable compensation, is pensionable compensation when deferred, not when received (Morgan, Lewis & Bockius July 15, 1992 opinion at p.22 & 35). The LACERA opinion concurs with the opinion of independent counsel and further states "To recognize such compensation when paid, rather than earned, would allow a one-time, non-uniform, lump-sum payment from outside the final compensation period to be included within pensionable compensation in violation of the principles governing the statutory definitions of "compensation," "compensation earnable" and "final Compensation." (Hufstedler, Kaus, & Ettinger September 10, 1992 opinion at p.71)

Additional support for the opinion of the independent counsel and LACERA counsel is provided by an informal survey of twenty 1937 Act Counties conducted by the County Counsel. This survey indicates that of the three counties with delayed salary payments, Los Angeles, Alameda and Contra Costa Counties, only Los Angeles includes these payments when received. In both Alameda and Contra Costa these payments are included in the salary base in the period earned.

Based upon a consideration of the above legal opinions, the LACERA Retirement Board has subsequently adopted a policy that delayed salary ormer it increases shall constitute "compensation earnable" when deferred not when received. Considering available information and the actions taken by the LACERA Retirement Board, this Commission concurs with the position that delayed salary and delayed merit increases be included in pensionable compensation when earned, rather than when paid.

#### RECOMMENDATION:

That your Board:

13. *That your Board reaffirm the action taken on September 8, 1992 by the Los Angeles County Employees Retirement Association (LACERA) stating that "delayed salary or merit increases shall constitute Compensation Earnable within the meaning of the Government Code Section 31461 when deferred, not when received."*

14. *Direct the Chief Administrative Officer, after obtaining legal advice from County Counsel, to present a plan to discontinue the use of the deferred salary program and to submit to your Board an analysis of the value of such a program prior to any future implementation.*
15. *Direct the County Counsel to submit to your Board an opinion identifying the specific obligations of the County to those employees currently involved in salary deferral arrangements as well as the County's aggregate accrued liability for deferred salary.*
16. *Direct the Chief Administrative Officer to your Board the fiscal impact of any identified contractual obligations of the deferred salary program and to identify options through which any such obligations can be met.*

## **TREATMENT OF TRANSPORTATION ALLOWANCE**

It is the opinion of County Counsel that since the amount of the transportation allowance is not related to actual usage or actual expenses and is reported to the IRS as fully taxable income, transportation/security allowances fall within the definition of "compensation" and should be considered "compensation earnable". "If it were reimbursement, it could be excluded from the employee's income." (County Counsel June 10, 1992 opinion at p 28).

Counsel for LACERA also supports this opinion for inclusion stating that this allowance is both substitutable for benefits ordinarily paid out of salary and are available to all employees within the same grade or class (Hufstedler, Kaus, & Ettinger September 10, 1992 opinion at p.61-62). The LACERA opinion further expands upon this presentation by stating that "...the additional allowance functions as a very efficient salary substitute." (Hufstedler, Kaus, & Ettinger September 10, 1992 opinion at pp.61-62).

The opinion of independent counsel is that while under the rationale of one appellate court case transportation allowances would not constitute pensionable compensation, the rationale is not entirely sound and could well be dismissed or overruled by another court. (Morgan, Lewis & Bockius July 15, 1992 opinion at p.35).

An informal survey of twenty 1937 Act Counties was conducted by County Counsel indicating the following:

- Five (5) counties have cash only programs, three (3) of which include the cash in the retirement base.
- Eleven (11) counties have car/cash programs, four (4) of which include the cash in the retirement base.
- Four (4) counties do not provide a car allowance.

Los Angeles County has a cash only program. The two other counties that include the cash program in the retirement base are Ventura and Stanislaus Counties. Of sixteen (16) counties that have either cash or car/cash programs, seven (7) include and nine (9) exclude this allowance in the retirement base.

The question raised by the legal opinions refers to the original policy intent of the Board in granting a transportation allowance. If the intent of this action was to provide a means of "salary enhancement", then no action would be required since the above opinions support this action. If, on the other hand, the intent of the Board was to consider this allowance a reimbursement to insure that employees were not held personally liable for transportation expenses incurred in the conduct of county business, the design of the current program fails to accomplish this objective.

The Commission recognizes the responsibility of the County to reimburse its employees for transportation expenses incurred on its behalf. There is also an equally compelling responsibility on the part of the employee to adequately demonstrate that expenses did, in fact, occur in the conduct of that business. If this action was taken with the intent of functioning "as a very efficient salary substitute" rather than to accomplish the objective of reimbursement, there would exist a confusion as to the level salary being paid for services rendered. To the extent that the Board wishes to increase the salary of individuals now receiving this allowance as a "salary substitute" it should do so by increasing their base salary. As a result this Commission feels that transportation costs should be reimbursed based upon demonstrated expenses. By insuring that employees are reimbursed for transportation expenses, rather than being provided an allowance, the status of this expense will be changed from "compensation" to "reimbursement", thus "it could be excluded from the employee's income." (See County Counsel opinion above)

**RECOMMENDATIONS:**

That your Board:

17. *Direct the Chief Administrative officer to develop procedures that properly consider transportation expenses as reimbursement to individuals for those transportation expenses incurred in the conduct of county business and that these expense be adequately documented These revised procedures should be communicated to all employees.*
18. *Direct the Chief Administrative Officer to submit to your Board a report identifying any contractual obligations of the county to those employees allowed to include transportation allowances in pensionable compensation.*
19. *Direct the Chief Administrative Officer to identify to your Board the fiscal impact of any identified contractual obligations as a result of including a transportation allowance in "compensation earnable" and to identify options through which any such obligations can be met.*

## OPERATION OF THE RETIREMENT SYSTEM

This Commission agrees with the provisions of the recently passed Assembly Bill 2721 which requires the notice of all salary and benefit increases affecting represented and unrepresented employees. It is important to note that this legislation also requires that the notice include an explanation of the financial impact the proposed benefit change or salary increase will have on the funding status of the retirement system.

As you have learned from previous information provided to your Board on the structure of the Los Angeles County Retirement System, the issues with which you are dealing are complex and have potentially serious consequences. Events demonstrate this complex interaction and seem to indicate that a significant amount of confusion exists as to the responsibilities for overall system design and operational coordination. It is obvious that close coordination is vital to insure that all parties to the process are aware of the cost and structural implications of the granting of future benefits.

Staff's lack of advance coordination with LACERA on the modification of flexible benefits, the requirement to establish the appropriate treatment of salary deferral and transportation allowance after the fact, and a staff failure to communicate to the Board of Supervisors the impact of the actions they approved are all symptoms of a larger systemic problem requiring a simplification of the retirement system.

A failure in coordination also indicates a lack of independent control of these responsibilities for the operation of the Retirement System. A more formalized system during both the development and the approval processes might well have prevented much of the repercussion that has subsequently arisen. Without this process in place and understood, concerned parties have less of an opportunity to express their objections to any plan modification. A more formalized process that addresses the issue of responsibility will also greatly assist in defining accountability. It is valuable to deal with these matters before, rather than after the fact when granted benefits have potentially become vested.

Some of the problems that have arisen may also have been identified earlier in the process through a routine review of the level of benefits being received by retirees. Although there is no procedure in place to accomplish this review, consideration should be given to determining if it could be accomplished through automation and/or, when necessary, field audits. This process, or some other more appropriate process could provide LACERA, and in turn the County, with information as to the operational efficiency and effectiveness of the Retirement Systems structure. This review would not

impair any member's benefit and can be fully administered within existing law. Also, it has no negative effect on disability, death or retired benefits and assures that proper benefits are being paid.

In addition, an evaluation of the long term costs associated with the commitment of the county to provide full medical, dental and vision coverage to employees with 25 or more years of service should be undertaken. With longer life expectancies and the continuing growth in medical costs a strategy must be established to insure its continued funding.

**RECOMMENDATIONS:**

That your Board:

20. *Direct the Chief Administrative Officer to provide an analysis of impacts to your Board with the input of the LACERA, prior to the implementation of any proposed action that affects retirement benefits. This analysis must consider all issues such as: with policy, fiscal impacts. recruiting retention, and any additional relevant information. In cases where a conflict of interest appears to exist from the implementation of any proposed changes in retirement benefits, an independent wza4sis should be obtained.*
21. *Direct the Chief Administrative to review the existing substantial financial commitment of fully paid medical coverage for some retirees and, in coordination with LACERA, to explore methods for financing this commitment in the future.*
22. *Request that LACERA consider reviewing retirement member compensation for compliance with the law and the policies established by Los Angeles County if compensation increases beyond "normal" expectations, particularly during the final compensation period.*
23. *Request LACERA and the Chief Administrative Officer to investigate options for simplifying the retirement system and to return to your Board with recommendations.*

## CONCLUSIONS

This report recommends specific actions for consideration by the Board of Supervisors that the Economy and Efficiency Commission feels will resolve existing concerns for the Los Angeles County retirement system.

Many organizations, both within and outside the County, have struggled with these retirement issues and problems, and specifically, with that of arriving at a definition of "compensation earnable". To the extent that these efforts are attempting to remedy an existing problem they are to be commended, but the vision of language to address this specific issue has been tried many times to no avail. Another approach might be that suggested by the State Association of County Retirement Systems (SACRS) and the California Public Employees Retirement System (CALPERS). These organizations have discussed the possibility of simplifying the retirement system, thus, eliminating the necessity for carefully defining "compensation earnable". By adopting this strategy it may be possible to institute a simplified methodology in defining the basis upon which a retirement benefit would be granted.

Whatever remedies are undertaken by your Board to overcome the deficiencies identified both in this and other reports, it is obvious that future pension actions must be governed by a stated Board policy and written procedures that leave little room for interpretation. Los Angeles County appears to be providing an unintended level of benefits at a moment in time when our fiscal situation and budget are in dire straits. Effective action on this issue will significantly enhance public confidence in the judgement of the Board of Supervisors. Fiscal impacts and comparison of benefits with other public and private organizations of comparable size must be a basis for any future revisions to the system.





**APPENDIX A**  
**LOS ANGELES COUNTY RETIREMENT SYSTEM**

**THE LOS ANGELES COUNTY RETIREMENT SYSTEM**

Overview

In order to provide a more complete understanding of the operations of the retirement system in Los Angeles County, it is critical that the responsibilities for the operations of the retirement system be identified.

The Los Angeles County Employees Retirement Association (LACERA) provides the administrative management of the Los Angeles County Retirement System. This Association is a quasi-independent public entity established under the County Employees Retirement Law of 1937 (California Government Code Sections 31450 through 31898). Its operations are governed by the California Constitution, the County Employees Retirement Law of 1937, and the By-Laws, Procedures and policies adopted by the Boards of Retirement and Investments. The County Board of Supervisors may also adopt resolutions which may affect the benefits of LACERA members.

The general management of LACERA is the responsibility of the Board of Retirement. The Board of Investments is responsible for setting for the investment strategies, policies and objectives for the employees' retirement fund.

The following are the roles of LACERA:

- to provide retirement, disability and death benefits to its active general and safety members.
- to collect, deposit, invest and manage retirement trust funds solely in the interest of, and for the exclusive purposes of providing benefits to participants and their beneficiaries and minimizing employer contributions
- to act as a fiduciary agent for the accounting and control of member and employer contributions and investment income
- to act on the direction of the Boards of Retirement and Investments, and

**APPENDIX A (continued)**  
**LOS ANGELES COUNTY RETIREMENT SYSTEM**

- to identify, develop and advance legislation", rule: and policies which promote the interests of the Fund.

Types of Benefits: Provided by LACERA

Retirement Benefits: These are benefits payable to a member upon retirement for the life of the member. As noted in the section on Payment to Retirees, they are based on the member's plan, age, years of service and final compensation. After meeting minimum eligibility requirements, members may retire at any time after becoming eligible. A more detailed description of the general member open plans is enclosed.

Disability Benefits: These benefits are paid to members, except for plan E, who become permanently incapacitated for the performance of duty whether for service-connected (job related) causes or non-service-connected (non-job related) causes, and who meet the established eligibility requirements. A member, the head of the office employing the member, the Board or its agents, or any other person on the member's behalf may apply for disability retirement if the eligible member is believed to be disabled.

Survivor Benefits: Survivor benefits are paid to the eligible spouses and minor children of members who die either before (excluding Plan E) or after retirement and meet specific eligibility requirements. Spouses are notified of the benefits which are available and must elect their choice of benefit.

Plan Participants

Plan participants are County or district employees who are permanent and work at least 3/4 time. Membership in LACERA is mandatory and classified into two categories: safety and general.

LACERA is the largest such organization of the twenty 1937 Act counties. It is significantly larger than the next largest system, both in terms of assets and membership. As of June 30, 1991 LACERA had 65,640 active general members and 10,817 active safety members for a total of 76,457 active

**APPENDIX A (continued)**  
**LOS ANGELES COUNTY RETIREMENT SYSTEM**

members. It also had 30,450 retired general members and 5,752 retired safety members for a total of 36,202 retired members.

Plan Funding

LACERA's obligations are funded by a combination of employee contributions (plans A, B, C, and D only), county contributions, and investment earnings.

Employee contribution rates are calculated in accordance with the applicable sections of county retirement law. Each member contribution is determined by multiplying the member's retirement-eligible compensation by the member's contribution rate based on the member's age upon entry into the plan. The member contribution rates will not change unless there is a change in one of the following:

- The mortality rate among service retirees.
- The salary assumption for annual salary increases
- The interest rate the system expects to earn on its investments

County contributions are actuarially determined to provide for the balance of amounts not paid for by the employees and applied by aggregating the retirement-eligible compensation for all members (by plan and type) and multiplying it by the applicable employer contribution rate. The county's contribution rate may change if the benefits are changed or if any of the actuarial assumptions are not met. The county remains the ultimate guarantor of all retirement benefits.

Payment to Retirees

Initial payments to retirees are dependent on formulas contained in the California Government Code and is based on:

- the retirement plan to which the member belongs
- age at retirement
- years of service at retirement
- final average monthly compensation
- years of service covered under Social Security as a

**APPENDIX A (continued)**  
**LOS ANGELES COUNTY RETIREMENT SYSTEM**

County/District employee

In general, the formula for calculating the benefit is as follows:

Age Factor (as defined in the appropriate section of the Government Code) x Years of Service x Final Average Monthly Compensation = Monthly Retirement Benefit

The Benefit derived from the application of the above formula is reduced for each year of participation under Social Security.

Compensation for pension purposes is calculated for each of the identified plans as follows:

**FLEX OR MEGAFLEX PARTICIPANTS**

Salary Base Rate

- + Prior Salary and Retroactive Pay Adjustments
- + Transportation Allowance
- + Deferred Salary Repayment
- + Flex Plan or Megaflex county Contribution
- PBP Deferred Salary or Officers Deferred Salary.
- = Final Monthly Compensation

**CHOICES OR OPTIONS PARTICIPANTS (Nurses Only)**

Salary Base Rate

- + Prior Salary and Retroactive Pay Adjustments
- + Transportation Allowance
- + Deferred Salary Repayment
- + Maximum amount of choices, Options Taxable Cash, currently \$244
- PBP Deferred Salary or Officers Deferred Salary
- = Final Monthly Compensation

**APPENDIX A (continued)**  
**LOS ANGELES COUNTY RETIREMENT SYSTEM**

OPTIONS PARTICIPANTS (Except Nurses) Salary Base Rate  
+ Prior Salary and Retroactive Pay Adjustments  
+ Transportation allowance  
+ Deferred Salary Repayment  
+ Maximum amount of Options Taxable Cash, currently \$100  
and increasing to the choices amount by 7/1/94  
- PBP Deferred Salary or Officers Deferred Salary  
= Final Monthly Compensation

PBP = Performance Based Pay

Authority to Modify Plan Features

Plan features, as shown in Attachment 1 to this Appendix, can be modified by the following bodies:

1. Legislature

The County Employees Retirement Law (CERL) as codified in the California Government Code can be modified by legislative action. Some provisions apply to all 1937 Act Counties; some provisions apply to counties of a certain class, based on population; and some provisions are enabling, that is, may be adopted on a county by county basis through resolutions.

2. Board of Supervisors

As noted above, some provisions of the CERL are enabling and are made applicable in a county by the adoption of a resolution. In Los Angeles County, for example, Plans A, B, C or D are various configurations of age factors, final compensation periods and cost-of-living provisions adopted by the Board of Supervisors. Changes in plan provisions are usually pros-Vel that is, affect only new participants in LACERA. An exception to this has been made when enhancing benefits by having them "rolled back". This occurred when the County created Plans B, C, D and E.

3. Board of Retirement

The Board of Retirement is generally an administrative body with virtually no authority to modify plan provisions. Two exceptions to this

**APPENDIX A (continued)**  
**LOS ANGELES COUNTY RETIREMENT SYSTEM**

lack of authority exist; the first exception allows the Board to adopt a resolution providing for the period of time members may have to redeposit contributions from Plan B to Plan D, and the second allows the Board to provide for supplemental cost-of-living increases.

Cost of Living Allowances

The Board of Supervisors has the authority to determine which Government Code Sections are applicable in terms of granting ongoing cost-of-living increases. In Los Angeles County, Section 31870, which provides for a maximum 2% increase, applies to Plan B, C and D members, while Section 3 1870.1, which provides for a maximum 3% increase, applies to Plan A members.

Plan E, which was created by a specific article in the Government Code, has no provision for cost-of-living increases.

The Board of Retirement must determine, prior to April 1 of each year, whether there has been a cost-of-living increase based on the Consumer Price Index (CPI) and to adopt appropriate increases, approximating to the nearest one-half of one Percent the percentage change in the CPI.

Supplemental Cost-of Living Increases

When the CPI is greater than the maximum 2% or 3% increase allowable, the difference between CPI and the allowable increase is accumulated in a Cost-of-Living Adjustment (COLA) "Bank". For example, if the CPI is 4.4% and the increase allowable is 3%, the excess of 1.4% would be added to the bank.

Under Government Code Section 31874.3 there are two permissible methods by which the Board of Retirement may authorize supplemental cost-of-living increases. Permitting conditions differ for the two methods.

A. Under Government Code Section 31874.3(a) supplemental increase may be granted if:

**APPENDIX A (continued)**  
**LOS ANGELES COUNTY RETIREMENT SYSTEM**

1. the actual incase in the cost-of-living as shown by CPI exceeds 3%;
  2. the amount of the supplemental increase is limited to the difference between the actual increase in the CPI and the annual COLA grant by Government Code Section 31870 and 31870.1;
  3. the supplemental increase must be funded from surplus earnings;
  4. the supplemental increase is paid to all retirees; and,
  5. the supplemental increase shall not become part of the base retirement allowance.
- B. Under Government Code Section 31874.3(b), supplemental increases may be granted if:
1. the amount of the supplemental increase is funded from surplus earnings;
  2. the supplemental increase is limited to retirees with COLA accumulations in excess of 25%; and,
  3. the supplemental increases shall not become part of the base retirement allowance.

Surplus earnings are the investment earnings that remain after paying expenses, crediting member and employer reserves with interest (credit ingrate set by Board but historically, at LACERA, always equal to actuarial rate which is currently 8% unless there are insufficient earnings); and, depositing 1% of assets into a reserve for contingencies.

Of the two permissible approaches, the Board has elected the one which permits the supplemental cost-of-living increase to be paid to those retired members whose COLA accumulations exceed 25% as of January 1. The program is called STAR (Supplemental Targeted Adjustment for Retirees)and was implemented in January 1990. The program, in effect, restores the purchasing power of retirement allowances to 75% of the purchasing power

**APPENDIX A (continued)**  
**LOS ANGELES COUNTY RETIREMENT SYSTEM**

held by retirees at retirement. Before this program was implemented, the Board of Retirement complied with Government Code Section 7507 in obtaining the cost impact of the benefit as determined by an enrolled actuary.

Cost Impact of Benefit Changes

Pursuant to Government Code Section 7507, the Legislature and local legislative bodies shall secure the services of an enrolled actuary to provide a statement of the actuarial impact upon future annual costs before authorizing increases in public retirement plan benefits. This information shall be made public at a public meeting at least two weeks prior to the adoption of any such increases. Section 7507 applies to the Legislature and to local legislative bodies which would include the Board of Supervisors. The passage of Assembly Bill 2721 reinforces this Code Section.



**ATTACHMENT 1 TO APPENDIX A**

**SERVICE RETIREMENT PROVISIONS  
FOR GENERAL MEMBERS  
Open Plans Only**

	Plan D	Plan E
<b>Normal Retirement Age</b>	65	65
Vesting Requirement	100% with 5 or more years of service	100% with 10 or more years of service
Coverage	All General members hired after May 1979 have elected coverage	All General members hired after January 4, 1982 and electing coverage
Final Average Salary (FAS)	3 years	3 years
<b>Service Retirement</b>		
<b>a. Requirement</b>	Age 50 and 10 years of service or 30 years of service regardless of age	Age 55 and 10 years of service
<b>b. Formula</b>	$1.67\% \times \text{FAS} \times \text{years of service} \times \text{AF}$	$(2.0\% \times \text{FAS not to exceed } 35 + 1.00\% \text{ FAS} \times \text{years of service in excess of } 35, \text{ not to exceed } 10 \text{ years}) \times \text{AF}$
<b>c. Adjustment Factor</b>		
50	.7091	not available
55	.8954	.3640
60	1.1500	.5915
62	1.2548	.7260
65 and over	1.4593	1.000
<b>d. Benefit Percentage Per Year of Service</b>	1.182%	not available
50	1.182	not available
55	1.492	0.728%
60	1.917	1.183
62	2.091	1.452%
65		2.000%
<b>e. Maximum benefit</b>	100% of FAS	70% of FAS if service is less than 35, otherwise 80% of FAS
Death after retirement spousal continuance after service retirement	60%	50%
Cost of Living Adjustment	60%	50%
Employee Contributions Rates		
Sample Entry Ages		
20	6.45%	None
30	7.16%	None
40	7.92%	None
50	8.73%	None
59 and over	9.51	None



**APPENDIX B**

**Assembly Bill No. 2721**

Chapter 1047

An act to amend Section 31596.1 of, and to add Sections 7513, 23036, and 31529.1 to, the Government Code, relating to public employee benefits.

[Approved by Governor September 27, 1992. Filed with Secretary of State September 29, 1992]

LEGISLATIVE COUNSEL'S DIGEST

AB 2721, Elder. Public employee benefits: eligible rollover distributions: county retirement-legal representation.

Federal income tax law requires, upon distribution from certain state and local public retirement systems to members, certain withholdings, unless an eligible rollover distribution is directly rolled over into an eligible retirement plan, as defined.

This bill would authorize those state and local public retirement systems to make those eligible rollover distributions to those eligible retirement plans.

Existing law generally requires the county board of supervisors to conduct regularly scheduled open meetings.

This bill would require, with respect to any county which has established a county employees' retirement system pursuant to the County Employees Retirement Law of 1937, that the board of supervisors shall make public at a regularly scheduled meeting all salary and benefit increases affecting represented and non-represented employees. The bill would require that notice of any increase shall be put on the agenda, as an item of business, posted at least 72 hours before the meeting. The bill would require that notice shall occur prior to the adoption of the increase and that the notice include

## APPENDIX B

an explanation of the financial impact the proposed benefit change or salary increase will have on the funding status of the retirement system. By imposing these notice requirements, this bill would create a state-mandated local program.

The bill would authorize the board of retirement or board of investments to have an enrolled actuary prepare an estimate of the actuarial impact of the salary or benefit increase.

The County Employees Retirement Law of 1937 makes various provisions for the acquisition by boards of retirement and boards of investment of legal advice and services. This bill would authorize the board of retirement or the board of investment in Los Angeles County to elect to secure legal representation, on such matters as either board may specify<sup>1</sup> from other than the county counsel and would make related changes.

The California Constitution requires the state to reimburse local agencies and school districts for certain costs mandated by the state.

Statutory provisions establish procedures for making that reimbursement, including the creation of a State Mandates Claims Fund to pay the costs of mandates which do not exceed \$1,000,000 statewide and other procedures for claims whose statewide costs exceed \$1,000,000.

This bill would provide that, if the Commission on State Mandates determines that this bill contains cost mandates by the state, reimbursement for those costs shall be made pursuant to those statutory procedures and, if the statewide cost does not exceed \$1,000,000, shall be made from the State Mandates Claims Fund.

*The people of the State of California do enact as follows:*

**APPENDIX B**

**SECTION 1.** Section 7513 is added to the Government Code to read:

**7513.** (a) In case of a state or local retirement system or plan that is subject to Section 401(a)(31) of the Internal Revenue Code, if, under the terms of the system or plan, a person becomes entitled to a distribution that constitutes an "eligible rollover distribution" within the meaning of Section 401(a)(31)(C) of the Internal Revenue Code, the person may elect, under terms and conditions to be established by the administrator of the system or plan, to have the distribution or a portion thereof paid directly to a plan that constitutes an "eligible retirement plan" within the meaning of Section 401(a)(31)(D) of the Internal Revenue Code, as specified by the person. Upon the exercise of the election by a person with respect to a distribution or portion thereof, the distribution by the system or plan of the amount so designated, once distributable under the terms of the system or plan, shall be made in the form of a direct rollover to the eligible retirement plan so specified.

(b) The purpose and intent of this section is to enable the state and local retirement Systems and plans that are subject to Section 401(a)(31) of the Internal Revenue Code of 1986, as amended, to comply with the requirements of that section regarding the provision of an election for direct rollover of certain plan distributions.

**SECTION 1.5.** Section 23026 is added to the Government Code, to read:

**23026.** In any county which has established a county employees' retirement system pursuant to the County Employees Retirement Law of 1937 (Chapter 3 (commencing with Section 31450) of Part 3 of Division 4), the board of supervisors shall make public, at a regularly scheduled meeting of the board, all salary and benefit increases that affect either or both represented employees and non represented employees. Notice of any salary or benefit increase shall be included on the agenda for the meeting as an item of business in

**APPENDIX B**

compliance with the requirements of Section 54954.2 Notice shall occur prior to the adoption of the salary or benefit increase, and shall include an explanation of the financial impact that the proposed benefit change or salary increase will have on the funding status of the county employees' retirement system.

The board of retirement, or board of investments in a county in which a board of investments has been established pursuant to Section 31520.2, 15 authorized, consistent with its fiduciary duties, to have an enrolled actuary prepare an estimate of the actuarial impact of the salary or benefit increase. The actuarial data shall be reported to the board of supervisors.

Nothing in this section shall be construed to limit or lessen the requirement imposed by Section 7507 that the costs associated with increases in public retirement plan benefits be determined by an enrolled actuary and publicly disclosed two weeks prior to an adoption of the increase in public retirement plan benefits.

**SECTION 2.** Section 31529.1 is added to the Government Code, to read:

**31529.1** Notwithstanding any other provision of this part, the board of retirement or the board of investment may elect to secure legal representation, on such matters as the board of retirement or the board of investment may specify, from other than the county counsel. The cost of the legal representation shall not exceed one-hundredth of 1 percent of system assets in any budget year. This section applies only to a county of the first class, as defined by Section 28020, as amended by Chapter 1204 of the Statutes of 1971, and Section 28022, as amended by Chapter 43 of the Statutes of 1961.

**SECTION 3.** Section 31596.1 of the Government Code is amended to read:

**APPENDIX B**

**31596.1** The expenses of investing its moneys shall be borne solely by the system. The following types of expenses shall not be considered a cost of the administration of the retirement system, but shall be considered as a reduction in earnings from those investments or a charge against the assets of the retirement system as determined by the board:

(a) The costs, as approved by the board, of actuarial valuations and services rendered pursuant to Section 31453.

(b) The compensation of any bank or trust company performing custodial services.

(c) When an investment is made in deeds of trust and mortgages, the fees stipulated in any agreement entered into with a bank or mortgage service company to service such deeds of trust and mortgages.

(d) Any fees stipulated in an agreement entered into with investment counsel for consulting or management services in connection with the administration of the board's investment program, including the system's participation in any form of investment pools managed by a third party or parties.

(e) The compensation to an attorney for services rendered pursuant to Section 31607 or legal representation rendered pursuant to Section 31529.1.

**SECTION 4.** Notwithstanding Section 17610 of the Government Code, if the Commission on State Mandates determines that this act contains costs mandated by the state, reimbursed to local agencies and school districts for those costs shall be made pursuant to Part 7 (commencing with Section 17500) of Division 4 of Title 2 of the Government Code. If the statewide cost of the claim for reimbursement does not exceed one million dollars (\$1,000,000), reimbursement shall be made from the State Mandates Claims Fund. Notwithstanding Section 17580, of the Government Code, unless otherwise specified in this act, the provisions of this act shall become operative on the same date that the act takes effect pursuant to the California Constitution.





**APPENDIX C**

August 18, 1992

Honorable Deane Dana  
Chairman, Board of Supervisors  
County of Los Angeles  
869 Hall of Administration

Dear Supervisor Dana:

During the Commission's August 5, 1992 meeting, the Commissioners discussed the status of the Los Angeles Retirement system in detail. In light of the County Counsel and independent counsel's opinion, the Commission unanimously adopted (with one abstaining vote) to

recommend:

*That your board take interim action to avoid incurring additional liability and consider giving notice to new employees, and to the extent legally permissible,, current employees, regarding potential changes in the pension system.*

Additionally, it is recommended:

*That your Board request County Counsel provide appropriate legal advice Executive Director to implement those changes, as needed, in the information provided to employees.*

**APPENDIX C**

Without having concluded our study on these issues, the Commission hesitates to make any additional recommendations. However, there is a strong consensus within the Commission that there is an immediate need for the County to take action. This action should prevent the County from incurring any additional pension liabilities until the entire issue is reviewed. We also felt it important to support your Board in exercising control over the type of retirement information given to employees that could result in any potential future liability for the County.

Sincerely,

Gunther W. Burke  
Chairperson

cc: Each supervisor  
Each Commissioner  
Richard B. Dixon, CAO  
De Witt W. Clinton, County Counsel  
Bruce J. Staniforth

**APPENDIX E**

September 11, 1992

Honorable Dean Dana, Chair  
Los Angeles County Board of Supervisors  
500 West Temple  
Room 822, Hall of Administration  
Los Angeles CA 90012

Dear Chairman Dana,

During a recent meeting you requested that the Economy and Efficiency Commission provide your Board with a brief summary of the independent legal counsel opinions on the question of what constitutes compensation earnable for retirement purposes. Per that request the following is a brief summary of the major conclusions of that opinion.

- Flexible benefits were probably included as a part of compensation earnable for purposes of the retirement system.

- Under judicial precedent, transportation allowances would not be treated as compensation earnable, but the existing judicial precedent is questionable and may well not be followed by another court.

- Deferred compensation is compensation earnalbe when deferred and not, as it has been treated, compensation earnable when paid.

- An actuarial impact statement does not appear to have been required before the decisions were made on the treatment of flexible benefits, transportation allowances and deferred compensation. Even if required, the failure to obtain an actuarial impact statement would probably not defeat the employees vested rights existing in the present method of treatment of these items.

**APPENDIX E**

- Although contrary arguments can be made, it is likely that the courts would find that the current employees of the County have been vested and contractual rights to continue to have flexible benefits, transportation allowances and deferred compensation considered in the definition of compensation earnable.

This summary has been reviewed by and concurred with Mr. Frank Smith, the independent counsel issuing the opinion.

Sincerely,

Gunther W. Buerk  
Chairperson

cc: Each supervisor  
Each Commissioner  
Roger Whitby, County Counsel  
Frank Smith, Esq.  
Don Landis, Chair, Productivity Commission  
Bruce Staniforth, Executive Director

**APPENDIX E**

**COMPARABILITY ANALYSIS**

LOS ANGELES COUNTY EMPLOYEES' RETIREMENT BENEFITS  
PREPARED FOR LOS ANGELES COUNTY ECONOMY AND EFFICIENCY COMMISSION  
SEPTEMBER 1992

PRODUCED BY W F CORROON

COPIES MAY BE OBTAINED UPON REQUEST FROM THE ECONOMY AND EFFICIENCY  
COMMISSION



**APPENDIX E**

**EXECUTIVE SUMMARY**

**SECTION 3.1** The assumption and methodologies employed In our analysis are  
**METHODOLOGY** disclosed in this section. The pivotal elements include:

- ◆ Focus on retirement plans "open" to flew hires.
- ◆ Evaluation of all retirement Income sources available from the employer.
- ◆ Use of the County retirement system actuarial assumptions where applicable.
- ◆ Identification of a group of six "typical employees", which In total provides a representative cross-section of LA County General employees
- ◆ Exclusion of Safety members from the study due to significant differences In responsibilities and, therefore, benefits between these employees and private sector employees.
- ◆ The typical employees are:

**Represented**

SEIU Local 660  
Coalition

**Job Title**

Secretary I  
Property Agent II

**Nonrepresented**

Other  
Professionals/Managers  
Performance Based Pay Recipients  
Senior Management/  
Department Heads

**Job Title**

Senior Secretary III  
Data Processing Manager I  
Data Processing Manager III  
Auditor                      Controller

**APPENDIX E**

**SECTION 3.2  
GENERAL  
ANALYSIS  
ADEQUACY  
ELEMENT**

This section of the report deals with the following question:  
Do the benefits under the Count's retirement program provide an adequate level of retirement income to all classes of our typical employee group?

- ◆ The results of measurement indicate that:
  - At retirement, the income for the typical employee group is generally adequate to sustain the employee's preretirement lifestyle when employee contributions are considered. The County funded portion of Benefits replaces 50% to 80% of preretirement earnings.
  - Inflation of 5% will result in a reduction in average purchasing power over the employee's retirement years of 30% for the typical employees covered under Plan d and 40% under Plan E. These reductions do not include the purchasing power protection promoted under the STAR supplemental cost-of-living program for Plan D.
- ◆ Adequacy measures are based upon benefits generated from amounts
  - The County Retirement System, plus
  - The County's 401(k) and 457 Retirement Savings Plans, and
  - For the DP Manager III and Auditor Controller positions under Plan E, amounts generated from personal savings, to the extent that employees were precluded from making full contributions to the 401k plan due to federal limits.

**SECTION 3.3  
INTRA-  
COUNTY  
COMPARISON  
EQUITY  
ELEMENT**

This section of the report deals with the following question:  
**Is the County retirement program equitable to all classes of our typical employee group?**

Our equity measures is based upon the Retirement Benefit Adequacy (RBAC) developed in Section 3.2

- ◆ As measured by the RBAC, the typical employees in the Choices and the options flexible benefits plans receive less adequate retirement Benefits than the typical employees who participate in the MegaFlex Plan. This is the direct result of the level of flexible benefit cash options included as pensionable earnings.
- ◆ The results of equity tests among the typical employees who participate in the MegaFlex plan indicate a bias towards highly compensated employees (based on the IRS definition of "highly compensated employees"). The desirability of this situation is a compensation and benefit policy issue.



## APPENDIX E

- ◆ The Commission may want to recommend further study of executive compensation benefits as they relate to public and private sector employees.

### Section 3.4 COMPETITIVE ELEMENT

This section of the report deals with the following question:

**How competitive are County benefits when compared with other entities, both public and private?**

- ◆ When viewed in the aggregate, Los Angeles County provides retirement income plans comparable to those available to the 17 other employers surveyed.
- ◆ In comparing the forms of compensation includable in pensionable earnings, Los Angeles County is unique among those surveyed for including transportation allowance, security allowance, and county flexible benefit contributions. However, survey data provided to us by the commission indicated that some of the smaller 1937 Act retirement systems include these items in pensionable earnings.

### SECTION 3.5 FUNDING/ACT UARIAL ISSUES: FINANCING ELEMENT

This section of the report deals with the following question:

**Are the Retirement System Benefits being funded in a reasonable and responsible manner considering the increases in liabilities that occurred as a result of the inclusion of flexible benefit cash additional compensation elements into pensionable compensation?**

- ◆ Though contribution levels have been increased, the funded status of the system remains sound.
- ◆ There was a decrease in the government accounting standard funding ratio from 84.9% as of June 30, 1990 to 81.5% as of June 30, 1991. Even with this reduction, the Los Angeles County system's funded ratio is above that of the median county retirement system, and sits very close to the average for all these systems.

#### ◆ Actuarial Assumptions

In general we found the actuarial assumptions used by the Retirement System to be reasonable and consistent with those used by other 1937 Act county retirement systems. There are three specific items we would comment on:

#### ▪ Options Flexible Benefit Plan

An additional increase in unfunded liability will occur when Flexible benefit cash options attributable to the options plan, first effective in 1992, are included in actuarial calculations.

**APPENDIX E**

▪ Population Growth Assumption

We recommend that the Board of Investments review the appropriateness of the 1% growth assumption when the amortization period is reevaluated in four years.

▪ Future Flexible Benefits Amounts under Choices

It was assumed in the actuarial valuation that the cash option available under the Choices plan will increase as the same rate as future salaries, ie., 6% per year. If it increases more rapidly than this (e.g., if it increases in unison with increases in medical premiums under the Choices plan) there will be substantial future increases in the unfunded liability.

This is an area where there is need for close coordination between County administration and the Retirement System so that all parties are acutely aware of the retirement cost implications of future negotiated cash options available under the Choices plan. These same concerns will also apply to the cash options under the Options Flexible Benefits Plan.

◆ Fiscal Management Policies

Government Code Section 7507 requires that actuarial studies to determine future annual costs be carried out by "local legislative bodies before authorizing increase in public retirement plan benefits. This legal requirement should not be the sole guide to responsible fiscal management of retirement benefits costs. The County management must maintain a consistent policy of formally communicating with the Retirement System Boards and staff to be sure that retirement cost implications of their actions are evaluated before they are instituted.

◆ STAR Program

Future costs of continuing this program will increase because of the inclusion of the additional compensation elements in pensionable earnings.

SECTION 4:  
CONCLUSION  
AND  
RECOMMENDAT  
ION

**BASIS UPON WHICH OUR RECOMMENDATIONS ARE DEVELOPED:**

The core conclusions upon which our recommendations have been developed are:

◆ Retirement Benefit Adequacy

In general, the benefits are not overly generous when one considers that a substantial portion of the benefits is funded by the employee, and the reduction in benefit adequacy that occurs through the inflationary losses in purchasing power after retirement.

## APPENDIX E

### ◆ Retirement Benefit Equity Among Employees

Using our typical employee group as a benefit for comparison, County retirement benefits are more adequate for employees participating in the MegaFlex plan. Within the MegaFlex covered group, County funded retirement benefits are more adequate for the highly compensated employees.

### ◆ Competitiveness of the Los Angeles County Retirement Program with Comparable Public and Private Employers' Programs

In general, the programs are comparable with the exception of benefits provided to highly compensated employees. This is the direct result of the inclusion of compensation elements such as County contributions toward the flexible benefit plan and transportation allowances into pensionable earnings. These items are not used by other employers in our sample.

### ◆ Financing Elements

The additional compensation elements that have been introduced into pensionable earnings have resulted in an increase in the unfunded liability of \$265 million. This does not include the effect of the Options flexible benefit plan implemented for local 660 members earlier this year. There are potentially added future costs that may result from the continuation of the STAR supplemental cost of living program for future retirees. The additional unfunded liability has been determined assuming that the cash options under the Choices program increases at 6% per year in direct proportion with increases in salary. To the extent that this amount increase.

Before offering possible solutions to the issues raised above, it is important to discuss the realistic potential for implementation of solutions.

## RECOMMENDATIONS

The recommendations which follow have important legal, labor relations and policy implications which must be carefully considered before they are implemented. They have not been given any legal review. They have been formulated under the assumption that reductions in retirement plan expenditures are an important fiscal objective. Adoption of these recommendations must be considered in terms of their impact on the entire compensation and benefits package of County employees.

1. Flexible Benefit Cash Options In our opinion, granting higher pension benefits when flexible benefit plan cash options are available does not spend employer benefit dollars in the most effective manner. Pension increases so provided are not necessarily essential from a retirement benefit design prospective, but are being brought about as a side-effect of flexible benefit plan design and legal interpretation.

## APPENDIX E

Thus, it may well be the case that county dollars spent to support these pension increases would be better spent in other benefit areas or to make different improvements in the retirement area. For this reason, we suggest that future increases in the cash options under the Choices and Options plans be carefully considered, controlled, or possibly eliminated, unless compelling arguments in other areas argue for their increase. In addition, we suggest that the cash option under the MegaFlex and Flex Plans be reduced by one or both of the courses set out below to the lowest level consistent with acceptable flexible benefits plan design and prior commitments to employees.

- a. Freeze the MegaFlex plan cash option at its present dollar level for each employee. Any increase in the County contributions to these plans would be provided in the form of benefits rather than cash options.
- b. Offset future cost-of-living pay increases granted to employees in the MegaFlex Plan against the MegaFlex cash option. The rationale for using the offset is to avoid reducing the present take home pay available to employees.

For example, assume an employee is entitled to a County contribution to MegaFlex equal to 17% of salary, all of which is available to be taken in cash. For illustrative purposes, assume that a 3% cost of living raise is given on July 1, 1992. The January 1, 1993 MegaFlex cash option would be reduced to 14%, the 17% option reduced by the 3% pay increase. There would still be a 17% of salary MegaFlex contribution, but there would be less available to take in cash. This strategy could be used to bring the MegaFlex cash options with the Options and Choices plans closer over time. We understand that only 15% of employees are taking all of their MegaFlex contribution in cash.

To lessen the impact of the reduction of the cash option on employees, the expansion of MegaFlex and Flex to include 401(k) could be investigated.

2. The county should explore the feasibility of offsetting County retiree health insurance contributions by the retirement benefit increases resulting from the inclusion of the flexible benefit amounts into pensionable earnings. In section 3.2 we addressed the policy issue of what the appropriate pay base should be to measure income replacement for retirement benefit purposes. We believe that the mere existence of a flexible benefits plan does not create the need for additional retirement income. The County contributions to the flexible benefit plans resulted from a conversion of

## APPENDIX E

employee benefits into cash equivalents. Once these benefit values are incorporated into the pension formula, the retirement program begins replacing both income and benefits. As a result, there may justification to use the increase in benefits that a retiree gets from incorporating flexible benefits amounts into pensionable earnings against the amounts the County would otherwise contribute to that retiree's medical benefits.

As an example, assume an employee retires at age 62 from Retirement Plan D with 30 years of service. Assume further that the employee his final annual earnings of \$30,000 before including the MegaFlex annual cash option and \$35,100 after including it. The retiree is entitled to a monthly retirement benefit of \$1,835.14 of which \$266.65 is due to the inclusion of the MegaFlex cash option. This employee would be required to contribute towards the cost of retiree health Insurance up to the lesser of the cost of the chosen coverage or \$266.85 per month. In future years, the \$266.65 would be increased with cost-of-living adjustments.

In effect this extends the flexible benefits concept into the retirement years (albeit without the tax advantages) since the retiree can choose to contribute towards and participate in the County health plan, or to keep \$266.65 per month.

3. Eliminate the incorporation of flexible benefits amounts and transportation allowances from pensionable earnings for new hires. To lessen the impact of the reduction of the cash option on employees, the expansion of MegaFlex and Flex to include 401(k) could be investigated.
4. Either include all future special salary deferral arrangements in pension- able earnings on an as-earned basis or discontinue such salary deferral arrangements. This practice promotes "spiking" of pension benefits which produces inequitable benefits and understatement of ultimate pension costs.
5. The evaluation of executive compensation and benefits issues as they relate to public and private sector employees is beyond the scope of our study. The Commission may want to recommend that this issue be studied further.