

RIVERSIDE TRANSIT AGENCY  
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May 24, 2007

TO: BOARD OF DIRECTORS  
THRU: <sup>J</sup>Larry Rubio, Chief Executive Officer  
FROM: <sup>CF</sup>Craig Fajnor, Chief Financial Officer  
SUBJECT: Pre-funding of Government Accounting Standards Board (GASB) 43 and 45

Summary:

Officially starting in FY2008, the Agency is facing the financial disclosure and funding issues brought on by GASB 43 and 45. In summary, the Agency must now estimate, disclose, reserve for, and fund its total long-term Other Post Employment Benefit (OPEB) obligations rather than report them on an annual pay-as-you-go basis. The Agency's OPEB obligation is its retiree medical plan. As not to confuse the two retiree benefit plans offered by the Agency, the Agency's retirement, or pension, benefit plan is administered by CalPERS and is funded per plan guidelines. The GASB 43/45 obligation is substantial, whether it is funded as a lump sum or in annual installments, even when the obligation is considered over a thirty year moving window of time. The Agency is currently in the process of procuring a "one-stop shopping" approach to managing the required Plan and Trust per GASB 43/45.

The Agency had an actuarial of its retiree medical program prepared by Total Compensation Systems, Inc. in June 2006. The actuarial considered a 30-year outlook and was based on data at that time. In summary, the added cost of GASB 43/45 (or "non-pay-as-you-go") liability to the Agency for the next 30 years, based on a 5 percent rate of return of invested assets (ROR), is \$1,832,171. At a 7 percent ROR, the annual amount is reduced to \$1,282,221. This figure is currently considered in the projected FY2008 Operating budget of the Agency yet to be approved by the Board of Directors. It should be noted that Agency staff also had the professional services firm of Ernst & Young review the actuarial process, procedures and findings in order to validate the above figures and they deemed them to be sound.

Further, the change in qualification for and benefit coverage from the current retiree medical plan for employees hired after June 22, 2006, did not make

a material impact on the actuarial performed due to a lack of census data under the revised plan. It is expected that, in time, the financial liability generated by employees under the revised plan will be greatly diminished when compared to employees “grandfathered” under the pre-June 22<sup>nd</sup>, labor agreement.

Using FY2007 forecasted operating expenses as a basis, the annual future liability value of the Agency’s OPEB represents 3 percent of the budget. Again, this is a figure that addresses the non-pay-as-you-go amount of the future obligation. As the Agency’s retiree population grows, the pay-as-you-go liability/expense will grow each and every year.

The Agency has applied for and received approval to request a credit from the Internal Revenue Service (IRS) for Federal Excise Tax. The credit is a result of the 2006 Highway Bill in which consumers of alternative fuels (i.e. – CNG) can apply for a \$.50 per gasoline gallon equivalent (GGE) against the Federal Excise Tax pool. Despite being a tax-exempt entity, the Agency qualifies for this tax credit due to the utilization of CNG buses. The tax credit is currently legislated to cover the period of October 1, 2006, through September 30, 2009. This three-year span covers three-quarters of FY2007, one-hundred percent of FYs 2008 and 2009, and one-quarter of FY2010. It is not known at this time whether the tax credit program will be extended beyond its current end date.

As stated before, the Agency is a tax-exempt entity for most tax liabilities – including Excise Tax. Since the Agency does not pay Excise Tax, the tax credit to be received under this program is deemed to be other local revenue versus being considered an offset against an expense. The determination of the tax credit being accounted for as revenue versus expense has been supported by and agreed to by the Agency’s external auditing firm (Brown Armstrong) and the Riverside County Transportation Commission’s (RCTC) chief financial officer. This determination is crucial as it has tremendous positive effects on the Agency’s farebox recovery ratio.

By making special and specific use of the FET credit during its currently-legislated three-year life, the Agency could take dramatic steps to cover a significant portion of its OPEB liability with this specific revenue source. In doing so, the Agency would greatly reduce the annual cost of this benefit for many years to come while protecting it via an irrevocable trust, thereby ensuring this important component of Agency employees’ and retirees’ benefits. Based on recent prior years’ CNG consumption, the Agency is likely to reap \$3 million of Excise Tax credit over the life of the current Excise Tax credit program. At an 18 percent farebox recovery ratio, the Agency could fund approximately \$16.67 million of the \$21.83 million retiree medical plan liability.

Staff believes that a late year FY2007 budget amendment is warranted in order to take advantage of the first nine months of the FET credit revenue. It is estimated that the FET credit impact in FY2007 will be \$775,000 of additional local revenue to the Agency. At a farebox recovery ratio target of 18 percent, the Agency could absorb an expense/reserve charge for GASB 43/45 alone of \$4,305,555 this fiscal year without having an adverse impact on its farebox recovery ratio. Further, when current projected year end FY2007 Agency Performance Improvement Program (PIP) performance without the FET credit is considered, additional GASB 43/45 pre-funding of \$700,000 could be accommodated and still have the Agency make its mandated farebox recovery ratio target of 17.65 percent as well as the minimum three of six of the remaining PIP discretionary targets. Focusing only on Farebox Recovery Ratio compliance, the Agency could absorb as much as \$8,500,000 of GASB 43/45 pre-funding in FY07 and still achieve its target ratio of 17.65 percent.

However, if additional expenses are booked for GASB 43/45, the Agency would not meet its mandatory PIP target for Cost Per Revenue Service Hour. Staff believes that RCTC will exclude the portion of GASB 43/45 expense above the Annual Required Contribution (ARC) from PIP computation. The ARC represents the current year estimated “pay-as-you-go” plus the added cost of GASB 43/45. The expenses-over-ARC exclusion is based on balancing the pre-funding strategy’s long-term positive impact on the financial condition of the Agency with the basic intent of the PIP program. The Agency’s compliance with PIP continues its ability to bring much-needed bus transportation services to the citizens of western Riverside County.

In summary, this approach provides an optimal short-term solution to a long-range problem by following the strategy of maximizing GASB 43/45 pre-funding while still achieving farebox recovery. Further, the strategy aims to maintain compliance with the other seven PIP metrics during this period by excluding the pre-funding costs of GASB 43/45 beyond ARC levels. This plan provides the benefit of securing the future medical benefit promised to our loyal Agency employees, both past and present, and while mitigating the future cost outlay required to provide for the Agency’s OPEB for retiree medical insurance. In doing so, the Agency can maintain its focus on providing conservative, focused, productive service growth while containing costs when possible. In addition, the Agency’s financial condition and credit worthiness is greatly bolstered by having mitigated the vast majority of this substantial liability within three years.

This strategy and plan has the support of RCTC, who shares the goal of mitigating the GASB 43/45 liability as rapidly as possible while maintaining the intent of the PIP program. It is mutually agreed that the GASB pre-funding cost above the ARC will be excluded from PIP compliance. This

plan is contingent on full IRS support via receipt of the first FET credit reimbursement check, which is anticipated approximately June 1, 2007, and full approval of RCTC.

Fiscal Impact:

FY2007 impact:

- Operating budget increase of approximately \$8,500,000 to commence pre-funding of the Agency's OPEB liability per GASB 43/45 while still achieving the mandated farebox recovery ratio target. This amount will be funded with FET credit funds, RTA's Allocated Unclaimed Operating Reserve, and other Western County apportionment LTF. RTA's 10 percent Rainy Day Reserve will be left intact.
- Local revenue budget increase for FET credit, estimated to be \$775,000.
- No change to current year PIP targets due to exclusion of the added costs of GASB 43/45 beyond the ARC amount.

FY2008 thru FY2009 impact:

- Funding of approximately \$5,555,555 per year to cover the ARC and additional pre-funding the Agency's OPEB liability per GASB 43/45. Funding will come from FET credit and other Western County apportionment LTF.
- GASB 43/45 costs above ARC levels shall be excluded from PIP computation

Committee Recommendation:

This item was discussed at the Board Executive Committee meeting of April 26, 2007, and at the Board Budget and Administration Committee meeting of May 2, 2007. The Committees' members unanimously approved and recommended this item to the full Board of Directors for their consideration.

Recommendation:

- Authorize staff to request an FY2007 Short Range Transit Plan (SRTP) amendment to fund approximately \$8,500,000 in order to initiate funding of the Agency OPEB for retiree medical benefits contingent upon the Agency achieving its mandated Farebox Recovery Ratio. Funding sources in order of priority will be 1) FET credit from the IRS; 2) the Agency's Allocated Unclaimed Reserve - Operating - held at RCTC; and, 3) other Western County apportionment Transportation Development Act (TDA) funding in the form of Local Transportation Funds (LTF). The Agency's 10 percent Rainy Day Reserve shall not be used for GASB 43/45 funding.
- Request RCTC to exclude the additional GASB 43/45 cost above the Annual Required Contribution (ARC) from PIP compliance during the 3-year window of the FET credit.
- Recommendation is contingent upon RCTC approval of this plan.