Culver CITY

INTEROFFICE MEMORANDUM

DATE: 01/19/2006

TO: The Honorable City Council

FROM: Jerry Fulwood, Chief Administrative Officer

SUBJECT: Report on the Status of the Self-Insurance Fund

I have reviewed the history and current condition of the City's Self Insurance Fund - Fund 309 (SIF) from the period July 1, 2000 to June 30, 2005 (the inquiry period). Further, a Self-Insurance Fund Task Force comprised of at least one member from each of the City's Departments was convened to discuss the current status and make recommendations to better manage the SIF. The purpose of this report is to provide the City Council with a brief history of the fund, explain its current status, and provide recommendations to improve the status of the SIF.

HISTORY

This SIF was created in the City's Internal Service Funds Group of accounts in order to help manage the financial accounting of the City's risks (both employee and external sources). Overall, the SIF expenditures include items such as: insurance premiums, external liability claims payments, internal workers compensation claim payments, and IOD (Injured On Duty) benefits. Revenues have been generated through an allocation formula generally based upon a percentage of employee salaries attributable to the various City Departments.

Retained Earnings and Fund Equity

The following tables contain the consolidated Statement of Retained Earnings and the consolidated Balance Sheet for the inquiry period:

Consolidated Statement of Retained Earnings
in 000's

Item	FY 00/01	FY 01/02	FY 02/03	FY 03/04	FY 04/05
Beginning Balance:	4,533	2,717	(4,070)	(10,919)	(12,837)
Revenues:	3,606	3,682	3,736	2,991	5,298
Expenditures:	5,422	10,469	10,585	4,909	8,728
Net Change in RE:	(1,816)	(6,787)	(6,849)	(1,918)	(3,430)
Ending Balance:	2,717	(4,070)	(10,919)	(12,837)	(16,267)

Consolidated Balance Sheet in 000's					
Item	FY 00/01	FY 01/02	FY 02/03	FY 03/04	FY 04/05
Current Assets	11,717	9,906	5,388	2,062	1,242
Fixed Assets	42	37	32	28	23
Current Liabilities	9,042	14,013	48	54	53
Long-Term Liabilites	0	0	16,291	14,873	17,479
Fund Equity	2,717	(4,070)	(10,919)	(12,837)	(16,267)

During the inquiry period, the SIF has gone from having a cash position that exceeds accrued liabilities (a favorable surplus) to having accrued liabilities which exceed its current cash balance (an unfavorable deficit).

How did we get Here?

As shown in the above tables, the last five fiscal years have seen a significant reversal in the SIF's financial status. Historically, the City has been able to charge each City Department with an amount that not only generated sufficient revenue to pay current liabilities (defined as those liabilities expected to be expensed in the current fiscal year) but was also able to accrue a fund cash balance to pay accrued long-term liabilities (those liabilities expected to be paid at some point in the future beyond the current fiscal year). This begs the question – What happened?

Revenues

The SIF's source of revenues is a "charge for service" to the City's departments. Prior to fiscal year 2005/2006, the SIF charges were based upon a percentage of a department's salary. The charge rates were based upon the rates used State-wide. Prior to Fiscal Year 2005/2006, these charges generated and average annual revenue for the SIF of $3.5 million. Recognizing the prior years' revenue shortfall, the approved budget for Fiscal Year 2005/2006 includes use of updated charge rates that are approximately double what had been used in prior years. This change in rates increased budgeted annual revenue to the SIF to $7.436 million.

Expenditures

The SIF expenditures are comprised of several components divided into five major areas:

1) Administration

2) IOD Expenses

3) Liability Claims

4) Unemployment (U/I) Claims

5) Workers' Compensation (W/C) Claims

The following table shows the claims and expenses paid by the SIF during the inquiry period.

Summary of Claims and Expenses Paid
(Source: Colen and Lee)

Item	FY 01/02	FY 02/03	FY 03/04	FY 04/05
Administration	$593,174	$468,793	$300,897	$485,534
IOD Expenses	$653,033	$483,078	$703,741	$730,606
Liability Claims	$898,063	$3,075,075	$977,650	$1,208,781
U/I Claims	($70,199)	$181,596	$95,890	$55,208
W/C Claims	$3,067,688	$3,415,471	$3,784,055	$2,790,194
Totals:	$5,141,759	$7,624,013	$5,862,233	$5,270,323

Insurance Premiums

As with most entities, both private and public sector, the insurance markets were negatively affected by the September 11, 2001 terrorist attacks in New York, Pennsylvania, and Washington D.C. The resulting high claims and added uncertainty in the risk markets caused liability and property insurance rates to skyrocket. This impacted the City through a a significant increase in premiums paid, including an **octupling** of workers' compensation premiums and a ***quadupling*** of liability insurance premiums payable by the City.

In addition to liability and property insurance, the State of California's workers compensation insurance program (noted as one of the most generous programs in the nation) began to experience unprecendented cost increases. Again, the result was a significant increase to the City in the form of higher worker's compensation premiums. The following table summarizes the increases in premiums experienced by the City during the inquiry period:

Summary of Insurance Premiums Paid

Item	FY 00/01	FY 01/02	FY 02/03	FY 03/04	FY 04/05
Workers' Comp.	$50,514	$288,393	$299,952	$393,026	
Liability	$111,638	$122,496	$410,880	$423,410	
Property/Spec. Ins.	$318,598	$541,095	$451,040	$633,374	
Totals:	$480,750	$951,984	$1,161,872	$1,449,810	

Unfortunately, the recent natural disasters (Hurricanes Katrina and Rita) will have a continued tightening effect on the risk markets resulting, at best, in a status-quo in the currently high premium expenses to the City. It is possible, rates may increase. Because of recently enacted reforms by the State Legislature, we present a more slightly rosy outlook for workers' compensation premiums. The status quo is expected, with a possibility of a moderate decrease in premiums.

Recording Long-Term Liability

In addition to the direct expenditures outlined in the above tables, in accordance with Generally Accepted Accounting Principles (GAAP), the City Treasurer's Office Accounting Staff books a journal entry to recognize potential future Long-Term Liability. The jornal entry is reflective of estimations provided by our workers' compensation third party administrator and liability consultant. It is an attempt to account for claims that are outstanding but not fully settled. The following table outlines the journal entries booked over the inquiry period:

Future Liability Journal Entries

Item	FY 00/01	FY 01/02	FY 02/03	FY 03/04	FY 04/05
Workers Comp.		$5,280,739	$844,529	$112,657	$71,000
Liability		$482,746	($794,100)	$243,531	($109,925)
Totals:		$5,763,485	$50,429	$356,188	($38,925)

These long-term liabilities are subject to change as the claims develop. As additional claims are filed, the long-term liability will increase. Conversely, as claims are settled, the long-term liability will decrease. Additionally, settlement of a claim may result in an increase in short term expenses with a decrease in the associated long-term liability.

So, What Did Happen?

Flat Revenue Stream Coupled with Increased Claims and State Take-Aways

As seen in the above tables, the SIF got hit with a triple whammy. The City's allocation formula remained at the historically adequate rate at a time when costs skyrocketed. Additionally, the City was significantly and negatively impacted by the generally lackluster economic conditions prevalent during the inquiry period. The State of California's fiscal crisis and the associated raids on local revenues (punctuated by the VLF take-away and the "triple flip" tax swap) also reduced the City's financial resources at a time when the SIF would have benefited by increased charges for services.

The expenditure tables also show a significant increase in costs during the inquiry period. As mentioned above, the overall costs for insurance premiums tripled and claims payments for liability and workers' compensation remained above the period average. A combination of the flat contribution rates and significantly higher expenses resulted in the SIF moving from a surplus into a deficit. Without corrective action, the SIF's long-term liabilities and current accumulated defecit pose a significant financial challenge to the City, especially its General Fund.

Recommended Corrective Actions

After reviewing the condition of the SIF and consulting with the Self Insurance Fund Task Force, I recommend three actions which would, over time, return the SIF to firm financial footing and reduce the significant impact on the City's General Fund.

Increased Employee Education and Training

Workers' compensation claims can be minimized by increasing employee education and training. With the filling of two key positions on the City's Risk Management Staff, additional opportunities are being made available for City Staff to become more aware of ways to improve workplace conditions and, thereby, reduce the potential for workers' compensation claims and associated costs.

Implemetation of an Improved Current Cost Allocation Formula

Risk Management Staff, led by Kermit Francis and Nick Kimball, have proposed an Improved Current Cost Allocation Formula. In summary, the new formula would depart from the fixed rate system and improve the SIF's current revenues by taking into account changes in claims payments and including a component consisting of a moving five year average of the claims paid. This would also moderate potential "wild swings" in the cost allocations attributable to unexpectedly high claim payment years.

Amortization of the Long-Term Liability Over a 20-Year Time Horizon

Currently, the SIF has a $16.267 million unfunded long-term liability. In calculating the long-term liability, the City's third party administrators have used a 20 year time horizon. It is recommended the City amortize this currently unfunded liability over the same time horizon. This would require an amortization charge of approximately $815,000 annualy over all City Departments. This would be over and above any amount allocatable to the Departments through implementation of the Improved Current Cost Allocation Formula.

Conclusion

The City's Self-Insurance Fund is an important financial and management tool to help the City properly manage its risk. Generally Accpeted Account Principles require the City to financially recognize certain of its long-term liabilities. With the implementation of Government Accounting Standards Board Pronoucements 42 and 45 in 2007, these requirements will be expanded to include future retiree health benefits.

While returning the SIF to firm financial footing will require significant current and future financial commitments (especially from the General Fund), to allow a large long-term liability to accrue without offsetting financial resources to retire that liability would pose a significant threat to the City's continued fiscal stability. Therefore, we recommend the City Council seriously consider implementing the recommendations contained in this report effective with Fiscal Year 2006/2007.