



# Finance Committee Memorandum

*City of Arts & Innovation*

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**TO: FINANCE COMMITTEE** **DATE: OCTOBER 10, 2018**

**FROM: FINANCE DEPARTMENT** **WARDS: ALL**

**SUBJECT: ANNUAL FINANCIAL REVIEW OF THE CITY'S LIABILITY INSURANCE TRUST FUNDS - FISCAL YEAR 2017-2018 - DIRECT SUBMITTAL**

**ISSUE:**

Receive an annual financial review of the City's Liability Insurance Trust Funds for Fiscal Year 2017-18.

**RECOMMENDATION:**

That the Finance Committee receive, provide input on, and forward to the City Council for approval an annual financial review of the City's Liability Insurance Trust Funds ("LITF") for Fiscal Year 2017-18.

**BACKGROUND:**

Effective fiscal year 2015-16, City staff began presenting to the City Council, through the Finance Committee, a financial and operational review of the City's liability funds, including claim activity. This review includes the Workers' Compensation and General Liability Funds.

The Human Resources Department administers the City's Workers' Compensation program. The Risk Management Division of the City Attorney's Office, through a third party administrator, has responsibility for the General Liability program on behalf of the City.

The City carries insurance coverage to mitigate the most significant losses it may incur. For General Liability losses, the City carries commercial liability insurance in the amount of \$20,000,000 for general and auto liability claims, with a self-insured retention of \$3,000,000 per occurrence. This means the City covers out of funds on hand, the costs of any claim up to the first \$3,000,000 incurred. After that, the insurance policy covers the next \$20,000,000. If a claim exceeds the combined total of \$23,000,000, then the City would be responsible for the additional costs out of its own funds.

The situation is identical for the Worker's Compensation program, except that the insurance coverage has a policy limit of \$25,000,000. The self-insured retention for the Workers' Compensation is also \$3,000,000 per occurrence. There have been no claims settled in the last ten years that exceed insurance coverage under either program. Each year, as the insurance

policy is renewed, the existing structure with the \$3.0 million self-insured retention is re-evaluated to determine if a more beneficial (less risk exposure) option exists. This specific structure has been the best option for many years.

All City departments participate in the Risk Management program and make payments to the LITF based on actuarial estimates of the amounts needed to fund prior and current year claims and incidents that have occurred but have not been reported.

## **DISCUSSION:**

### *Financial Overview*

Attachment 1 provides an overview and analysis of all revenues and expenditures for the Self Insurance Trust Funds. Historically, the two largest cash outlays in the liability trust funds are claim payments and outside legal fees. Claim payments in FY 2017-18 for the Workers' Compensation Fund and the General Liability Fund were \$5,239,000 and \$3,932,000, respectively. While claim payments are driven by many factors, outside legal expenses are a byproduct of claims in process and initiated during the year. For FY 2017-18, outside legal fees for the Worker's Compensation and General Liability funds were approximately \$424,000 and \$2,707,000, respectively.

### *Cash Position and Fund Balance*

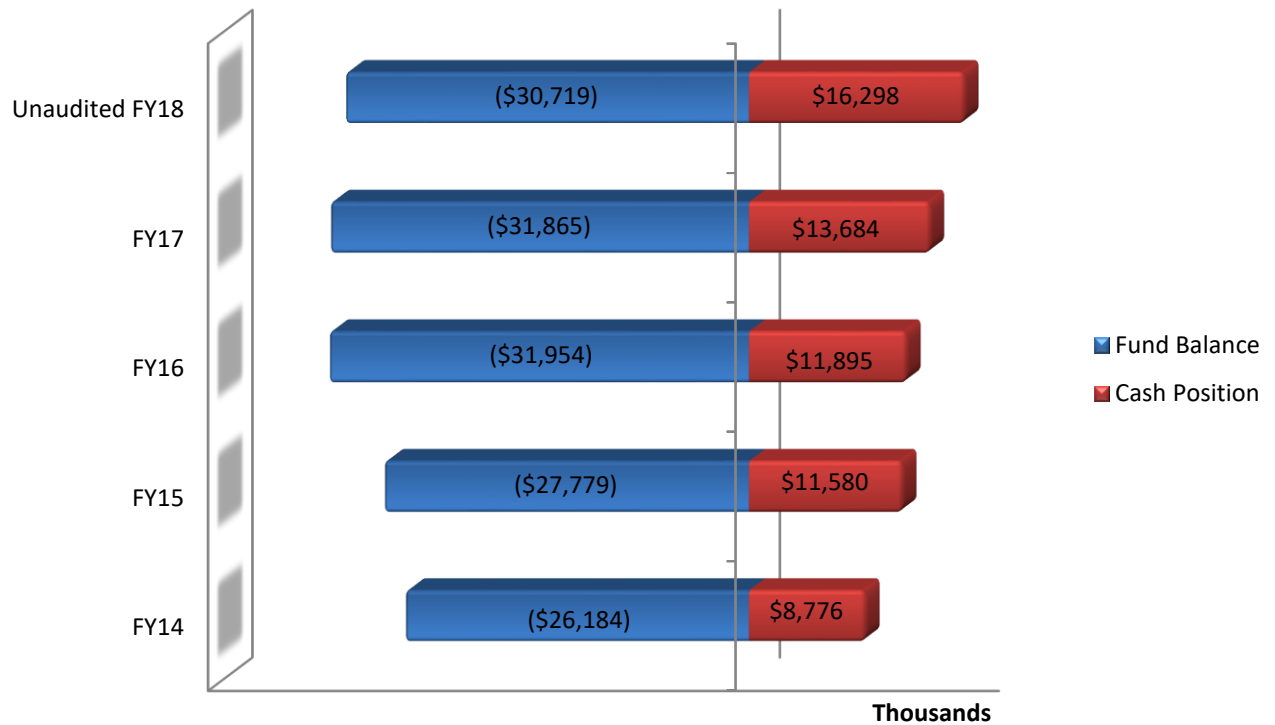
Total **cash** currently on hand between both funds is approximately \$16.3 million, an increase of \$2.6 million from the prior year. The reason for the increase is primarily a result of the General Fund and Measure Z Fund each contributing \$2.5 million to the General Liability Fund in FY 2017/18; however, total claim payments collectively increased by approximately \$3.3 million from prior year totals. The General Fund contribution was a one-time payment. A second Measure Z contribution of \$2.5 million will be provided in FY 2018/19.

The **fund balance** is negative and reflects the long term nature of many of the claims, in other words, there is not enough cash on hand now to cover all potential claims and liability payouts expected in future years. Currently, there is sufficient cash on hand to cover 35% of the long-term liabilities. This coverage ratio is projected to increase to 48% in FY 2018-19 based on increasing charges for services to the various city departments and a second \$2.5 million Measure Z contribution in FY 2018/19.

On November 28, 2017, City Council approved the Self-Insurance Trust Funds Reserve Policy establishing a 40% minimum funding level of the total combined current claims liability outstanding for the Self-Insurance Trust Funds effective June 30, 2018, increasing that minimum level to 50% effective June 30, 2020. As of June 30, 2018, the unaudited cash on hand is projected to be below the 40% minimum fund level. As a result, staff will continue to monitor the fund and address this potential target shortfall during the mid-cycle update. If necessary, staff will request additional contributions from departments through the mid-cycle adjustment to ensure that the fund meets the targeted minimum funding level of 50% by June 30, 2020.

Even though the cash position in the Liability Funds has improved, claims are rather volatile and unpredictable. The Finance Department will continue to address overall fund balance through increases in internal charges for services with the intent of bringing the cash position of the Funds to the required minimum funding levels.

## Cash Position and Fund Balance



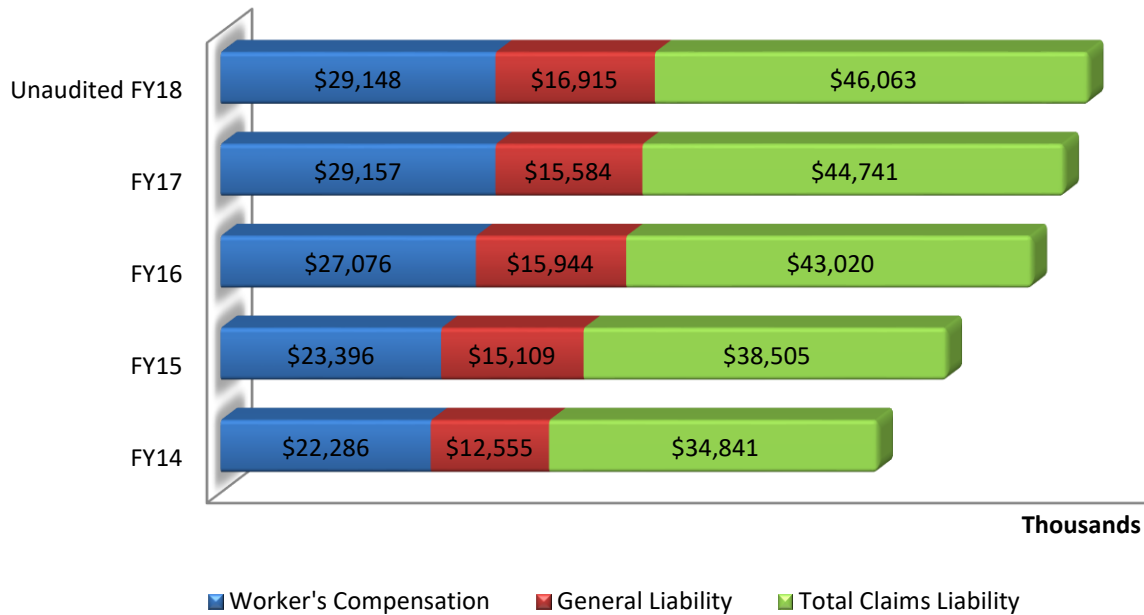
### Claims Liability

It is important to recognize that the claims liability amount recorded in each fund is an estimate of the amount for which that claim will ultimately be settled. These claims are often resolved for less than the total amount reflected in the claims liability figure, and that full amount of cash is not required to service the total claims liability. Additionally, in both funds, but particularly with Workers’ Compensation, the actual outlay of cash is many years away (as many as 30 or more) for much of the outstanding liability.

Being self-insured requires valuing the City’s claims liability for incurred claims losses and maintaining appropriate reserve funds to meet these future liabilities. In accordance with accounting standards, the City engages an actuarial consultant to perform a complex analysis of claims for both the Worker’s Compensation and General Liability fund, the result of which is the determination of the total claims liability for each fund at the end of each fiscal year. The recorded estimate for total claims liability is based on the result of this study and includes an estimate for claims incurred but not reported and for allocated loss adjustment expenses. The actuary’s estimated liability considers the effect of inflation, recent claim settlement trends, frequency and amount of payouts, and other economic and social factors.

Following is a historical look at the trend of claims and judgment liability for the General Liability and Worker’s Compensation fund.

## Claims and Judgment Liability By Fund



The trend for the total claims liability, as determined by the actuary, has been increasing for several years. Despite cash outflows being volatile from year to year, the estimated annual increasing liability will create an even greater negative fund balance. Increasing the internal charge for services from departments will have a positive impact on cash position of the trust funds, but will put additional pressure on operating budgets throughout the City.

### **FISCAL IMPACT:**

There is no direct fiscal impact associated with this report; however, the liability funds are currently inadequately funded based on the Self Insurance Trust Funds Reserve Policy, with an unaudited projected cash on hand of 35% in FY 2017-18 and 48% by FY 2019-20. Staff will continue to monitor activity in the funds and, if necessary, request additional contributions from departments through the mid-cycle adjustment to ensure that the funds meet the targeted minimum funding level of 50% by June 30, 2020.

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 Approved by: Lea Deesing, Assistant City Manager  
 Approved as to form: Gary Geuss, City Attorney

### Attachment:

1. Self Insurance Trust Fund Analysis
2. Presentation