November 29, 2023
Finance Commission - Insurance Fund Committee Report

Committee Members: Fred Findley, Sheila Rossi

Executive Summary

Recommendation: Establish and maintain a cash reserve, in accordance with policy, of a ***minimum of 70% of*** the net present value of the actuarial reported total Self-Insured Workers Compensation and General Insurance Liabilities through a transfer of funds from the General Fund to the Insurance Fund. Establish internal controls and policies for the ongoing management of the Insurance Fund, claims liability reserve balance, and risk management activities.

Fiscal Impact: The fiscal impact is isolated to the accounting for the General Fund Unreserved Balance. The General Fund Projected Unassigned Balance for June 2024 was reported as $18,478,145 on September 28,2023. The expected present value of liabilities as forecast by actuarial reports is *$2,723,000.* A 70% minimum reserve balance equates to $1,906,100. Assuming no current cash reserves (worst case scenario), this would equal a transfer or commitment from the General Fund, resulting in a General Fund unassigned balance of $16,648,777 and a 42% Reserve of the $39.6 million of projected General Fund Revenues for Fiscal Year 2023-24. Any existing cash assets in the fund would result in a reduction of the recommended transfer amount.

Background: The 2020 audit reported an actuarial self-insured liability of $1,736,000 and a cash reserve balance of $172,076 (10% of liabilities). The City recognized it was in non-compliance with its Risk Management Policy goal to maintain a minimum of 70% reserve by the fiscal year 2023-24 and it pledged to achieve its funding goal within the next three years. Due to increases in insurance claims over the past three years the Insurance Fund had deficit balances of ($1,724,921) in 2021, ($1,952,519) in 2022 and ($1,928,000) in 2023. In accordance with GASB Statement No. 10, the City is required to accrue a liability in its financial statements for a reasonable estimate of the cost of claims and expenses associated with all reported and unreported claims. The amount of the accrued liability would be determined by the annual actuarial report.

Process: To develop a recommendation, the Ad-hoc Insurance Fund Committee reviewed the following:

- Legal, Contractual, and Fiduciary Obligations
- Current Actuarial Data
- Current Funding Proposals
- Internal Service Fund Structure and Timeline
- Historical financial information reported in the 2011-2022 ACFRs.
- Historical information reported in the 2011-2024 adopted budgets.
- Self-insured reserve policies for other California municipalities.
- Historical information related to the decision to switch insurance carriers.

The Internal Service Fund Background

Initial Use of Internal Service Fund

The City of South Pasadena manages risk across the organization through a combination of purchased insurance and self-insurance. In 2014, the City of South Pasadena established an Internal Service Insurance Fund to manage the City's General Liability and Worker's Compensation claim payments, claims liabilities, and cash reserves, in compliance with contractual obligations made with the Public Risk Innovation, Solutions, and Management (PRISM) Self-Insured Risk Management Pool. An initial transfer of $303,640 was used to establish a cash reserve of $290,000 as security for future liabilities and to pay current year claims and administrations expenses. The initial cash transfer was funded through payments from the General Fund ($187,640), Water ($72,500), Sewer ($14,500), and Lighting, Landscaping & Management ($29,000).

From 2014-2021, the Insurance Fund (IF) was *only* used to pay for general liability and worker's comp insurance *claim payments, liabilities, and cash reserves.* The Insurance Fund *was not* used to manage payments and cost allocations for the approximately $1.2 MM to $1.4 MM *annual* Worker's Compensation and General Liability premiums. During this period, premium payments appear to have been directly expensed at the individual departmental and fund level.

Claims, Liabilities, and Cash Balances

During the City's first four years as a member of PRISM, the City *appeared* to maintain appropriate cash reserves in the IF. However, starting in 2018, the City's claims expenses began to increase rapidly, resulting in a depletion of the Fund's cash reserves. In 2020, the City's claim payments increased dramatically to $1,205,280. Further, in 2020, the City and its auditors were made aware of the City's failure to accrue for and maintain a cash reserve for its expected incurred and incurred but not reported (IBNR) claims liability. As a result, the 2020 audit utilized actuarial reports to determine a liability of $1,736,000, reported claim payments of $1,205,280, and a cash balance of $172,076 (10% of liabilities) which was insufficient to cover liabilities or meet the fund's reserve minimum. Had the City utilized actuarial studies to accrue for liabilities prior to 2020, the increases in claims expenses would most likely have been forecast and accounted for appropriately.

ACFR	Insurance Cost	Claims Paid	Liability	Cash Reserve	Net Position Ending	Transfers In
2015	$14,207	$13,640	$567	$290,000		$303,640
2016	$45,830	$46,397	$567	$290,000		$ 64,956
2017	$82,306	$81, 712	$594	$290,000	$289,406	$81,712
2018	$229,942	$227,948	$2,588	$62,052	$59,464	$46,397
2019	$306,906	$307,067	$2,427	$24,941	$22,514	-
2020*	$2,941,010	$1,205,280	$1,736,000	$172,076	$(1,566,081)	$140,000
2021	$2,167,384	$2,146,352	$1,759,189	$34,268	$(1,724,921)	$1,127,250
2022	$4,324,990	$2,797,054	$2,304,591	$352,077	$(1,952,514)	-

Recognition of Non-Compliance with Policy #9: 2021-2022 Approved Budget

In the 2021-2022 Budget, the City recognized its non-compliance with Policy #9 Risk Management Policy "the goal of maintaining a minimum 70% reserve is anticipated and that this goal will be achieved incrementally, and *fully* achieved by Fiscal Year 2023-2024". In adopting the 2021-2022 Budget, the City Council and City staff pledged to fulfill its funding obligations to the self-insurance risk pool over a period of ***three years***. However, despite the substantial increase in internal charges, the fund has been operating at a deficit, rather than accruing assets to offset incurred liabilities. This is largely attributed to high net claim payments and structural imbalances of the fund. The June 2023 Fund Balance was stated to be ***-*** *$1,928,000, with projected liabilities of $2,723,000*.

On September 28, 2023, staff proposed a 10-year amortization of the 2024 General Fund liabilities to address the June 30, 2024, deficit fund balance. The recommendation's annual payments of $155,000 did not seek to address funding for the additional $1.2 million in liabilities allocated to the Water, Sewer, Street Lighting, and Arroyo Funds. The proposal represented a significant deviation from City policy.

As a result, on September 28, 2023, the Finance Commission established an ad-hoc Insurance Fund Committee to conduct an in-depth review of the Insurance Fund and provide recommendations related to the funding and management of the Insurance Fund and Self Insurance Cash Reserve.

Materials Reviewed

1. Legal, Contractual, and Fiduciary Obligations

In evaluating South Pasadena's Insurance Fund and Risk Management Policy, we reviewed the legal, contractual, and fiduciary obligations as defined by GASB, Public Risk Innovation, Solutions, and Management (PRISM), and the Actuarial Data.

Self-Insurance Cash Reserves

As a self-insured entity, the City effectively operates as an insurance company, and is ***required*** to maintain a sufficient reserve against substantial claims and liabilities.

- In accordance with Governmental Accounting Standards Board Statement No. 10 the City is required to accrue a liability on its financial statements for a reasonable estimate of the cost of claims and expenses associated with all reported and unreported claims. The accrual amount is determined by annual actuarial report information at the expected confidence level for the present value of projected losses, including incurred but not reported (IBNR) liabilities.
- A balanced fund requires fund assets equal to its liabilities.
- An Insurance Fund may earn interest on its cash reserves, and build equity to protect against future increases in expenditures.
- Cash borrowed by other funds should be considered a loan and incur an interest expense.

Public Risk Innovation, Solutions, and Management (PRISM) MOU: Exhibit A

As a Member of a Self-Insured Risk Management Pool, The City is obligated to maintain a reserve in accordance with the Public Risk Innovation, Solutions, and Management (PRISM) MOU: Exhibit A https://www.prismrisk.gov/resources/prism-documents/governing-documents/general-liability-1-memorandum-of-understanding/

The Member shall obtain an actuarial study performed by a Fellow of the Casualty Actuarial Society (FCAS) at least once every three (3) years. Based upon the actuarial recommendations, the Member should maintain reserves and make funding contributions **equal to or exceeding** *the present value* of expected losses and a reasonable margin for contingencies.

Joint Powers Agreement – Amended June 30, 2020

Public Risk Innovation, Solutions, and Management (PRISM) Annual Premiums & Surcharges

https://www.prismrisk.gov/resources/prism-documents/governing-documents/joint-powers-agreement/

As a party to the PRISM Joint Powers Agreement, the City may be subject to annual premium surcharges up to three (3) times the annual premium amount for a given year, to assure adequate program funding in the event of an unusually large number of losses to the risk pool.

Public Risk Innovation, Solutions, and Management (PRISM) Annual Premiums:

  - Participant's share of expected program losses including a margin for contingencies as determined by the Board of Directors, program reinsurance costs, and program administrative costs for the year, plus that participant's share of PRISM general expense allocated to the program by the Board of Directors.

- If PRISM experiences an unusually large number of losses under a program during a policy year, which may exhaust the joint insurance funds, PRISM may impose premium surcharges on all participating members.
  - Premium surcharges imposed pursuant to (i) and/or (ii) above shall be in an amount which will assure adequate funds for the program to be actuarially sound; provided that the surcharge to any participating member **shall not exceed an amount equal to three (3) times the member's annual premium for that year**, unless otherwise determined by the Board of Directors or the program's governing committee.

2. 2023 Actuarial Projections

The actuarial projections performed by Bickmore Actuarial provide the estimated values of the City's net claim liability at various confidence intervals or probabilities of occurrence. The 50% confidence level represents the 'expected', 'best actuarial' or 'central' estimate for the cost of incurred liabilities. Meaning that in 5 out of 10 years the estimated cost should be sufficient to cover the actual cost of the incurred liabilities. The 50% confidence level represents the minimum amount in the range to be accrued and is not necessarily the amount of loss that is experienced.

The actuarial reports also provide a Net Present Value (NPV) to discount future payments, using an annual discount rate of 2% based on the average projected duration of the accrued liabilities. The NPV amount takes into consideration what has been discussed in reports by staff as the "long-tail" of claims payments included in the liability.

2023 Actuarial Report

	Total @ 50%*	NPV @ 50%	Total @ 80%	NPV @ 80%
Workers Comp	$ 1,682,000	$ 1,518,000	$2,078,000	$1,875,000
General Liability	$1,242,000	$ 1,205,000	$1,545,000	$1,499,000
Total	$2,924,000	$ 2,723,000	$3,623,000	$3,374,000

3. Reserve Funding Proposals

General Fund "Reserve"

Staff has suggested that the excess unreserved balance in the General Fund is more than adequate to cover the required reserve levels for expected liabilities. Staff has also suggested that this approach would allow the use of those monies for other purposes. However, monies available for other purposes does not constitute a reserve. For the General Fund to be used to 'hold' the reserve, a committed reserve *must* be established in the General Fund. A committed reserve results in an equivalent reduction to the General Fund Unrestricted Balance.

10-year Amortization of Liabilities

The staff proposed a 10-year amortization of the current $2.7 million in liabilities to allow time to fund the reserve at a rate of $277,000 a year, split between the General Fund, Water, Sewer, and the Lighting, Landscaping & Maintenance Fund. With $155,000 a year to be expensed from the General Fund for this purpose. This would constitute a reserve balance of 10% and take 7 years to reach the minimum reserve level requirement. Amortization of the NPV of expected losses does not provide for the cash required to be held in reserve today, nor does it account for the potential increase in the value of the losses over time- a minimum of an additional $200,000 (50% confidence level) and up, depending on confidence level. It does not address any additional expected annual liabilities incurred during the course of the next 10 years.

It also does not allow for the accrual of equity to the fund to plan for future increases in insurance costs.

A more appropriate approach to planning for these expected liabilities includes:

1) Maintaining a reserve at the expected present value of the liabilities 100% +
2) Utilize the reserve to pay for liabilities as they come due.
3) Replenish the reserve to a minimum 70% of liabilities each year.
4) Ensuring that the reserve does not drop below the minimum 70% of liabilities.
5) Accruing earned interest from the cash reserves to offset the future value of the liabilities.

4. Historical Information: Internal Service Fund Structure Timeline

Fiscal Year 2014: Fund Established

- **Expenditures:** Payments made for claims, legal fees, deductibles, and claim administration expenses (internal and external).
- **Revenues:** Fund revenues generated through internal charges to city departments and funds allocated based on annual assessments of claim experience and outstanding liabilities.
- **Liabilities:** To book expected claims liability.
- **Cash Reserves/Assets:** A balance was established, in accordance with PRISM policy, using actuarial data in the first year to cover expected claims.
- **Not Included:** Revenues and payments for Worker's Compensation and General Liability *Premiums.*
- **Actuarial Reports:** It does not appear that actuarial data was used from 2014-2020 to provide a forecast of liabilities or to maintain the appropriate level of cash reserves.

Fiscal Year 2020 - Accrual of Liabilities:

- During the Fiscal Year 2020 audit process, which began in 2021, the City was notified that they were required to utilize actuarial reports to determine and book the expected present value of its incurred and IBNR claims liability, in accordance with PRISM policy.
- Cash assets were insufficient to cover either the 2020 actual claims experience or the expected present value of its incurred and IBNR claims.
- A transfer was made from the General Fund to cover the cash payments made to pay claims.
- The transfer was not sufficient to meet the required reserve level for the expected present value of its incurred and IBNR claims liability.
- In the 2022 budget, which was developed after the completion of the 2020 ACFR in 2021, the City added language to its financial policy #9, stating: The city's goal is to maintain reserves to fund its outstanding self-insured liabilities at the *minimum* level of 70 percent.
- The City noted its deficiency in meeting the reserve requirement and pledged to make incremental contributions to refund the reserve by Fiscal Year 2023-2024.

Fiscal Year 2022 - Change in Fund Structure:

- In 2022, the City made a change to the management of the Internal Service Insurance Fund, to include payments and reimbursements for General Liability and Worker's Comp Insurance Premiums $441,879 WC, $648,832 GL.
- Premium Allocations continued to be expensed at the Department and Fund Levels as Worker's Compensation and Liability and Surety Bonds Expenditures. Interdepartmental and fund payments were made to the Insurance Fund and recorded as an Operating Revenue to the Insurance Fund. The Insurance Fund then became responsible for making consolidated premiums payments, booked as Operating Expenditures.
- In 2022, the City incurred $1,897,423 in net claims expenditures.
- Interdepartmental charges (WC+ GL) = $2,471,480 were insufficient to cover the $3MM of net claims and premiums expenditures (let alone the incurred liability or overhead expenses)
- The 2022 ACFR reported a $1.2MM Operating Loss and a $1.95 MM negative net position.
- Cash Assets were not sufficient to meet the required reserve level for the expected present value of its incurred and IBNR claims liability.
- In the City's 2022-2023 Adopted Budget, the City noted its continued deficiency in meeting the reserve requirement and pledged to make incremental contributions to refund the reserve by Fiscal Year 2023-2024.

5. Historical Annual Comprehensive Financial Report (ACFR) and Budget Data 2012-Present

To understand the historical and current funding and obligations of the City's Insurance Fund, we conducted a review of the City's published ACFR for Fiscal Years 2011/2012 to 2021/22.

During our review of the ACFRs, we learned that prior to 2014, the City maintained a GF committed "Self Insurance" reserve of $401,000, in lieu of maintaining an Insurance Fund for the management of claim payments, liabilities, and self-Insurance cash reserves. CJPIA provided first dollar coverage which means that the city did not retain any risk per covered claim.

In 2012, the City reported a long-term liability of $1,958,598 attributable to a CJPIA Retrospective Deposit Adjustment Payment for the period ending in June 2010. The liability was recorded as paid in fiscal year 2013. However, a new Retrospective Deposit Adjustment Payment was expected for the period ending in July 2013. The 2014 ACFR reported a "decrease of $1,276,760 in general government" as a result of the change in insurance carriers from CJPIA to PRISM. Given this language, it appears that the City may have believed that it could avoid a Retrospective Deposit Adjustment payment for the period ending in July 2013 by switching insurance carriers. However, it is not clear in the ACFR how this "savings" was determined.

At the March 2023 Mid-year Budget meeting, City staff notified the Council that it had received a bill from CJPIA for the amount of $1,654,761 to cover claims from a period ending in 2013. Coincidently, a future value calculation for $2,276 MM over 9 years at 2.92% = $1,654,761.

ACFR 2012: Lance, Soll, Lunghard, LLP

- The City maintained a General Fund committed "Self Insurance" Reserve of $401,000 and a separate unrelated "Legal Reserve" of $255,000
- The City's 2012 Budget included $923,563 for General Liability Premiums
- The City budgeted $1,355,661 for 2013 General Liability Premiums
- The Retrospective Deposit Adjustment Payment (Annual Contribution/Premium) of $1,958, 598 was booked as a long-term liability as of June 2012.
    - Governmental activities expense increased by $2,450,995 or 9.4% during FY 2012, due primarily to recording the cumulative deposit payable to the California Joint Powers Insurance Authority for the City's general liability and workers' compensation coverage (See Note 7f).

f. CJPIA Retrospective Deposit Liability

Retrospective deposits and refunds are cost allocation adjustments to prior coverage periods. Some claims take many years to resolve and over time their estimated value changes. The retrospective adjustments are calculated annually and take into consideration all the changes in claim values that occurred during the most recent year. The formula is designed to adequately cover the cost of claims brought against members and to ensure the overall financial strength and security of the Authority. The formula was developed to be as equitable as possible by taking into consideration both risk exposure and claims experience of individual members. CJPIA has temporarily deferred the payment on retrospective deposits owed to the Authority by members. The payment deferral period extends until July 1, 2013 for the Liability program and July 1, 2015 for the Workers' Compensation program. Retrospective deposit payments are scheduled to resume on these dates. The October 2011 annual retrospective adjustment is included in these balances. The City at June 30, 2012 had a retrospective deposit due of $1,958,598.

Optional Payment Plans

When retrospective deposit payments resume as indicated above, members will have the opportunity to select from a variety of optional payment plans. Discounts under the incentive plan are available to members choosing to voluntarily accelerate payment during the deferral period. The City has chosen not to voluntarily accelerate payment at this time.

CITY OF SOUTH PASADENA

NOTES TO FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2012

Note 7: Long-Term Debt (Continued)

After the deferral period, members choosing from among the optional payment plans will be subject to a moderate annual fee. The fee is intended to provide a means for the Authority to recover otherwise foregone investment earnings and to serve as a minor disincentive for the selection of longer financing terms.

Retrospective Balances will Change Annually

Retrospective balances will change with each annual computation during the payment deferral period. Member balances may increase or decrease as a result of the most recent year's claim development. Accordingly, some members who chose to pay off their balance in full may be required to pay additional retrospective deposits in the future based on the outcome of actual claim development reflected in subsequent retrospective deposit computations. Conversely, if claim development is favorable then subsequent retrospective adjustments could potentially result in refunds to the member.

More information on the CJPIA retrospective balances can be found on the CJPIA website at CJPIA.org.

ACFR 2013: Lance, Soll, Lunghard, LLP

- The City maintained a General Fund committed "Self Insurance" Reserve of $401,000 and unrelated committed "Legal Reserve" of $250,000
- The CJPIA General Liability Retrospective Deposit Payable of $1,958,598 was paid to decrease the City's long-term debt.

ACFR 2014: Lance, Soll, Lunghard, LLP

- The City's General Fund committed 'Self Insurance' Reserve was eliminated at Council Direction on May 15, 2013. The General Fund committed "Legal Reserve" was increased to $500,000.
- The City claimed a $288,122 increase in insurance reimbursements and a $44,470 General Liability Deposit Payable to CJPIA.
- The City claimed a "decrease of $1,276,760 in general government" as a result of the change in insurance carriers from CJPIA to PRISM. It is unclear where or when the $1.276 MM liability was recorded in the financial statements and if this liability was attributable to 2012-2013 deferred Liability Deposits. It is unclear how the liability would have been eliminated as a result of a change in Insurance Carriers.
- The City's 2014 Budget is listed as *Not Available* on the website for the budget year 2013/2014. As a result, there is no information available related to the City's consolidated Worker's Compensation and General Liability Insurance premium costs from 2014-present.

f. CJPIA Retrospective Deposit Liability

Retrospective deposits and refunds are cost allocation adjustments to prior coverage periods. Some claims take many years to resolve and over time their estimated value changes. The retrospective adjustments are calculated annually and take into consideration all the changes in claim values that occurred during the most recent year. The formula is designed to adequately cover the cost of claims brought against members and to ensure the overall financial strength and security of the Authority. The formula was developed to be as equitable as possible by taking into consideration both risk exposure and claims experience of individual members. CJPIA has temporarily deferred the payment on retrospective deposits owed to the Authority by members. The payment deferral period extended until July 1, 2013 for the Liability program and extends until July 1, 2015 for the Workers' Compensation program. Retrospective deposit payments are scheduled to resume on these dates. The October 2011, annual retrospective adjustment is included in these balances. The City at June 30, 2014, had a retrospective deposit payable in the amount of $44,470.

Expenditures increased by $581,208 or 2.7% over the prior year due primarily to an increase of $1,840,523 in capital outlay, offset by a decrease of $1,276,760 in general government as a result of the City changing their insurance carrier and therefore reducing their insurance costs.

ACFR 2015: Moss, Levy, & Hartzheim, LLP

-The Internal Service Fund is established and reported in the ACFR. A $303,640 transfer is made to the Insurance Fund to establish a cash reserve of $290,000. The funds used to establish the cash reserve included: General Fund $187,640 , LLM $29,000, Water $72,500, Sewer $14,500

Language outlining the City's obligations, liabilities, and premium payments as a member of the PRISM Self Insurance Pool is omitted from the ACFR. This is a substantial deviation from prior year reports.

Accounting for the Insurance Fund going forward includes Insurance Costs (Cash Paid + Current Liabilities), Cash Assets (Reserve), Transfers, and Net Position (Cash Assets – Current Liabilities).

ACFR 2016- 2018: Transfers from General Fund, Sewer Fund, Water Fund, and Nonmajor funds into the Insurance Internal Service Fund were to provide *initial* funding for the Insurance Fund. 2016 - $64,956, 2017 - $81,712 (p 43), 2018 - $46,397 (p 43).

ACFR 2020: $140,000 cost of insurance

ACFR 2021: $1,227,250 – transferred from the General Fund to the ISF for increasing the City's coverage of the actuarial estimated liability for insurance claims and general cost of insurance (p 41).

ACFR 2015-2022: Insurance Cost, Cash Paid, Liability, Cash Assets (Reserve), Net Position

2015-2017: Moss, Levy, & Hartzheim, LLP

2018-2022: Rogers, Anderson, Malody & Scott, LLP

	Insurance Cost	Claims Paid	Liability	Cash Reserve	Net Position Ending	Transfers In
2015	$14,207	$13,640	$567	$290,000		$303,640
2016	$45,830	$46,397	$567	$290,000		$ 64,956
2017	$82,306	$81, 712	$594	$290,000	$289,406	$81,712
2018	$229,942	$227,948	$2,588	$62,052	$59,464	$46,397
2019	$306,906	$307,067	$2,427	$24,941	$22,514	-
2020*	$2,941,010	$1,205,280	$1,736,000	$172,076	$(1,566,081)	$140,000
2021**	$2,167,384	$2,146,352	$1,759,189	$34,268	$(1,724,921)	$1,127,250
2022**	$4,324,990	$2,797,054	$2,304,591	$352,077	$(1,952,514)	-

2020 ACFR*: Based on the audit reports, the City does not appear to have accounted for the accrued liability for the NPV of Expected Losses (incurred and IBNR) until Fiscal Year 2020.

2021 ACFR: The City transfers $1,127,250 to ISF “for increasing the City’s coverage of the actuarial estimated liability for insurance claims and the general cost of insurance” (p.41) Establishes a reserve of 15% of 2022 liabilities.

****2022 ACFR:** The Draft ACFR presented to the Finance Commission on February 6, 2023 (page 19) showed the Insurance Fund to have total assets = $2,881,428. A sufficient amount of cash to meet the reserve requirement. However, the Draft ACFR also showed the fund to have a liability (loan) Due to other funds in = $2,529,352, meaning the cash was borrowed from the General Fund.

In the Final ACFR, published on February 8,2023, both the $2,529,352 loan and $2,529,352 in cash assets are no longer on record. No notes related to this transaction are included in the ACFR.

Note 15: prior year adjustments (2021**) for $982,534 that appears to be related to the Internal Service Fund. However, the 2024 Budget line items for Actual 2021 allocations does not reflect these changes.

CITY OF SOUTH PASADENA

NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2022

Note 15: Prior Period Adjustment

The cumulative effects of correction of errors in reporting of prior balances resulted in the following prior period adjustments:

	General Fund	Non-major Funds	Total Governmental Activities
Fund balance, as previously reported	$ 25,643,607	$ 14,410,347	$ 40,053,954
Prior period adjustment	(1,287,988)	(76,036)	(1,364,024)
Fund balance, as restated	$ 24,355,619	$ 14,334,311	$ 38,689,930

	Governmental Activities	Business-Type Activities
Net position, as previously reported	$ 49,907,349	$ 45,454,016
Prior period adjustment	(381,490)	(344,027)
Net position, as restated	$ 49,525,859	$ 45,109,989

	Water	Sewer	Arroyo Seco Golf Course	Total Proprietary Funds/Business-Type Activities	Internal Service Funds
Net position, as previously reported	$ 37,543,665	$ 5,947,068	$ 1,963,283	$ 45,454,016	$ (1,724,921)
Prior period adjustment	(270,583)	(73,444)	-	(344,027)	982,534
Net position, as restated	$ 37,273,082	$ 5,873,624	$ 1,963,283	$ 45,109,989	$ (742,387)

Prior Period Reallocation/Adjustments to the Insurance Fund Totaling $982,534:

- $270,000 from the Water Fund
- $73,444 from the Sewer Fund
- $638,507 Unclear

**Insurance Costs and Claims Paid include Worker's Comp ($441,879) and General liability ($648,832) Premiums.

2020-2021 Budget- Policy 9 Risk Management Policy Compliance: Although the City had been informed that it was out of compliance with the PRISM requirements for General Liability and Worker's Compensation actuarial reports, the budget documents fail to disclose the non-compliance issue. Instead, the documents discuss compliance with actuarial reports for unrelated retiree medical costs.

> Current insurance costs are fully funded with a retention of $100,000 for general liability, and $125,000 for workers' compensation. Funding on a pay-as-you-go basis for leave liabilities, claims and judgments, and retiree health insurance costs remains the City's practice. In accordance with GASB 45, a third-party actuarial valuation of the City's liability for annual retiree medical costs has been completed every two years since FY 2008/09. An updated actuarial valuation is being prepared for the FY 19/20 Audit.

The 2021-2022 Budget

- The City's goal is to maintain reserves to fund its outstanding self-insured liabilities at the minimum level of 70 percent. It is anticipated that this goal will be achieved incrementally, and fully achieved by Fiscal Year 2023-2024.

Analysis of Historical ACFR and Budget Review

The historical audits provide insight into the City's management of the Insurance Fund. Based on the audits, it does not appear as though appropriate training was provided for the establishment, maintenance, and management of the Insurance Fund. It does not appear as though the City staff was provided training at the time the fund was established to appropriately account for and manage its premiums, claims liabilities, cost allocations, cash, or interest earnings. It also doesn't appear that the staff or audit team has understood the distinction between OPEB and Insurance Fund actuarial reports.

The notes provided by the City's auditors have been inconsistent and incomplete over the past 10 years. Information pertaining to the City's annual insurance premiums, liabilities, obligations, and transactions appear to have been inconsistent and insufficient since 2014. In note 15, the auditors indicate that they failed to identify $982,534 in errors in prior periods and provide limited discussion to explain a substantial adjustment.

The Insurance Fund has been burdened by extraordinarily high net claim payments (approx. $2.5 MM in fiscal year 2022 and $2.075 MM in 2023), in addition to its annual premium expenses and an unexpected CJPIA payment. The total expenditures for the fund, *excluding accrual of liabilities* has equaled $3.76 MM in 2022 and $3.46MM in 2023. Revenues generated through internal service charges to the General Fund, Water, Sewer, and Lighting, Landscaping & Maintenance Fund have increased substantially, from $1.089 MM in 2021 to $2.471 MM in 2022 and $2.698 in 2023 to pay for the rising expenses, increasing the operating expenditures for the supporting funds.

6. **Comparison of Policy to Other Cities**

In evaluating South Pasadena's Risk Management Policy, we reviewed risk-management policies of municipalities across the State, including San Luis Obispo, Sacramento, Irvine, and Santa Clara County. During our review, we found that South Pasadena's minimum reserve requirement is consistent with requirements held by other cities and municipalities.

- City of San Luis Obispo - The SIR will be funded based on 150% (75% confidence level) of the previous five-year average claims experience (claims paid, reserves for known claims, and administrative expenses).
- City of Irvine – 70% of outstanding liabilities
- City of Sacramento – In addition to annual funding of projected claims at the 80 percent confidence level, the City shall maintain a reserve equal to two Self-Insured Retention allotments.

City of San Luis Obispo Policy on the Insurance Fund

1. Insurance Fund. The City shall maintain an Insurance Fund to manage payments for liability, workers' compensation, crime, pollution, special events, property, and volunteer insurance. Within the Insurance Fund, a self-insured retention (SIR) will be set aside to cover expenses associated with claims from the Excess Liability Insurance Program. The SIR will be funded based on 150% (75% confidence level) of the previous five-year average claims experience (claims paid, reserves for known claims, and administrative expenses). The Insurance Fund will maintain a reserve sufficient to guard against substantial claims which will be determined based on annual actuarial report information.

   If required due to depletion of fund balance, sufficient annual appropriations will be transferred to the Insurance Fund from the General Fund in the amount needed to ensure the 150% funding status.

City of Irvine Risk Management Policy

1. An annual actuarial study shall be conducted in accordance with Governmental Accounting Standard Board Statement No. 10. This statement requires the City to accrue liability on its financial statements for a reasonable estimate of the cost of the claims and expenses associated with the reported and unreported claims.

2. The City shall maintain reserves to fund its outstanding self-insured liabilities at the minimum level of 70%.

3. The City shall maintain a Self-Insurance Fund to both fund the liability reserve and recover all associated risk management costs, including claim payments, insurance premiums, and any deductibles, and claims administration (internal and external). The fund's revenues shall be generated through assessments to City departments based on their claim experience and outstanding liabilities. These departmental assessments shall be evaluated annually and adjusted as needed.

4. Staff shall report to Finance Commission and City Council at least annually on the claims processed, amounts paid, and steps taken to manage and reduce the City's risk and liability.

5. Source: City of Irvine FY 2023-2025 Adopted Budget

City of Sacramento: Page 419 FY 2022/2023 Approved Budget

1) The City's Risk Management Funding Policy documents the City's approach to providing adequate financial resources to fund the City's General and Auto Liability and Workers

Compensation Programs and establishing and maintaining adequate reserves in the Risk Management Internal Service Fund.

2) Policy:

   a) In order to methodically and consistently measure the City's projected claims, the City will contract with a professional outside actuary to prepare annual actuarial valuation reports for both categories of claims. Program funding will be based on the annual actuarial valuation reports.

   b) The City's funding policy will provide program funding at the 80 percent confidence level, including recognition of anticipated investment income. Confidence level is used by actuaries to determine the realistic possibilities that a given funding rate will be sufficient to cover all claims that might be incurred in any one program year. An 80 percent confidence level indicates that the funding rate should be adequate eight out of 10 years.

   c) The City shall maintain a Risk Management Reserve dedicated to mitigation of the risk of loss arising from potential claims and lawsuits against the City for general and auto liability as well as workers' compensation claims. The Risk Management Reserve shall be funded at the following levels:

      General and Auto Liability – In addition to annual funding of projected claims at the 80 percent confidence level, the City shall maintain a reserve equal to two Self-Insured Retention allotments.

      Workers' Compensation – In addition to annual funding of projected claims at the 80 percent confidence level, the City shall maintain a reserve equal to two SIR allotments.

      If the SIR amount changes in future years, the two SIR allotments will continue to be the reserve requirement for both programs.

      If either program maintains a balance above the minimum funding and reserve requirement, the excess reserves will be used to subsidize City contributions over a 1-5 year period depending upon the amount of the excess and the City's economic condition.

      If either program has excess claims requiring additional contributions to the fund, the City will increase contributions over a 1-3 year period depending on the amount of the shortfall and the City's economic condition to get to the minimum funding and reserve requirement.

      If one program has excess reserves and the other program has a shortfall, transfers between programs may be implemented to reduce or eliminate the program shortfall.

Additional Policies:

https://www.cityofsacramento.org/-/media/Corporate/Files/Finance/Budget/26_Financial-Policies.pdf?la=en Budget Control Policy: page 306 Interdepartmental Loans

7. **The Decision to Switch from CJPIA to PRISM (CSAC)**

As part of our analysis of the Insurance Fund, we conducted a review of the City's decision to switch insurance carriers. **https://opengov.southpasadenaca.gov/WebLink/0/doc/21415/Page1.aspx**

The June 5, 2013, Agenda (Item 21) provides detail into the decision to switch from CJPIA to PRISM based on a "Zero Based" Review of Insurance Pools at the direction of the City Council. The presentation included Critical Discussion Point comparing CJPIA Vs CSAC (PRISM)

CJPIA Benefits, Services, and Limitations

- Lower Worker's Comp Premiums, Higher GL Premiums
- No Deductible
- Little to no risk to the city, predictable annual budget
- No need to budget for a custodial account with a TPA.
- Reduced or eliminated need to maintain a General Liability or Worker's Comp claim reserve.
- Higher level of customer service, onsite training, and claims management. Reduced need for City risk management staff.
- Claims managed by TPA hired by the pool. Little involvement in claims management by the city.

PRISM (CSAC) Benefits, Services, and Limitations

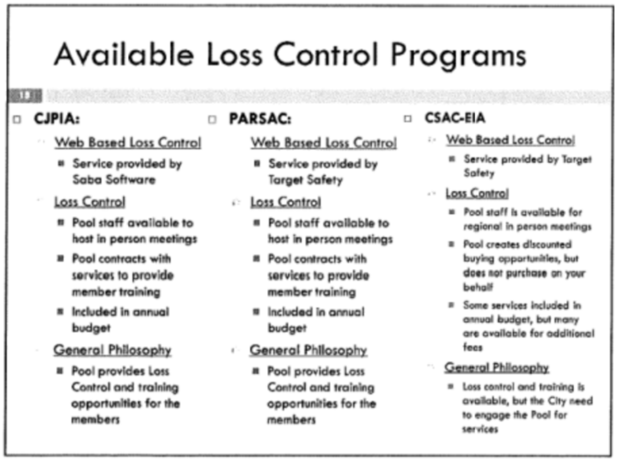
- Lower initial General Liability premiums, more variability in annual costs
- Deductible of $10,000 per claim. Actual PRISM deductible listed in the 2014 ACFR is $100,000.
- Requires budgeting for a custodial account with TPA and maintenance of a Worker's Comp and General Liability Reserve.
- PRISM does not pursue heavy involvement in claims management. Claims administration services available at an additional cost.
- Identified as the only pool to allow the City Staff to select/hire the TPA and oversee GL Claims. This "benefit" allowed for greater control (responsibility) over the risk management and claims process, including the selection of vendors and law firms to manage or litigate claims.
- Required additional billed time for the City Attorney to receive training and "build relationships".

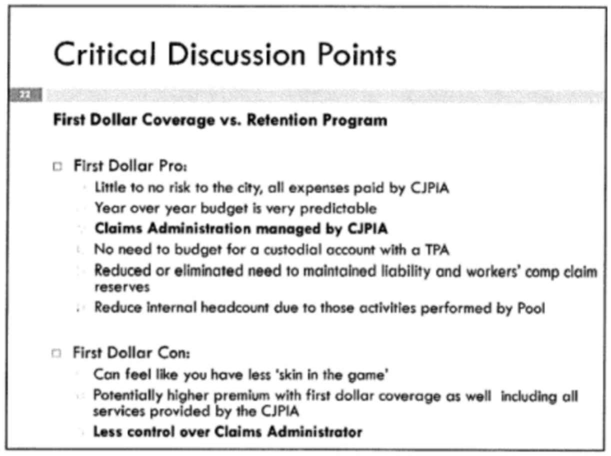
Analysis:

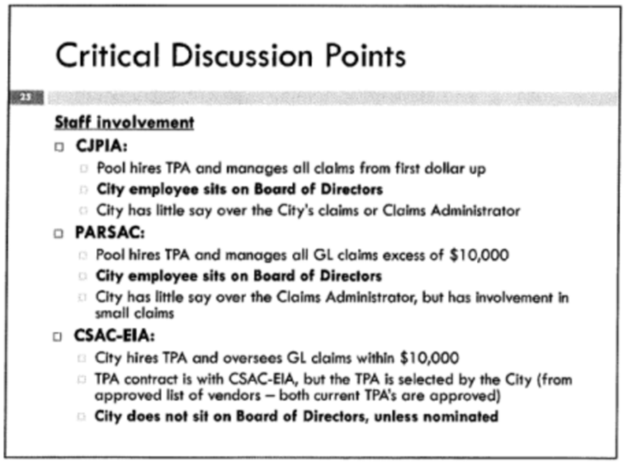
In selecting PRISM as its insurance carrier, the City chose to take a higher level or responsibility and risk over its Risk Management function. It appears that the City and its contracted City Attorney at the time felt that they could manage risk more effectively and at a lower cost than the professional staff dedicated to Risk Management at CJPIA. As noted in the presentation, the City Attorney required additional billed hours for training and for "building relationships" to take over the Risk Management responsibility.

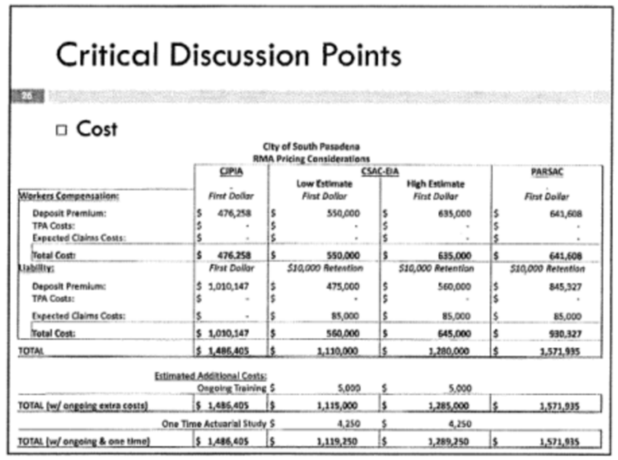
It is unclear if the City staff received training related to the accounting and management of an Insurance Fund, including the contractual obligation to utilize actuarial data to maintain a required cash reserve. The City does not appear to have implemented a Risk Management system to manage claims, reimbursements, and risk-mitigation. Further, the "Zero-Based" Review did not consider the City's outstanding liabilities of $1,276,760 or claims management experience under CJPIA.

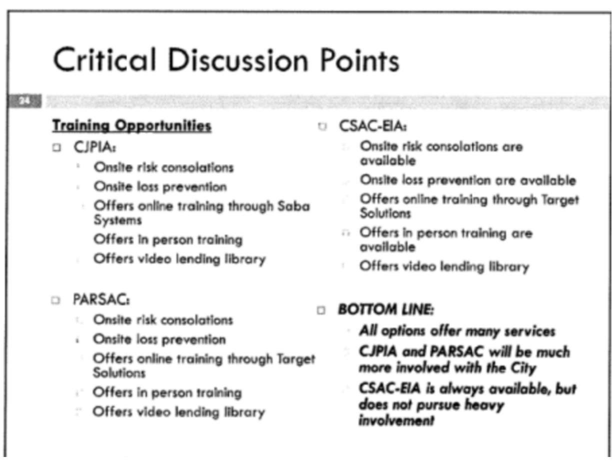
a.











8. **Insurance Fund Revenues and Cost Allocations:**

The fund's revenues shall be generated through assessments to City funds based on their claim experience and outstanding liabilities. These departmental assessments shall be evaluated annually and adjusted as needed.

Annual departmental claims assessments and cost allocations provide an effective cost-accounting mechanism to manage risk at the departmental level. When utilized appropriately, cost allocations based on claims experience ensure that the full cost of a department's operations are reflected appropriately during the budgeting process and considered in decision making. For instance, claims experience can highlight situations in which short-term cost cutting measures, such as deferred maintenance, may result in increased risk exposure and expense to the city.

Historically, Worker's Compensation premium payments appear to have been budgeted, expensed, and paid for at the individual departmental level. General Liability premium payments appear to have been budgeted, expensed, and paid for at the fund level. General Fund (60%), Water (25%), Sewer (5%) and LLD (10%). However, it does not appear as though the City has had a process in place to assess and allocate WC or GL claims expenses at the fund or departmental level.

As a result, departments and funds have not been bearing or aware of the full cost of their insurance liabilities. While there has been a 329% increase in allocations across funds for General Liability expenditures between 2020 and 2024, the increase in allocations has not been sufficient to cover the total expenses associated with the Insurance Fund. Due to the change in fund structure in 2022, it is unclear how much of the increase in allocations was attributable to increased claims expenses vs premium payments that were previously expensed at the departmental or fund level.

Sufficient funding of the Insurance Fund using departmental claims assessments and cost allocations will require careful planning to address potential structural imbalances at the departmental level.

Additional Insurance Fund Recommendations:
Insurance Fund Reserve

- The City is contractually obligated to maintain a reserve and make funding contributions *equal to or exceeding* the present value of expected losses and a reasonable margin for contingencies.
    - Immediately establish and maintain a cash reserve, in accordance with the City's contractual obligations and budgetary policy. Fully fund the reserve.
    - Allocate interest earned on the cash reserves to the insurance fund to account for the future value of the cash payments as they come due.
- In the event of a short-term financial shortfall:
    - The City may defer contributions to the reserve, so long as the reserve is maintained above the minimum threshold of 70% of liabilities.
    - A plan is established to replenish the fund within 2-3 years.

Internal Controls and Policies

Establish internal controls and policies for the ongoing management of the Insurance Fund, claims liability reserve balance, and risk management activities.

- Report annual consolidated premium costs for Workers Comp and General Liability Insurance in the City's annual budget.
    - Insurance premiums represent a significant cost that needs to be regularly tracked and forecasted.

- Report expected cost of claims (actuarial projections) vs the claim experience.
    - Claims experience needs to be regularly monitored in relation to the projected costs of claims.
      Key performance indicator for claims management and legal representation/strategy.

- Report claims reimbursement rate vs actuarial projected reimbursement rate.

- GL had a reimbursement rate of 13%, while the actuarial reports were assuming the department was collecting reimbursements.
- Critical KPI for the Risk Management function.

- Department level claims experience for Workers Comp and General Liability
  - Costs are currently allocated using a blunt % allocation across the GF, Water, Sewer, Arroyo, and LL&M funds.
  - Costs should be allocated to individual departments and funds utilizing a cost allocation method based on actual claims experience.
  - This is vital to risk management to encourage departments to address operational risk factors.
    - ex.. Claims expenditures from tree limbs falling on personal property may be greater than any realized savings from short-term cost cutting measures such as deferred maintenance.