ATTACHMENT B

ATTACH B

MAYOR AND COUNCIL AGENDA

NO. 12 DEPT.: Finance DATE PREPARED: October 1, 2007
STAFF CONTACT: Gavin Cohen FOR MEETING OF: October 22, 2007

SUBJECT:
Governmental Accounting Standards Board (GASB) Statement No. 45 entitled *Accounting and Financial Reporting by Employers for **P**ost-**E**mployment **B**enefits **O**ther Than Pensions.* (OPEB).

RECOMMENDATION:
Staff recommends that the Mayor and Council accept and file the report entitled Post-Retirement Medical and Life insurance Benefits Actuarial Valuation As Required by GASB 45.

BACKGROUND:
The City offers its retirees health benefits as specified in the City's pension plan when certain conditions are met. See attachment 1 for a full description of this benefit. The City, like many other jurisdictions, funds this benefit annually during the budget process i.e. it appropriates the funding needed annually under what is termed PAYGO, or cash method of funding i.e. each year the cash cost is recorded and no provision is made for future costs, or cost differentials that may exist between active employees and retirees.

GASB is the board that sets the accounting standards for local government entities. These standards collectively are called GAAP or Generally Accepted Accounting Principles. It is voluntary to comply with GAAP, but choosing not to follow the standards means getting a qualified audit report, so entities comply, as they cannot afford a qualified audit report that would affect bond ratings and the ability to borrow money, amongst other things.

In June, 2004, GASB issued statement No. 45 which changes the way local government entities report the cost for providing benefits, other than pensions, to its retirees, see attachment 2. Because the City follows GAAP, it is required to comply with GASB 45 beginning with its financial statements ending FY 09, which has policy implications for the upcoming FY 09 budget process. In order to be in compliance, the City is required to have an actuarial valuation done which is the subject of tonight's presentation, attachment 3. The Policy issues surrounding GASB 45 will be addressed as part of the FY 09 budget process.

It is important to understand that GASB 45 deals with financial reporting and new financial reporting standards. As an example, it requires full accrual accounting for the cost of providing retirees' with benefits, whereas before cash accounting was allowed. Liabilities for the cost of future benefits have to now be recognized whereas before no liability was shown. This is important, as funding the benefit and reporting the cost of the benefit are two separate and distinct things.

ATTACH B

DISCUSSION:

In September of 2006, the City issued RFP No. 9-07 for actuarial services related to GASB 45. Twelve firms were solicited and ten proposals were received. A committee of Finance and Human Resources staff awarded a contract to Bolton Partners Inc. at a contract cost of $12,000.

Bolton Partners is one of the foremost actuarial firms in the country and they have performed hundreds of similar actuarial reports for local jurisdictions across the country.

Under GASB 45 the City is required to have a bi-annual actuarial valuation performed on its retiree health benefits. The scope of services is attached as attachment 4. The valuation is performed so that an estimate can be made of the true accounting cost to provide the benefit, and to estimate the liabilities associated with the benefit so that these can be shown in the City's financial statements.

Page 7 of the report contains a summary of the annual costs to the City as well as an estimate of what the City's liability is for providing the benefit. The costs as one can see are different under two different assumptions.

One assumption is that the City does indeed prefund the benefit. This means that every year the City will set aside funds in an irrevocable trust in order to pay out the benefits. The biggest advantage to this is that the earnings 7.75% on funds invested are a lot higher than what the City can earn on its own investment portfolio. Because the earnings are higher the City's costs and recorded liabilities will be lower. Another advantage is the City will know that it has set aside sufficient funding to cover its future liabilities.

The second assumption shown is that the City chooses not to prefund the benefit that will result in higher costs and larger liabilities. This is predominantly due to invested money earning interest at only 4%.

This choice on the surface may seem obvious, but due to the cost and budget implications involved, it is an important policy decision for the Mayor and Council to make.

The report is very detailed and contains an executive summary, detailed information concerning plan expenses and liabilities, and notes reflecting actuarial methods utilized and assumptions that are underlying the valuation.

FISCAL IMPACT:

The City's current cost as will be reflected in its FY 07 financial statements is $60,723 for 14 retirees. Depending on whether the City chooses to prefund or not to prefund this cost will increase to either $1,307,000 or $1,808,000. Accordingly, the City's liability will be reflected at either $10,136,000 or $15,257,000.

The increase is due both to changing from cash to accrual methods of accounting, and having to account for costs that are higher for retirees than for current employees. This leads to what is known as an implicit rate subsidy, one of the more controversial elements of GASB 45, and a leading cause of costs being as high as they are. The City can also choose to gradually increase its cash expenditures for post-retirement medical benefits and many jurisdictions have chosen a funding plan that increases cash expenditures to the expense over a three to five year period.

ATTACH B

NEXT STEPS:

An actuarial valuation is the first necessary step for the City to implement GASB 45. The second step will be policy decisions from the Mayor and Council whether to prefund the benefit or possibly to make changes to the benefit to reduce costs and associated liabilities. These policy decisions will be brought back to the Mayor and Council initially in November as part of the FY 09 budget preview. The third step will be to implement the policy decisions as part of the FY 09 budget, and lastly the costs and liabilities will be reported as part of the FY 09 financial statements.

In addition, if the Mayor and Council choose a prefunding option, there will be many steps involved in setting up an irrevocable trust along with all the documentation and administrative responsibilities that will accompany that solution.

In conclusion, GASB 45 is a very complex technical accounting standard that since its issuance has caused significant turmoil amongst local government jurisdictions. For Rockville, its impact will be felt beginning with the FY 09 budget process as it will add anywhere from $261,400 - $1,808,000 to the City's budget's bottom line, the majority of which will have to be absorbed by the City's General Fund.

PREPARED BY:

Gavin Cohen, Finance Director — Date: 10/3/2007

APPROVE: Scott Ullery, City Manager — Date: 10/5/07

LIST OF ATTACHMENTS:

1. City's OPEB Benefit from pension plan
2. GASB News release 8/2/04
3. Post-Retirement Medical and Life Insurance Benefits Actuarial Valuation as Required by GASB 45
4. Scope of Services – Request For Proposal (RFP)
5. E-Mail to M&C dated 1/30/06
6. GASB 45 A few Basic Questions and Answers
7. Dispelling OPEB "Urban Legends"
8. Coming to Grips with Other Post-Employment Benefits
9. Gazette – 3/28/07 Council Oks Plan to Prepay Retirement Costs
10. Paying for promises

City of Rockville Pension Plan

Section 5.5 Medical Insurance Premiums

For eligible Employees who stay with the City's policy group, the City shall pay the City's share of a retiree's medical insurance premium from retirement until age 65.

For Administrative Personnel and Union Employees, eligible Employees shall be Employees who (a) retire, having attained age 60 while employed with the City and who have completed at least ten years of Credited Service prior to retirement, (b) take early retirement, having attained age 50 while employed with the City and having completed ten years of Credited Service and deemed to be permanently and totally disabled in accordance with the Federal Social Security Act, or (c) take early retirement from the City when their age plus Credited Service equal or exceeds 85.

For Police Employees, eligible Employees shall be Police Employees who meet the conditions stated above or who have attained their Normal Retirement Date while in the service of the City. The City's share of the retiree medical insurance premium shall be the same amount the City would have paid for the Employee and the Employee's family had the Employee remained in the employment of the City. In the event the Employee is not eligible for coverage from the City's group health insurance policy due to the fact that the Employee lives outside of the coverage area, the City will reimburse the Employee for health insurance coverage up to the prevailing two-person coverage employer rate granted to current Employees.

This provision shall be considered as separate from the other provisions of the Plan for purposes of the Internal Revenue Code. The assets used for this provision shall not be commingled with the assets used for the other provisions of the Plan.

Governmental Accounting Standards Board

NEWS RELEASE 08/02/04

GASB Issues Statement That Addresses Employer Reporting of Postemployment Benefits Other Than Pensions

---

Norwalk, CT, August 2, 2004—The Governmental Accounting Standards Board (GASB) has issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions,* which addresses how state and local governments should account for and report their costs and obligations related to postemployment healthcare and other nonpension benefits. Collectively, these benefits are commonly referred to as *other postemployment benefits,* or *OPEB.*

The statement generally requires that state and local governmental employers account for and report the annual cost of OPEB and the outstanding obligations and commitments related to OPEB in essentially the same manner as they currently do for pensions. Annual OPEB cost for most employers will be based on actuarially determined amounts that, if paid on an ongoing basis, generally would provide sufficient resources to pay benefits as they come due. The provisions of Statement 45 may be applied prospectively and do not require governments to fund their OPEB plans. An employer may establish its OPEB liability at zero as of the beginning of the initial year of implementation; however, the unfunded actuarial liability is required to be amortized over future periods.

Statement 45 also establishes disclosure requirements for information about the plans in which an employer participates, the funding policy followed, the actuarial valuation process and assumptions, and, for certain employers, the extent to which the plan has been funded over time.

According to project manager Karl Johnson, "When implemented, Statement 45 will provide those who use government financial reports with improved information about the cost of providing postemployment benefits, the commitments that governments have made related to those benefits, and the extent to which those commitments have been funded."

Statement 45 is effective in three phases based on a government's total annual revenues. The largest employers would be required to implement the requirements of Statement 45 for periods beginning after December 15, 2006. Medium-sized employers have one additional year to implement the standards, and the smallest employers have two additional years. Earlier implementation is encouraged.

The Statement (product code GS45) can be ordered through the GASB's Order Department at (800) 748-0659 or **online** via its website at www.gasb.org.

About the Governmental Accounting Standards Board

The GASB is the independent, not-for-profit organization formed in 1984 that establishes and improves financial accounting and reporting standards for state and local governments. Its seven members are drawn from the Board's diverse constituency, including preparers and auditors of government financial statements, users of those statements and members of the academic community. More information about the GASB can be found at its website www.gasb.org.

Governmental Accounting Standards Board

Improving governmental accountability through better financial reporting

---

City of Rockville
Post-Retirement Medical and Life Insurance Benefits
Actuarial Valuation
As Required by GASB 45

Initial Implementation Year:	July 1, 2008 - June 30, 2009
Date of Report:	September 6, 2007
Prepared By:	Bolton Partners, Inc. 575 South Charles Street Suite 500 Baltimore, MD 21201

September 6, 2007

Gavin Cohen
Director of Finance
City of Rockville
111 Maryland Avenue
Rockville, MD 20850-2364

Dear Gavin:

The following sets forth GASB 45 Annual Expense for the City of Rockville for the fiscal year ending June 30, 2009.

The report is based on July 1, 2006 census data, which is less than 24 months before the first day of fiscal year 2009. Accordingly, provided that there are no significant changes in plan design or employee demographics, these results could be relied upon to comply with GASB 45 in FYE2009.

The report is based on data submitted by the City and medical claims reported by the carriers. We have not performed an audit of the data and have relied on this information for purposes of preparing this report.

The report set forth information that will be required in accordance with the Governmental Accounting Standards Board No. 45.

These values have been computed in accordance with generally accepted actuarial principles and practices. The various actuarial assumptions and methods are, in our opinion, appropriate for the purposes of this report.

Respectfully submitted,

Kevin Binder, F.S.A.
Consultant
(443) 573-3906
KBinder@BoltonPartners.com

Kay Moran
Kay Moran, C.E.B.S.
Consultant
(443) 573-3913
KMoran@BoltonPartners.com

Table of Contents

1. Executive Summary

Background

In June 2004 the Government Accounting Standards Board (GASB) released Statement 45, which revised the GAAP accounting standards for post employment benefits other than pensions (OPEB). This standard will be applied to post-retirement medical benefits that are provided to the City of Rockville retirees. Prior to the new standard these benefits were accounted for on a pay as you go basis. The new standard requires that these benefits be accounted for on an accrual basis.

This report determines the initial expense under the new standard for the City of Rockville.

The new standard is effective for periods starting after December 15, 2007 for Phase 2 governments. Phase 2 Governments are those with total annual revenues of at least $10 million but less than $100 million as of FY2000. Since the City of Rockville is a Phase 2 Government the standard is required to be used for the July 1, 2008 to June 30, 2009 period, but early implementation is encouraged.

GASB 45 does not require pre-funding of OPEB liabilities. However, the difference between the GASB (OPEB) annual expense and cash payments for OPEB benefits will be treated as a balance sheet liability. OPEB payments include payments made to a trust as long as the trust assets cannot be used for other purposes. In addition, GASB 45 requires footnote disclosure of OPEB liabilities.

GASB 45 provides another incentive to pre-fund OPEB liabilities by requiring that OPEB liabilities be measured using a discount rate based on the underlying investment return of the assets used to provide these benefits. Since general government assets are typically held in conservative short-term accounts earning relatively low investment returns, a decision not to pre-fund these benefits will result in a much lower discount rate and an annual expense which is much higher than the expense determined using a discount rate typically assumed for a pension plan. Accordingly, we have provided two sets of results (funded and unfunded) depending upon whether the City decides to pre-fund these benefits.

The Annual Expense (ARC)

The annual cost of OPEB benefits under GASB 45 is called the annual required contribution or ARC. This amount will be higher than the current pay as you go cost shown on the City's CAFR for two reasons. First it includes the hidden subsidy for retirees. In general, medical costs for retirees are higher than employees because older retirees utilize health cares services more often than younger employees. The second reason GASB45 expense is higher than the pay go cost is that it includes a portion of the estimated future retiree medical cost (an accrual) for employees as well as the cost for retirees.

1. Executive Summary (cont.)

The City of Rockville's ARC is shown in Section 2. If the City of Rockville decides to pre-fund OPEB liabilities by establishing a trust and to use the maximum allowed amortization period of 30 years the ARC for the FYE June 30, 2009 is $1.307 million. This amount is as of the end of the fiscal year. The estimated pay as you go cost for OPEB benefits during the same period is $408,000. The pay as you go cost is comprised of $141,900 of hidden cost and $266,100 of assumed cost.

If the City of Rockville decides not to pre-fund OPEB liabilities the FYE 2009 ARC increases from $1.307 million to $1.808 million. The end of year balance sheet liability is estimated to be $1.40 million, which is equal to the unfunded ARC minus pay as you go payments plus interest to the end of the year. If the plan is not pre-funded, the actual final balance sheet liability cannot be determined until the pay as you go costs are known.

In Section 2, we also show the funded and unfunded expenses using six different amortizations. There are two amortization methods, using three different amortization periods. The two amortization methods are the level dollar and level percent of pay methods. The three amortization periods are 20, 25 and 30 years. Most jurisdictions are using the 30 year level percent of pay amortization period because it results in the lowest expense.

It is important to note that, even if all the assumptions we use materialize, the ARC is expected to increase by between 4% and 5% per year, since the cost of annual accruals will increase with healthcare inflation and given the amortization method used for the Unfunded Accrued Liability (i.e., benefits earned to date). In addition, an increase in the work force will also increase the ARC in future years.

Funding Strategies

Results are shown under two separate funding policies 1) to contribute for OPEB approximately the ARC (fully funded) 2) to continue the current pay as you go cost (not fully funded). Under the first approach the City would be required to establish a Trust. The City could elect to contribute the entire ARC to the trust and then make benefit payments from the trust. However, many jurisdictions who are planning to be fully funded will continue to make OPEB benefit payments from general funds. These jurisdictions will contribute an amount equal to the OPEB expense less the estimated payments from the general funds.

Many jurisdictions are considering phase-in periods. For example, the State of Maine announced that it will gradually increase its contributions over a 10 year period to the funded expense. If this approach is used the discount rate used will be a blend between the discount rates used to determine the fully funded and not funded expenses.

1. Executive Summary (cont.)

Plan Provisions

Retirees can continue the same medical coverage they had (including family coverage) as active employees. Retirees receive an explicit subsidy for their post-retirement medical insurance. Employees must attain retirement eligibility in their respective pension plan. Disabilities must have attained age 50 with 10 years of service to be eligible.

There is no subsidy after age 64.

Deferred retirements are not allowed to elect coverage at the time of retirement.

Demographic Data

Demographic data as of July 1, 2006 was provided to us by the City of Rockville. This data included current medical coverage for current employees and retirees.

Because the census data is less than 24 months before the first day of fiscal year 2009, it can be relied on to comply with GASB 45 for FYE 2009.

Although we have not audited this data we have no reason to believe that it is inaccurate.

Claims Data

Monthly paid claims, administrative expenses and enrollment for retirees from January 2006 through December 2006 were supplied by the carrier. Although we have not audited the claims data we have no reason to believe that it is inaccurate.

1. Executive Summary (cont.)

Implicit Subsidy

The published insurance rates for persons prior to Medicare eligibility are based primarily on the healthcare usage of active employees. Since retirees use healthcare at a rate much higher than employees, using these blended rates creates an implicit subsidy for the retiree group. GASB 45 requires that the claims assumption we use for this valuation be based on the actual per-capita retiree cost. The difference between the actual usage of healthcare by retirees and the assumption built into the published rates is identified as the implicit subsidy amount. There is no implicit subsidy for the Medicare-eligible retirees.

Section 7 provides a 30-year projection of benefit payments. They are divided into the traditional pay-go costs that are based on the published rates, and the hidden subsidy costs. Until the City adopts GASB45 the CAFR shows only the published rates. Approximately 36 percent of the projected payments and thus the expense is due to the hidden subsidy. The percentage of the GASB45 expense that is due to the hidden subsidy is unusually high for the City of Rockville because there is no post age 64 coverage. There is generally no hidden subsidy for Medicare eligible retirees.

Demographic Assumptions

Demographic assumptions mirror those used for the City of Rockville Pension Plan. An indicator was provided by the City to determine which division employees are in.

Section 5 details the assumptions for electing coverage.

Projected Counts

The actuarial valuation applies the Demographic assumptions to the employee census information. Section 7 provides the estimated number of remaining employees and the number of projected retirees. Retirees over age 65 are not included because they do no receive an OPEB subsidy. The actuarial valuation is a closed valuation. We do not include a liability for replacement employees. The counts shown are for the closed group of current employees.

Section 7 also shows the estimated projected benefit payments.

1. Executive Summary (cont.)

Economic Assumptions

The discount rate assumption is tied to the return expected on the funds used to pay these benefits. The discount assumption will be materially tied to the decision of whether or not to pre-fund these benefits. Our funded results are based on a 7.75% annual return, which assumes that the City will pre-fund these benefits starting at the beginning of the fiscal year July 1, 2008. Results using an alternate assumption of 4% are also provided. This assumes that benefits continue to be funded on a pay-as-you-go basis and that general fund investments can earn 4% over the long term.

Medical claims are assumed to increase 9.5% from 2006 to 2007, decreasing 1% per year to an ultimate rate of 5.5%. While medical costs have increased by a rate well in excess of 5.5% in recent years, prevailing practice is to assume that these increases will slow in the future. This is based on the macroeconomic assumption that if they do not moderate, medical expenses will consume an unacceptable percentage of the gross national product. The long-term assumption selected is consistent with the centers for Medicare and Medicaid Services office of the actuary's assumption for per-capita increases in medical costs.

Payroll is assumed to increase at 4.0% per annum. This assumption is used to determine the level percentage of payroll amortization factor.

Managing OPEB Liabilities

The Annual Expense under GASB45 is considerably higher than the current pay as you go cost. The City could consider amending the benefit plan to reduce the Cost. Possible benefit plan changes to consider are:

- Capping the Subsidy (Hard Cap)
- Indexing the Subsidy (e.g. the current level indexed at 3 percent) (Soft Cap)
- Setting a Higher Retiree Rate
- Requiring the Retirees To Pay the Entire Hidden Subsidy
- Changing the Subsidy to An Accrual Pattern (e.g. 2.5 % subsidy per year of service at retirement)

However, the City of Rockville's post-retirement medical program is already less generous than many local government employers because it does not provide any coverage after age 64, and there is no subsidy (other than the hidden subsidy) for family members of the retiree.

1. Executive Summary (cont.)

Actuarial Certification

In preparing the valuation we relied on demographic and claims data provided by the City of Rockville. We reviewed the data for reasonableness, but did not audit the data. The actuarial methods and assumptions used in this report comply with GASB 45 and the actuarial standards of practice promulgated by the American Academy of Actuaries.

The healthcare cost trend rate selected is consistent with prevalent practices. The 2005 to 2006 increase is consistent with recent experience. As discussed above, increases of this magnitude cannot be sustained indefinitely. Accordingly, standard actuarial practice (and GASB 43 Paragraph 34.g.) is to assume an "ultimate trend" which is consistent with the best estimate of GNP growth. However, the number of years until the ultimate trend is attained and the rate of decrease are not known. There is a significant probability, that between now and the next actuarial valuation we will not observe the anticipated amelioration of medical trends. If this is the case, typical practice is to reset the initial trend and to defer the year that the ultimate trend rate is attained. If this occurs annual actuarial losses of 5% to 15% of liabilities due to the revised trend rate can be expected.

Kevin Binder is a Member of the American Academy of Actuaries and meets the Qualification Standards of the American Academy of Actuaries to render the actuarial opinion contained in this report.

2. Plan Expense

Expense – FYE 2009 Adoption

Below is a summary of the calculation of the Plan's Expense under the current provisions the City of Rockville elects to adopt GASB45 for FYE 2009. This is the year in which the City of Rockville is required to apply the provisions of GASB45. These amounts are calculated as of the end of the year.

		Funded 07/01/2008	Not Funded 07/01/2008
(1)	Interest Rate	7.75%	4.00%
(2)	Amortization of Unfunded Accrued Liability		
	(a) Unfunded Accrued Liability	$10,136,000	$15,257,000
	(b) 30 Year Amortization Factor (Rounded)	17	29
	(c) Amortization Amount	$581,000	$529,000
(3)	Annual Required Contribution of Employer (ARC) – As of End of Fiscal Year		
	(a) Normal Cost	$726,000	$1,279,000
	(b) 30 Year Amortization of Unfunded Accrued Liability	$581,000	$529,000
	(c) Total ARC	$1,307,000	$1,808,000
(4)	Annual OPEB Cost (AOC)		
	(a) ARC	$1,307,000	$1,808,000
	(b) Less NOO Amortization	$0	$0
	(c) Plus Interest on NOO	$0	$0
	(d) Total Cost	$1,307,000	$1,808,000
(5)	1% Sensitivity (AOC)	$1,507,000	$2,150,000
(6)	Net OPEB Obligation (NOO)		
	(a) Beginning of Year NOO	$0	$0
	(b) Current ARC	$1,307,000	$1,808,000
	(c) Expected Cash Payment	$1,307,000	$408,000
	(d) Projected End of Year NOO (a + b – c)	$0	$1,400,000

2. Plan Expense (cont.)

Expense – FYE 2009 Under Differing Amortization Periods

	Funded	Not Funded
As a Level Percent of Pay		
Amortization Period	20	20
Normal Cost	$726,000	$1,279,000
Amortization of Unfunded Liability	$ 749,000	$793,000
Total 2009 Expense	$1,475,000	$2,072,000
Amortization Period	25	25
Normal Cost	$726,000	$1,279,000
Amortization of Unfunded Liability	$647,000	$635,000
Total 2009 Expense	$1,373,000	$1,914,000
Amortization Period	30	30
Normal Cost	$726,000	$1,279,000
Amortization of Unfunded Liability	$581,000	$529,000
Total 2009 Expense	$1,307,000	$1,808,000
As a Level Dollar Amount		
Amortization Period	20	20
Normal Cost	$726,000	$1,279,000
Amortization of Unfunded Liability	$1,013,000	$1,123,000
Total 2009 Expense	$1,739,000	$2,402,000
Amortization Period	25	25
Normal Cost	$726,000	$1,279,000
Amortization of Unfunded Liability	$929,000	$977,000
Total 2009 Expense	$1,655,000	$2,256,000
Amortization Period	30	30
Normal Cost	$726,000	$1,279,000
Amortization of Unfunded Liability	$879,000	$882,000
Total 2009 Expense	$1,605,000	$2,161,000

3. Liabilities

Liabilities as of Valuation Date – FYE 2009 Adoption

Below is a summary of the Plan's Liabilities under the current provisions as of 7/1/2008. Item (4) shows the impact of a 1% increase in medical cost trend.

			Funded 07/01/2008	Not Funded 07/01/2008
(1)	Discount Rate		7.75%	4.00%
(2)	Actuarial Accrued Liability			
	(a)	Actives	$9,897,000	$14,991,000
	(b)	Retirees in Pay Status	$239,000	$266,000
	(c)	Total	$10,136,000	$15,257,000
(3)	Normal Cost (End of Year)			
	(a)	Normal Cost for Benefits	$726,000	$1,279,000
	(b)	Expense Load	$0	$0
	(c)	Total Normal Cost	$726,000	$1,279,000
(4)	Trend Sensitivity			
	(a)	Actuarial Accrued Liability	$11,377,000	$17,447,000
	(b)	Total Normal Cost (End of Year)	$855,000	$1,545,000

ATTACH B

4. Summary of Principal Plan Provisions

The following summary describes principal plan provisions assumed in calculating the cost of your post-retirement medical plan.

General Eligibility Rules

Eligible participants are assumed to be employees, former employees or beneficiaries of the City of Rockville who had health coverage as an active employee.

Eligibility for a disability benefit is attained age 50 with 10 years of service. No distinction has been made between ordinary disability and line of duty disability for purposes of this valuation.

Police normal retirement eligibility is age 51 with 25 years of service or age 60 regardless of service. All other employees have a normal retirement eligibility of age 60 with 10 years of service or 85 points. The points are determined by adding a participants' age and accrued service together.

Underlying Plan Description

Pre-Medicare retirees may choose between several medical plans including a PPO plan, an HMO plan, and a POS plan, all of which are packaged with prescription benefits.

Retiree Contribution

Retirees and their families pay 20% of the published rates. Surviving spouses receive no explicit subsidy, but are permitted to remain in the plan and pay 100% of the published costs.

5. Valuation Data

Counts

The following table summarizes the counts, ages and coverage as of 7/1/2006, for those currently enrolled in Medical/Drug coverage:

		General	Police	Total
(1)	Number of Participants			
	(a) Active Employees	361	43	404
	(b) Retirees (Pre- Medicare)	N/A	N/A	11
(2)	Active Statistics			
	(a) Average Age	43.48	37.38	42.83
	(b) Average Service	8.65	10.25	10.09
(3)	Inactive Statistics			
	(a) Average Age (Pre-Medicare)	N/A	N/A	61.74

5. Valuation Data (cont.)

Active Age - Service Distribution

Shown below is a distribution based on age and service of active participants who are currently receiving medical and drug benefits from the City as of the valuation date.

	Years of Service as of 07/01/2006							
Age	Under 1	01-04	05-09	10-14	15-19	20-24	25+	Total
Under 25	11	8	1	0	0	0	0	20
25 - 29	14	20	6	1	0	0	0	41
30 - 34	8	17	15	1	0	0	0	41
35 - 39	15	16	13	7	0	0	0	51
40 - 44	8	7	24	5	22	2	0	68
45 - 49	10	15	18	5	18	8	5	79
50 - 54	7	3	7	7	10	6	6	46
55 - 59	7	4	7	4	11	2	10	45
60 - 64	2	1	1	0	2	1	3	10
65 & Up	0	0	2	1	0	0	0	3
Totals	82	91	94	31	63	19	24	404

The following table shows averages in total for the above participants.

	Averages
Age:	42.83
Service:	10.09

6. Valuation Methods and Assumptions

Cost Method

This valuation uses the Projected Unit Credit method, with linear pro-ration to assumed benefit commencement.

Amortization Method

Liabilities are amortized over a 30 year period as a level of percentage of payroll.

Coverage Status and Age of Spouse

Actual coverage status is used; females are assumed to be 3 years younger than their male spouse. Employees with individual coverage are assumed to elect individual coverage in retirement, and those with spouse/family coverage are assumed to continue this coverage upon retirement.

This valuation assumes that 100% of eligible participants will continue the same coverage levels upon retirement.

Interest Assumptions

	Funded	Not Funded
Discount Rate	7.75%	4.00%
Payroll Growth	4.00%	4.00%

Trend Assumptions

	Base	Sensitivity
Medical and Drug		
06/30/2007	9.50%	10.50%
06/30/2008	8.50%	9.50%
06/30/2009	7.50%	8.50%
06/30/2010	6.50%	7.50%
06/30/2011	5.50%	6.50%
Ultimate	5.50%	6.50%

6. Valuation Methods and Assumptions (cont.)

Decrement Assumptions

Below is a summary of decrements used in this valuation. Sample Disability and Termination rates are illustrated in the tables below.

Mortality Decrements	Description
(1) Healthy	RP 2000 Combined Healthy Table
(2) Disabled	RP 2000 Combined Disabled Table

Retirement Age	
	Police: 100% at Normal Retirement. Non-Police: The latter of attained age 60 or 10 years of credited service.

Disability

Selected rates of disablement are shown below:

Age	Male	Female
25	.00085	.00107
30	.00077	.00136
35	.00121	.00200
40	.00169	.00270
45	.00280	.00387
50	.00515	.00610
55	.00969	.00940
60	.01482	.01198

6. Valuation Methods and Assumptions (cont.)

Decrement Assumptions (Cont.)

Withdrawal

The following illustrative rates were used.
For employees with less than six years of service
(excluding those in the Adm. And Union DB):

Service	Adm. TP	Union TP	Police
0	.1200	.1200	.0800
1	.1120	.1120	.0720
2	.1040	.1040	.0640
3	.0960	.0960	.0480
4	.0880	.0880	.0400
5	.0800	.0800	.0320

Withdrawal

The following illustrative rates were used.
For employees with six or more years of service:
Selected rates of withdrawal are shown below

Age	Union TP & Adm. TP	Adm. DB	Police
20	16.74%	4.65%	4.65%
25	12.24%	3.40%	3.40%
30	9.09%	2.53%	2.53%
35	7.11%	1.98%	1.98%
40	5.85%	1.63%	1.63%
45	4.95%	1.38%	1.38%
50	4.05%	1.13%	1.13%
55	0.00%	0.00%	0.00%

No withdrawal is assumed for the Union DB

6. Valuation Methods and Assumptions (cont.)

Claims Assumption

The plan is fully insured. To determine the assumed cost and the retiree contributions, we weighted the 2006 premium rates by the current enrollment.

Gross claims are equal to the age adjusted assumed cost. The resulting average pre age 65 claims were age adjusted.

6. Valuation Methods and Assumptions (cont.)

The following chart shows the total costs including both medical and prescription drug as well as the assumed costs.

	July 1, 2006 to June 30, 2007	
	Single	**Family**
1. Total Costs		
a. Under 50	4,403	9,810
b. Age 50-54	5,364	11,954
c. Age 55-59	6,289	14,014
d. Age 60-64	7,584	16,900
e. Age 65 and Older	N/A	N/A
2. Assumed Costs	4,737	10,555

7. 30 Year Projected Benefit Payments and Participant Counts

Participant Counts – Closed Group Valuation

	Counts			
Year Ending	BOY Actives	Emerging Inactive	Initial Inactive	Total Inactives
2007	404	13	11	24
2008	369	22	11	33
2009	341	29	9	38
2010	319	37	8	45
2011	298	41	4	45
2012	280	47	2	49
2013	264	50	2	52
2014	246	52	2	54
2015	229	60	2	62
2016	210	61	1	62
2017	193	71	1	72
2018	165	71	1	72
2019	153	72	1	73
2020	139	82	1	83
2021	121	77	1	78
2022	108	83	1	84
2023	96	83	0	83
2024	88	79	0	79
2025	80	75	0	75
2026	70	67	0	67
2027	63	60	0	60
2028	54	57	0	57
2029	47	55	0	55
2030	40	49	0	49
2031	35	47	0	47
2032	28	45	0	45
2033	24	40	0	40
2034	19	37	0	37
2035	16	35	0	35
2036	13	37	0	37
2037	8	35	0	35

ATTACH B

7. 30 Year Projected Benefit Payments and Participant Counts (cont.)

Benefit Payments – Pay-Go and Implicit Subsidy

Year Ending	Pay-Go (CAFR)	Implicit Subsidy	Grand Total
2007	124,000	71,000	195,000
2008	204,000	115,000	319,000
2009	266,000	142,000	408,000
2010	341,000	173,000	514,000
2011	427,000	240,000	667,000
2012	468,000	266,000	734,000
2013	530,000	299,000	829,000
2014	636,000	363,000	999,000
2015	667,000	366,000	1,033,000
2016	767,000	415,000	1,182,000
2017	934,000	523,000	1,457,000
2018	980,000	544,000	1,524,000
2019	1,089,000	617,000	1,706,000
2020	1,197,000	697,000	1,894,000
2021	1,298,000	759,000	2,057,000
2022	1,371,000	831,000	2,202,000
2023	1,284,000	772,000	2,056,000
2024	1,312,000	805,000	2,117,000
2025	1,337,000	840,000	2,177,000
2026	1,301,000	803,000	2,104,000
2027	1,319,000	801,000	2,120,000
2028	1,301,000	786,000	2,087,000
2029	1,298,000	762,000	2,060,000
2030	1,317,000	773,000	2,090,000
2031	1,344,000	786,000	2,130,000
2032	1,279,000	752,000	2,031,000
2033	1,270,000	731,000	2,001,000
2034	1,254,000	719,000	1,973,000
2035	1,199,000	685,000	1,884,000
2036	1,186,000	667,000	1,853,000
2037	1,189,000	678,000	1,867,000

8. Glossary

Annual OPEB Cost (AOC): An accrual-basis measure of the periodic cost of an employer's participation in a defined benefit OPEB plan.

Annual Required Contributions of the Employer(s) (ARC): The employer's periodic required contributions to a defined benefit OPEB plan, calculated in accordance with the parameters.

Covered Group: Plan members included in an actuarial valuation.

Defined Benefit OPEB Plan: An OPEB plan having terms that specify the amount of benefits to be provided at or after separation from employment. The benefits may be specified in dollars (for example, a flat dollar payment or an amount based on one or more factors such as age, years of service, and compensation), or as a type or level of coverage (for example, prescription drugs or a percentage of healthcare insurance premiums).

Employer's Contributions: Contributions made in relation to the annual required contributions of the employer (ARC). An employer has made a contribution in relation to the ARC if the employer has (a) made payments of benefits directly to or on behalf of a retiree or beneficiary, (b) made premium payments to an insurer, or (c) irrevocably transferred assets to a trust, or an equivalent arrangement, in which plan assets are dedicated to providing benefits to retirees and their beneficiaries in accordance with the terms of the plan and are legally protected from creditors of the employer(s) or plan administrator.

Funded Ratio: The actuarial value of assets expressed as a percentage of the actuarial accrued liability.

Healthcare Cost Trend Rate: The rate of change in per capita health claim costs over time as a result of factors such as medical inflation, utilization of healthcare services, plan design, and technological developments.

Investment Return Assumption (Discount Rate): The rate used to adjust a series of future payments to reflect the time value of money.

8. Glossary (cont.)

Level Percentage of Projected Payroll Amortization Method:
Amortization payments are calculated so that they are a constant percentage of the projected payroll of active plan members over a given number of years. The dollar amount of the payments generally will increase over time as payroll increases due to inflation; in dollars adjusted for inflation, the payments can be expected to remain level. This method can not be used if the plan is closed to new entrants.

Net OPEB Obligation:
The cumulative difference since the effective date of this Statement between annual OPEB cost and the employer's contributions to the plan, including the OPEB liability (asset) at transition, if any, and excluding (a) short-term differences and (b) unpaid contributions that have been converted to OPEB-related debt.

Normal Cost or Normal Actuarial Cost:
That portion of the Actuarial Present Value of pension plan benefits and expenses which is allocated to a valuation year by the Actuarial Cost Method.

Other Post-employment Benefits:
Post-employment benefits other than pension benefits. Other post-employment benefits (OPEB) include post-employment healthcare benefits, regardless of the type of plan that provides them, and all post-employment benefits provided separately from a pension plan, excluding benefits defined as termination offers and benefits.

Pay-as-you-go (PAYG):
A method of financing a pension plan under which the contributions to the plan are generally made at about the same time and in about the same amount as benefit payments and expenses becoming due.

Payroll Growth Rate:
An actuarial assumption with respect to future increases in total covered payroll attributable to inflation; used in applying the level percentage of projected payroll amortization method.

Plan Liabilities:
Obligations payable by the plan at the reporting date, including, primarily, benefits and refunds due and payable to plan members and beneficiaries, and accrued investment and administrative expenses. Plan liabilities do not include actuarial accrued liabilities for benefits that are not due and payable at the reporting date.

8. Glossary (cont.)

Plan Members: The individuals covered by the terms of an OPEB plan. The plan membership generally includes employees in active service, terminated employees who have accumulated benefits but are not yet receiving them, and retired employees and beneficiaries currently receiving benefits.

Post-employment: The period between termination of employment and retirement as well as the period after retirement.

Post-employment Healthcare Benefits: Medical, dental, vision, and other health-related benefits provided to terminated or retired employees and their dependents and beneficiaries.

Select and Ultimate Rates: Actuarial assumptions that contemplate different rates for successive years. Instead of a single assumed rate with respect to, for example, the investment return assumption, the actuary may apply different rates for the early years of a projection and a single rate for all subsequent years. For example, if an actuary applies an assumed investment return of 8% for year 20W0, 7.5% for 20W1, and 7% for 20W2 and thereafter, then 8% and 7.5% are select rates, and 7% is the ultimate rate.

E. **Scope of Services**

The objective of this project is to be able to recognize OPEB costs systematically over employees' years of service and to provide relevant information about the actuarial accrued liabilities for these benefits. Specifically, the selected firm will provide:

1. A determination of the City's retiree medical benefit actuarial liability as of June 30, 2006 including:
   The actuarial present value of total projected benefits
   Actuarial accrued liability
   Actuarial value of assets
   The unfunded actuarial accrued liability
   Normal Cost
   Annual required contribution of the employer as a level dollar amount and as a level percentage of covered payroll
   Net OPEB obligation

2. A breakdown of this liability by the following:

   - Current Employees
   - Retired Employees
   - Valuation of liability assuming a trust fund would be used

3. An analysis and explanation of the various funding strategies that might be considered for funding the cost of benefits associated with past service and strategies for reducing the cost of the benefit going forward.

4. The required annual total contribution amounts under the various funding strategies utilizing different amortization periods (20, 25, and 30 years).

5. A breakdown of the annual contribution amount into the following components:

   - Normal contribution amount
   - Past service amount
   - All other unfunded liabilities
   - Interest earning component on contribution amounts

6. Determine the implicit rate subsidy, and the impact on the OPEB liability.

7. A schedule for indicating the projected number of retirees for each of the next 30 years based on the current pools of retirees and active, with the projected benefits payable.

8. Information necessary so that the City can comply with GASB OPEB reporting and disclosure requirements.

9. A summary of the actuarial basis and assumptions used in the valuation. If the assumptions are different than what is currently being used with the City's pension plan, then an analysis of the benefits of the allowed actuarial methods and amortization methods with the pros' and cons of each method and the most appropriate or commonly used one or two methods for this type of study, and their impact on the City's OPEB liability should be explained.

10. Prepare a cash flow analysis to show impact of paygo funding.

11. Provide recommendations on managing the City's OPEB liability including changes in plan design, formation of a trust fund, formation of an internal services fund etc. etc.

10. An executive summary of the results of this analysis.

The contracted firm shall perform the following activities to complete the actuarial funding study for the City's OPEB program:

1. Meet with City Staff to help select appropriate actuarial cost method (entry age, frozen entry age, attained age, or other deemed appropriate).

2. Estimate the appropriate Governmental Accounting Standards Board (GASB)-required reserve for the outstanding liability as of June 30, 2006, or more recently if possible.

3. Prepare a written report summarizing conclusions and recommendations and documenting the analysis.

4. Attend one (1) meeting with City officials and possibly with an external auditor to discuss the report.

5. If the City requests additional services or meetings the City will make payment based on the hourly billing rates

Scott Ullery/RKV
01/30/2006 08:52 AM

To redorse@yahoo.com, Larry Giammo/RKV@RKV, Susan Hoffmann/RKV, Phyllis Marcuccio/RKV@RKV, anner41@hotmail.com, "Susan Hoffmann"
cc Senior Staff
bcc
Subject

Dear Mayor and Councilmembers,

You may have read the article "Costly Change Looming for Retiree Benefits" in this morning's Washington Post Metro page, and wondered (and might be asked about) how this might affect Rockville.

Gavin has provided the following explanation of this requirement, which I hope you will find to be helpful:

Typically, government employers have reported the cost of heath care and other non-pension benefits on a "pay as you go" basis. It has been simple. The annual cash paid for benefits has been the annual expense with no other liabilities or funding requirements. In FY2005, the City's costs were $53,386 for 35 retirees, funded on a "pay-as-you-go" basis.

Under the new GASB 45 standards, state and local government employers must account for, and report, the annual cost of Other Post Employment Benefits (OPEB) in the same way they report pensions. As a result, the annual OPEB costs for most employers will be based on actuarially determined amounts rather than in the "pay-as-you-go" method.

GASB states that the current "pay-as-you-go" method doesn't accurately reflect the true costs that governments are accumulating for future benefits of current employees; the promise of future benefit is an expense that must be recorded rather than deferred as a liability to a future generation.

The City of Rockville will have to implement this for FY2008-09. We will engage an actuary in FY07 to establish what the funding requirements are and then incorporate it into the budget process to fund. The reporting will be similar to what is currently reported for pension plans.

What is OPEB?

OPEB includes covers certain benefits provided after employment ends. From an accounting perspective, these benefits are in exchange for employees' current services. The "O" in OPEB means that these benefits are those Other than pensions (which have established account rules covered by GASB Statements 25 and 27). OPEB usually includes healthcare benefits: medical, dental, vision, and prescription plans. They also can include other benefits: life insurance, disability, long-term care, and legal services, unless these benefits are provided through a pension (e.g. Defined Benefit) plan. OPEB does not include vacation, sick leave, or COBRA continuation.

What is GASB 45?

GASB 45 is a statement by the Governmental Accounting Standards Board which says that governmental employers must start recording costs of the OPEB plans that the current employees are accruing as an expense on financial statements. Previous rules only required that current payments to existing retirees be recorded as an expense. Governments must disclose information regarding funding, costs, and provisions of the OPEB plans. The private sector has had similar rules for many years (FAS 106 is the corporate equivalent of GASB 45).

GASB 45 does not require employers to prefund these expenses, however, it is recommended that they do since deciding not to prefund results in a higher expense. Also, this statement applies prospectively. For most large governments, the higher expense starts in FY2008 with some disclosure required a year earlier. It remains to be seen whether employers will start to prefund. The true cost needing to be reflected may impact the retiree benefits that an agency chooses to provide.

The rating agencies did not express any concern or ask us anything about this during their visit last year.
Complying with this requirement is not expected to affect our bond rating.

-Scott

GASB

GASB STATEMENT 45 ON OPEB ACCOUNTING BY GOVERNMENTS A FEW BASIC QUESTIONS AND ANSWERS

1. Why was Statement 45 on OPEB accounting by governments necessary?

Statement 45 was issued to provide more complete, reliable, and decision-useful financial reporting regarding the costs and financial obligations that governments incur when they provide postemployment benefits other than pensions (OPEB) as part of the compensation for services rendered by their employees. *Postemployment healthcare benefits,* the most common form of OPEB, are a very significant financial commitment for many governments.

2. How was OPEB accounting and financial reporting done prior to Statement 45?

Prior to Statement 45, governments typically followed a "pay-as-you-go" accounting approach in which the cost of benefits is not reported until after employees retire. However, this approach is not comprehensive—only revealing a limited amount of data and failing to account for costs and obligations incurred as governments receive employee services each year for which they have promised future benefit payments in exchange.

3. What does Statement 45 accomplish?

- When they implement Statement 45, many governments will report, for the first time, annual OPEB cost and their unfunded actuarial accrued liabilities for past service costs. This will foster improved accountability and a better foundation for informed policy decisions about, for example, the level and types of benefits provided and potential methods of financing those benefits.

The Standard also:

- Results in reporting the estimated cost of the benefits as expense each year *during the years that employees are providing services* to the government and its constituents in exchange for those benefits.
- Provides, to the diverse users of a government's financial reports, more accurate information about the *total cost of the services* that a government provides to its constituents.
- Clarifies whether the amount a government has paid or contributed for OPEB during the report year has covered its annual OPEB cost. Generally, the more of its annual OPEB cost that a government chooses to defer, the higher will be (a) its unfunded actuarial accrued liability and (b) the cash flow demands on the government and its tax or rate payers in future years.
- Provides better information to report users about a government's *unfunded actuarial accrued liabilities* (the difference between a government's total obligation for OPEB and any assets it has set aside for financing the benefits) and changes in the *funded status of the benefits* over time.

4. **What are the most common misconceptions about Statement 45?**

   a. **That it requires governments to fund OPEB.** Statement 45 establishes standards for *accounting and financial reporting.* How a government actually finances benefits is a policy decision made by government officials. The objective of Statement 45 is to more accurately reflect the financial effects of OPEB transactions, including the amounts paid or contributed by the government, whatever those amounts may be.

   b. **That it requires immediate reporting of a financial-statement liability for the entire unfunded actuarial accrued liability.** Statement 45 does not require immediate recognition of the unfunded actuarial accrued liability (UAAL) as a financial-statement liability. The requirements regarding the reporting of an OPEB liability on the face of the financial statements work as follows:

      - Governments may apply Statement 45 prospectively. At the beginning of the year of implementation, nearly all governments will start with zero financial-statement liability.
      - From that point forward, a government will accumulate a liability called the *net OPEB obligation,* if and to the extent its actual OPEB contributions are less than its annual OPEB cost, or expense.
      - The net OPEB obligation (not the same as the UAAL) will increase rapidly over time if, for example, a government's OPEB financing policy is pay-as-you-go, and the amounts paid for current premiums are much less than the annual OPEB cost.

      Statement 45 does, however, also require the *disclosure* of information about the *funded status* of the plan, including the UAAL, in the notes to the financial statements—and the presentation of multi-year funding progress trend information as a required supplementary schedule.

   c. **That it requires governments to report "future costs" for OPEB.** It is misleading and incorrect to describe accrual accounting for OPEB as requiring the expensing of "future costs." From an accrual accounting standpoint (the basis of accounting required for all transactions in the government-wide financial statements), the reported expenses relate entirely to transactions (exchanges of employee services for the promised future benefits) that *already have occurred.* Statement 45 requires governments to report costs and obligations incurred as a consequence of receiving employee services, for which benefits are owed in exchange. The *normal cost* component of annual expense is the portion of the present value of estimated total benefits that is attributed to services received in the current year. The annual expense also includes an amortization component representing a portion of the UAAL, which relates to past service costs. Estimated benefit costs associated with *projected future years of service* are *not reported.*

Dispelling OPEB "Urban Legends"

By Stephen J. Gauthier

Recently, it has become apparent that there are a number of common misconceptions about what GASB Statement No. 45 does and does not require. To avoid potential misunderstandings, this article underscores five important facts about GASB Statement No. 45.

In July 2004, the Governmental Accounting Standards Board (GASB) issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. States and large local governments will be required to implement the new guidance starting with the fiscal year that ends December 31, 2007. Medium-size and small governments will be required to do the same starting with the fiscal year ending December 31, 2008, and December 31, 2009, respectively.

The main thrust of GASB Statement No. 45 is to require for the first time that public-sector employers recognize the cost of other postemployment benefits (OPEB) over the active service life of their employees rather than on a pay-as-you-go basis. Early indications are that OPEB cost calculated in accordance with GASB Statement No. 45 is likely to be as much (or more) than three times the amount of pay-as-you-go payments, raising understandable concerns about the potential financial, managerial, and public-policy implications of implementing the new guidance.

Naturally, decision makers must have a sound understanding of the requirements of GASB Statement No. 45 if they are to develop an appropriate strategy for dealing with the issues raised by the implementation of that pronouncement. Unfortunately, many in this position appear to be laboring under some serious misapprehensions regarding exactly what the new GASB guidance does and does not require. Indeed, five such misunderstandings have become so widespread as to take on a status akin to an accounting-style "urban legend." This article seeks to dispel such legends so decision makers can focus on the real rather than the imaginary effects of implementing GASB Statement No. 45.

URBAN LEGEND 1 — THE OPEB-FUNDING POLTERGEIST

"We have no choice — we have to change how we fund OPEB if we want to keep getting a clean opinion from our auditors."

The GASB's authority is strictly limited to accounting and financial reporting. That is, the GASB cannot tell a government what to do – only how to reflect what it has done. Nothing in GASB Statement No. 45 prevents a government that elects to continue to finance OPEB on a pay-as-you-go basis from receiving an unqualified opinion from its independent auditors on the fair presentation of its financial statements.

URBAN LEGEND 2 — THE LOST FUND BALANCE

"The new accounting for OPEB will wipe out our fund balance overnight!"

"Fund balance" is reported only in funds that use the modified accrual basis of accounting (i.e., "governmental funds"). Under the modified accrual basis of accounting, expenditures for OPEB will continue to be recognized *only as funding occurs*, regardless of how the amount thus funded is calculated (i.e., advance funding, pay-as-you-go funding). That is, *fund balance* will only be affected in a given year by the amount actually funded in that year, on whatever basis.

URBAN LEGEND 3 — THE GHOST OF OPEB PAST

"We are going to have to report a huge liability right away on the face of the financial statements for all of the OPEB we promised in the past."

The present value of benefits earned to date but not funded (i.e., the *unfunded actuarial accrued liability*) will *not* be reported on the face of *any* financial statement. Instead, that amount will be amortized as part of *future* cost (i.e., a component of the actuarially determined *annual required contribution* — ARC) over a period not to exceed 30 years. As long as employers fully fund each year's ARC, they will *never* report a liability on the face of their financial statements. Moreover, even if they do *not* fully fund the ARC, a liability (for the unfunded portion of the ARC rather than for the full amount of the unfunded actuarial accrued liability) would only be recognized *gradually*.

URBAN LEGEND 4 — WARDING OFF THE OPEB EVIL EYE

"We don't have to worry about OPEB because we have no written agreement and the law specifically states that benefits are subject to appropriation each year."

Accounting traditionally has emphasized economic substance over legal form. Accordingly, the GASB's *Implementation Guide to GASB Statements 43 and 45* explains that employers can have OPEB to report even in the absence of a written plan (question 56) and even in situations where "benefits are limited by the amount of funding approved by the legislature on an annual basis" (question 57). Simply put, OPEB exist whenever there is a mutual understanding between employers and employees (i.e., *substantive plan*) that such benefits will be provided, period.

URBAN LEGEND 5 — THE OPEB OSTRICH

"As long as the retirees pay the full amount of their healthcare premium, there is no OPEB for the employer to report."

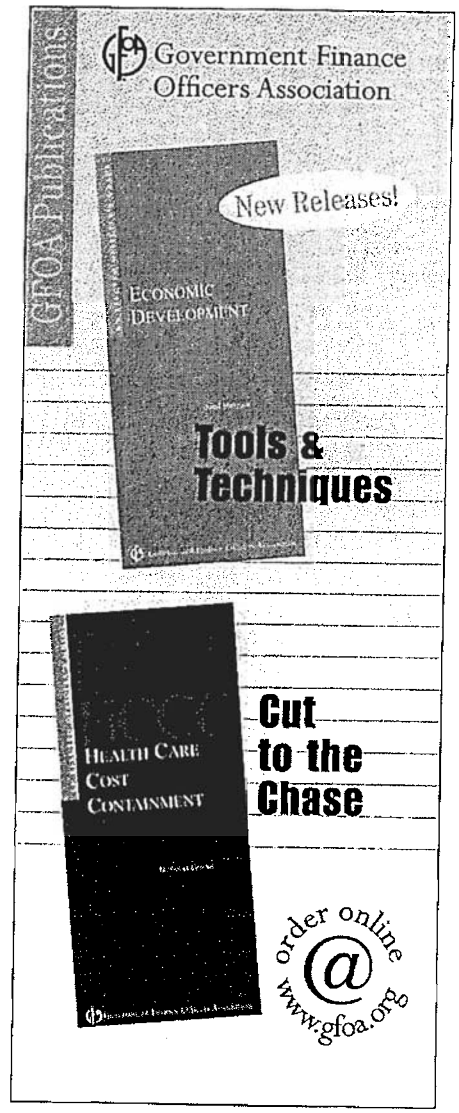
If retirees are allowed to pay the same healthcare premium as active employees, they are, in fact, enjoying an *implicit rate subsidy*. The GASB requires that such an implicit rate subsidy be treated as OPEB in its own right, even though the employer makes no direct payments on behalf of retirees. Thus, an employer must report OPEB cost today for active employees who will be able to continue to purchase health insurance once they retire at the same premium paid for active members.

CONCLUSION

There are important financial, managerial, and public-policy ramifications associated with the new employer accounting for OPEB. Clearly, a government's failure to control OPEB costs could have a serious negative impact on the its future financial position and economic condition. Consequently, rating agencies will likely take the new information furnished by GASB Statement No. 45 into account in assigning future ratings. It seems reasonable, in this latter regard, to expect that governments that craft a workable strategy for financing their OPEB in the wake of GASB Statement No. 45 will probably fare better than those that do not.

Many observers expect to see significant changes in how OPEB are managed and funded in the wake of GASB Statement No. 45. It is important that decisions regarding such changes be based upon a sound assessment of what ultimately is best for the government financially and economically, rather than upon a misapprehension of what generally accepted accounting principles do or do not require. ■

STEPHEN J. GAUTHIER is director of GFOA's Technical Services Center.



continue to be recognized *only as funding occurs*, regardless of how the amount thus funded is calculated (i.e., advance funding, pay-as-you-go funding). That is, *fund balance* will only be affected in a given year by the amount actually funded in that year, on whatever basis.

URBAN LEGEND 3 — THE GHOST OF OPEB PAST

"We are going to have to report a huge liability right away on the face of the financial statements for all of the OPEB we promised in the past."

The present value of benefits earned to date but not funded (i.e., the *unfunded actuarial accrued liability*) will *not* be reported on the face of *any* financial statement. Instead, that amount will be amortized as part of *future* cost (i.e., a component of the actuarially determined *annual required contribution* – ARC) over a period not to exceed 30 years. As long as employers fully fund each year's ARC, they will *never* report a liability on the face of their financial statements. Moreover, even if they do *not* fully fund the ARC, a liability (for the unfunded portion of the ARC rather than for the full amount of the unfunded actuarial accrued liability) would only be recognized *gradually*.

URBAN LEGEND 4 — WARDING OFF THE OPEB EVIL EYE

"We don't have to worry about OPEB because we have no written agreement and the law specifically states that benefits are subject to appropriation each year."

Accounting traditionally has emphasized economic substance over legal form. Accordingly, the GASB's *Implementation Guide to GASB Statements 43 and 45* explains that employers can have OPEB to report even in the absence of a written plan (question 56) and even in situations where "benefits are limited by the amount of funding approved by the legislature on an annual basis" (question 57). Simply put, OPEB exist whenever there is a mutual understanding between employers and employees (i.e., *substantive plan*) that such benefits will be provided, period.

URBAN LEGEND 5 — THE OPEB OSTRICH

"As long as the retirees pay the full amount of their healthcare premium, there is no OPEB for the employer to report."

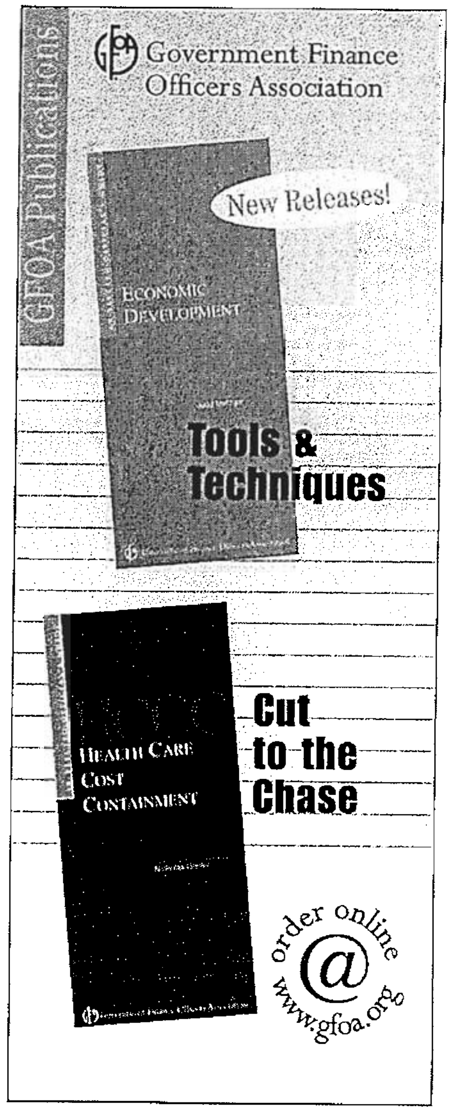
If retirees are allowed to pay the same healthcare premium as active employees, they are, in fact, enjoying an *implicit rate subsidy*. The GASB requires that such an implicit rate subsidy be treated as OPEB in its own right, even though the employer makes no direct payments on behalf of retirees. Thus, an employer must report OPEB cost today for active employees who will be able to continue to purchase health insurance once they retire at the same premium paid for active members.

CONCLUSION

There are important financial, managerial, and public-policy ramifications associated with the new employer accounting for OPEB. Clearly, a government's failure to control OPEB costs could have a serious negative impact on the its future financial position and economic condition. Consequently, rating agencies will likely take the new information furnished by GASB Statement No. 45 into account in assigning future ratings. It seems reasonable, in this latter regard, to expect that governments that craft a workable strategy for financing their OPEB in the wake of GASB Statement No. 45 will probably fare better than those that do not.

Many observers expect to see significant changes in how OPEB are managed and funded in the wake of GASB Statement No. 45. It is important that decisions regarding such changes be based upon a sound assessment of what ultimately is best for the government financially and economically, rather than upon a misapprehension of what generally accepted accounting principles do or do not require. ▮

STEPHEN J. GAUTHIER is director of GFOA's Technical Services Center.



Government Finance Review
GOVERNMENT FINANCE OFFICERS ASSOCIATION

PUBLISHER
Jeffrey L. Esser

EDITOR IN CHIEF
Anne Spray Kinney

ASSOCIATE EDITOR
Karen Utterback

SUBMISSIONS

The editors encourage finance officers, scholars, private consultants, and other knowledgeable individuals to submit manuscripts to *Government Finance Review*. All manuscripts should conform to the Editorial Policy and Guidelines for Authors, which are available online at www.gfoa.org. Manuscripts should be submitted electronically to gfr@gfoa.org.

CONTACT INFORMATION

Government Finance Review
c/o Government Finance Officers Association
203 N. LaSalle Street, Suite 2700
Chicago, Illinois 60601-1210
phone 312-977-9700 · fax 312-977-4806
e-mail GFR@gfoa.org

WEB SITE
www.gfoa.org

EDITORIAL
gfr@gfoa.org

ADVERTISING
Natalie Laudadio
nlaudadio@gfoa.org;
312-578-2298

PERMISSION AND REPRINTS
Karen Utterback
kutterback@gfoa.org;
312-578-5467

SUBSCRIPTIONS / CHANGE OF ADDRESS
Lynn Chorak
lchorak@gfoa.org;
312-578-4408

GFOA EXECUTIVE BOARD 2006-2007

President
Thomas J. Glaser,
Cook County, Illinois

President-Elect
Charles S. Cox, City
of Farmers Branch, Texas

Past President
Carla E. Sledge,
Wayne County, Michigan

Johnetta Brower Bond,
District of Columbia
Government

Len Brittain,
City of Toronto, Ontario

Kathleen Clarke Buch, Town
of Darien, Connecticut

Joseph P. Casey,
Hanover County, Virginia

Joya C. De Foor, City
of Los Angeles, California

Kathy DuBose,
City of Corinth, Texas

Michael A. Genito,
City of Rye, New York

Stan W. Helgerson, Village
of Carol Stream, Illinois

Perry E. James, City
of Raleigh, North Carolina

Paul Macklem, City
of Kelowna, British
Columbia

Keith Overly, Ohio Public
Employees Deferred
Compensation Program

Patricia A. Phillips, City
of Virginia Beach, Virginia

Alan J. Rolek, City of Lino
Lakes, Minnesota

Kenneth L. Rust, City
of Portland, Oregon

Mervyn C. Timberlake,
City of Boca Raton, Florida

[from the executive director]

COMING TO GRIPS WITH OTHER POST-EMPLOYMENT BENEFITS

Post-retirement healthcare and other post-employment benefits (OPEB) are certainly nothing new to the public sector, where they have long been an important element of employee compensation. All the same, GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, has focused attention now, as never before, on the ultimate cost of such benefits to state and local government employers. The challenge of funding OPEB provides government finance officers with an unparalleled opportunity to assume financial leadership as governments weigh their options and craft a strategy to respond to the challenge.

"JUST THE FACTS"

The first step in effective problem solving, of course, is to correctly identify the problem. As noted previously in this publication (*Government Finance Review*, "OPEB Urban Legends," June 2006), there are a number of common misconceptions that must be dispelled before the real issues raised by OPEB can be addressed:

- *GASB Statement No. 45 does not force governments to change how they fund OPEB.* Nothing in GASB Statement No. 45 prevents a government that decides to continue to finance OPEB on a pay-as-you-go basis from receiving an unqualified opinion from its independent auditors.
- *GASB Statement No. 45 will not immediately create a fund balance deficit in the general fund.* Under GASB Statement No. 45, governments will continue to recognize expenditures for OPEB only as funding actually occurs, regardless of how the amount funded is calculated (i.e., *fund balance* will only be affected in a given year by the amount actually funded in that year).
- *GASB Statement No. 45 will not cause a liability to be reported in the financial statements for benefits earned in the past.* GASB Statement No. 45 calls for the cost of OPEB earned as a result of past service to be only *gradually* amortized (up to 30 years) as part of *future* OPEB cost. Thus, the financial statements will report no liability at all for OPEB so long as the employer fully funds the actuarially determined annual required contribution (ARC) each year. Moreover, even if this contribution is not fully funded, a liability will be recognized *only for the underfunding*.
- *GASB Statement No. 45 applies even if benefits are "contingent."* Because accounting emphasizes economic substance over legal form, employers may have OPEB to report even in the absence of a written plan and even in situations where benefits are legally limited by the amount of funding approved by the legislature on an annual basis.

continued on page 4

Government Finance Review (ISSN 0883-7856) is published bimonthly in February, April, June, August, October, and December. Subscription price is $35 annually. Opinions expressed herein are the viewpoints of the authors. They may differ from the policies and recommendations of the Government Finance Officers Association, its committees, and staff. Letters to the editor are welcomed. Copyright 2006 by GFOA. Published by Government Finance Officers Association, 203 N. LaSalle Street, Suite 2700, Chicago, IL 60601-1210. Periodicals postage paid at Chicago, Illinois, and additional mailing office. Postmaster: Please send address changes to *Government Finance Review*, 203 N. LaSalle Street, Suite 2700, Chicago, IL 60601-1210.

continued from page 3

- *GASB Statement No. 45 may apply even if retirees pay their full healthcare premium.* GASB believes that retirees who are allowed to pay the same healthcare premium as active employees are, in substance, being subsidized, and that the indirect cost of this "implicit rate subsidy" needs to be recognized as OPEB by government employers.

Once these misconceptions have been eliminated, it becomes clear that GASB Statement No. 45 really requires only that OPEB be subject to the same accounting and financial reporting used for pension benefits (i.e., the cost of benefits must be recognized as expense as benefits are earned).

"SELECTING THE RIGHT MEDICINE"

It is important to distinguish accounting and financial reporting (i.e., form) from what they reflect (i.e., substance). GASB Statement No. 45 did not "create" the issue of OPEB. The new GASB guidance has simply spotlighted a major, ongoing issue that has challenged public sector finance officials for some time. Keeping this distinction in mind can be helpful in avoiding the very real risk of seeking an *accounting* remedy for what is fundamentally an *economic* problem. Just as the primary focus of a doctor must be on curing the disease, rather than just alleviating its symptoms, so too, government finance officers must strive to ensure that deliberations on OPEB in the wake of GASB Statement No. 45 focus on the underlying economics rather than just the accounting impact.

"BORROWING FROM PETER TO PAY PAUL"

In the wake of GASB Statement No. 45, a number of private-sector concerns have been urging government employers to issue tax-exempt bonds to help finance the cost of OPEB. Even in the best of circumstances, the decision to issue debt to finance post-employment benefits is a difficult one, given all of the attendant risks. Thus, GFOA issued a recommended practice urging governments considering the possibility of issuing pension obligation bonds to exercise caution. In the case of OPEB, the risk factors inherent in such borrowings are only exacerbated because of the lack of experience with advance funding such benefits. Therefore, government finance officers will best serve their governments by resisting efforts to promote the use of debt to finance OPEB.

"FAIR IS FAIR"

It is only natural, of course, that government employers would wish to re-evaluate all aspects of their OPEB, including program design, in the process of determining how best to respond to the long-term funding challenge. All the same, it clearly would be inequitable to expect hard-working government employees alone to shoulder the full burden of potential changes in plan design in the form of decreased or eliminated benefits. Few would argue that the best solution to the parental challenge of financing a child's college education is to discourage the child from attending college; so too, it is difficult to argue that drastic benefit reductions (or the elimination of benefits altogether) alone are the best "solution" to this challenge.

"THE OUTER LIMITS OF TRANSPARENCY"

GFOA has been a long-time leader in promoting full and timely disclosure. Thus, we firmly believe that any relevant, reliable, and timely information on OPEB should be disclosed promptly to current and potential purchasers of a government's debt securities. Conversely, we are concerned that the premature disclosure of purely preliminary and potentially inaccurate information could be misleading rather than helpful to investors. The GASB wisely provided a significant transition period for GASB Statement No. 45 to allow adequate time for employers to craft appropriate implementation strategies. An early step in this process is for a government to obtain a preliminary estimate of its unfunded actuarial accrued liability for OPEB. Some individuals have argued that governments with outstanding debt have a duty to automatically disclose such preliminary information as soon as it becomes available. We disagree. In our view, preliminary (and hence possibly inaccurate and potentially misleading) data are *not* an appropriate subject for disclosure unless governments are advised to do so by counsel.

CONCLUSION

The new spotlight that GASB Statement No. 45 puts on OPEB offers state and local governments a welcome opportunity for taking decisive steps to ensure the proper funding and viability of future benefits. It also provides government finance officers a unique opportunity to exercise financial leadership. The key challenge is to avoid misinformation and focus on the underlying economic issues highlighted by GASB Statement No. 45. In doing so, governments should resist proposals to use debt to finance the OPEB. Likewise, in fulfilling their disclosure obligations to current and potential purchasers of their debt, governments should seek the advice of counsel before disclosing potentially erroneous and misleading preliminary data.

Jeffrey L. Esser

Jeffrey L. Esser
Executive Director/CEO

Wednesday, March 28, 2007

Council OKs plan to prepay retirement costs

by Janel Davis | Staff Writer
E-mail this article \ Print this article

The County Council introduced a five-year plan on Tuesday to begin phasing in a $240 million annual payment for retiree benefits for county employees.

The money is needed to satisfy a federal rule for pre-paying employee retirement benefits, specifically health care.

The rule, issued by the Governmental Accounting Standards Board (or GASB), requires governments to detail how much money will be necessary to pay for retirement benefits if they are pre-funded while future retirees are still employed. Ideally, the benefits should be paid from money set aside in special accounts now, but many governments, including the state of Maryland and Montgomery County, pay benefits out of each year's budget for already retired workers. The accounting board says the pay-as-you-go format distorts actual financial outlooks because future obligations do not show up on financial statements.

To meet the county's full pre-funding goal, $31.9 million has been set aside in the county executive's recommended fiscal 2008 budget, the first year of the five-year plan. That includes payments for public schools, Montgomery College, Maryland-National Capital Park and Planning Commission and county government employees. The payment is in addition to the pay-as-you-go expense for fiscal 2008, which begins July 1.

Pre-funding payments would increase until the $240 million goal is reached in fiscal 2012.

"This is what good government does," said Jennifer E. Barrett, the county's finance director. "Current county employees should be comforted that money is set aside for future payments. For retirees, it means the same thing. There is similar comfort that the money is set aside. A real important part of people's personal financial planning is what they can rely on in the future."

GASB affects all county residents, not just county employees or retirees, Barrett said.

"People should care about this because it is a large draw on resources that are competing for various things in the budget," she said. "It has an impact on where residents' tax dollars are going, but we've managed it. It's funded in the budget."

Health care costs

"[GASB] was brought on by rising health care costs," said Mark Lynne, director of Health and Welfare Practice for Bolton Partners, an actuarial and benefits consultant firm in Baltimore that has worked with Montgomery, Anne Arundel, Howard and Baltimore counties. "The accounting community has been putting the pressure on making the public sector's financial statements truly reflect actual costs."

Bond rating agencies also play a role. GASB does not require governments to actually pre-fund the retirement expenses, just to have a plan for doing so, but the rating agencies are expecting its higher-rated jurisdictions, such as Montgomery, to prepay their plans, said Lynne and Barrett.

"If it weren't for [rating agencies], I'm not sure this would be much of an issue at all, but they are sending out signals that they want public sector agencies to put on their books that they have some plan," Lynne said. "If they see a five-year plan in established counties, they are usually going to give you a break."

For counties such as Montgomery and Baltimore, which have AAA ratings from all three major credit rating agencies, maintaining that status is essential. The AAA rating allows the county to borrow money at lower rates. A drop in rating could lead to higher borrowing rates.

"Our concern was that if we didn't take action it would have jeopardized our triple-A bond rating," said Donald I. Mohler, Baltimore County spokesman.

Baltimore County officials have already decided to set aside the full pre-funding amount for its county government employees for fiscal 2008.

"We have been out front on this issue. We started one year ahead of time by setting aside $103 million [in fiscal 2007] for pre-funding," Mohler said.

To meet a similar obligation this year, Baltimore County notified its employees that the traditional 30-year retirement has changed to 35 years and that an early retirement provision would be eliminated for all employees hired after July 1. Baltimore County is also in talks with its employee unions to restructure health care benefits.

Union reaction mixed

For localities not used to squirreling away retiree benefit funds, satisfying GASB requires measures such as budget cuts and postponing projects to funnel money into pre-funding accounts.

In dealing with expected revenue constraints and GASB requirements, Montgomery County Executive Isiah Leggett (D) used both budget cuts and project delays in his $4.1 billion budget proposal. He also tabled negotiations on health care and retirement benefits with the police and government employees unions because the sides could not come to an agreement.

"Unions are very concerned about this because they see it as leading to benefit cuts, which is true in some places," Lynne said. "But some are realizing that this is a good thing."

Montgomery County teachers union President Bonnie Cullison said GASB is definitely on the minds of her members. "We're certainly talking about it. We understand the county has to be allocating money judiciously to meet the operating needs," she said.

Cullison's concern is with the county's timing.

"If the County Council does not feel that we have enough to pay for operating budget needs, then we need to look at more time for GASB," Cullison said. "If we can do five years and meet the needs of the operating budget without having to make cuts, then five years is an acceptable schedule."

County government employees union President Gino Renne said the union's actuaries understand the GASB requirements, but are not "ringing the alarm bells."

"In my opinion, GASB 45 is being used by some officials to make or perpetuate the argument that times are tight," Renne said. "The County Council will try to set the stage for recessionary bargaining, but every time there have been fiscal constraints, unions have stepped up and resolved the problems. We just feel that there are different ways to deal with this."

John Sparks, president of the county's firefighters union, does not foresee a benefits cut.

"I thin there is a lot of overreaction to [GASB 45]," Sparks said. "I think everyone will understand it better a year from now. We'll get through it."

Paying For Promises

After the shock of the big numbers, states and localities are finding ways to deal with the costs of their retirees' health care.

By Jonathan Walters

Call it the six stages of GASB 45: anger, denial, sorrow, acceptance, study and action. That's been the general response to a new set of governmental accounting rules that ask state and local governments to spell out the costs of their promises to provide retired employees with health care as well as other post-employment benefits.

The new rules arrive courtesy of the Governmental Accounting Standards Board—the outfit in Norwalk, Connecticut, that sets all the accounting regulations for state and local governments—and are part of GASB's push to head these governments toward accounting for the long-range and cumulative consequences of financial obligations and promises made yesterday and today.

And when it comes to retiree health care, those promises carry quite a price tag. According to the 2006 Rockefeller Institute Report on State and Local Government Finances, aggregate state and local liabilities for retiree health care (as well as other non-pension post-employment benefits) come to around $1 trillion, with some individual eye-poppers such as the Los Angeles Unified School District's $5 billion and the state of California's $70 billion.

The new GASB rules don't require that states or localities actually do anything to close the liability gap. However, the gap will, over the next few years, become part of a jurisdiction's comprehensive annual financial report, and rating agencies will be watching to see how various governments deal with the new red ink being splashed across governmental ledgers.

According to Parry Young, head of public finance for the rating agency Standard & Poor's, his company is not expecting miracle fixes for what he acknowledges is a large and vexing new hole in public ledgers. "What we're looking for," Young says, "is a thoughtful plan on how they're going to manage this liability."

Figuring out how to react to GASB 45 has certainly been a sobering experience, says David Manning, chief financial officer for Nashville's metro government. Back-of-the-envelope calculations there indicate that Nashville is on the hook for about $1.5 billion. The city can tack on another half-billion or so if it includes teachers in the equation.

Nashville is currently where most states and localities are: They've done the quick and dirty calculation, and now they're trying to home in on a more exact number and figure out what to do about it. "Right now, we're updating our actuarial estimates to try and get a handle on what the implications are for us," says Manning. The city has a GASB 45 task force that was created by Mayor Bill Purcell to consider alternatives for dealing with the new directive. That task force has yet to report.

What's clear though, is that most states and localities are past the anger, denial and sorrow phase of GASB 45, and are developing concrete ways to deal with the new rule. Those responses have ranged from paying down the liability by digging directly into general funds to floating more debt. Governments are also taking a hard look at what, exactly, has been promised to retirees by way of benefits, with an eye toward cutting back and thereby reducing long-range

ATTACH B

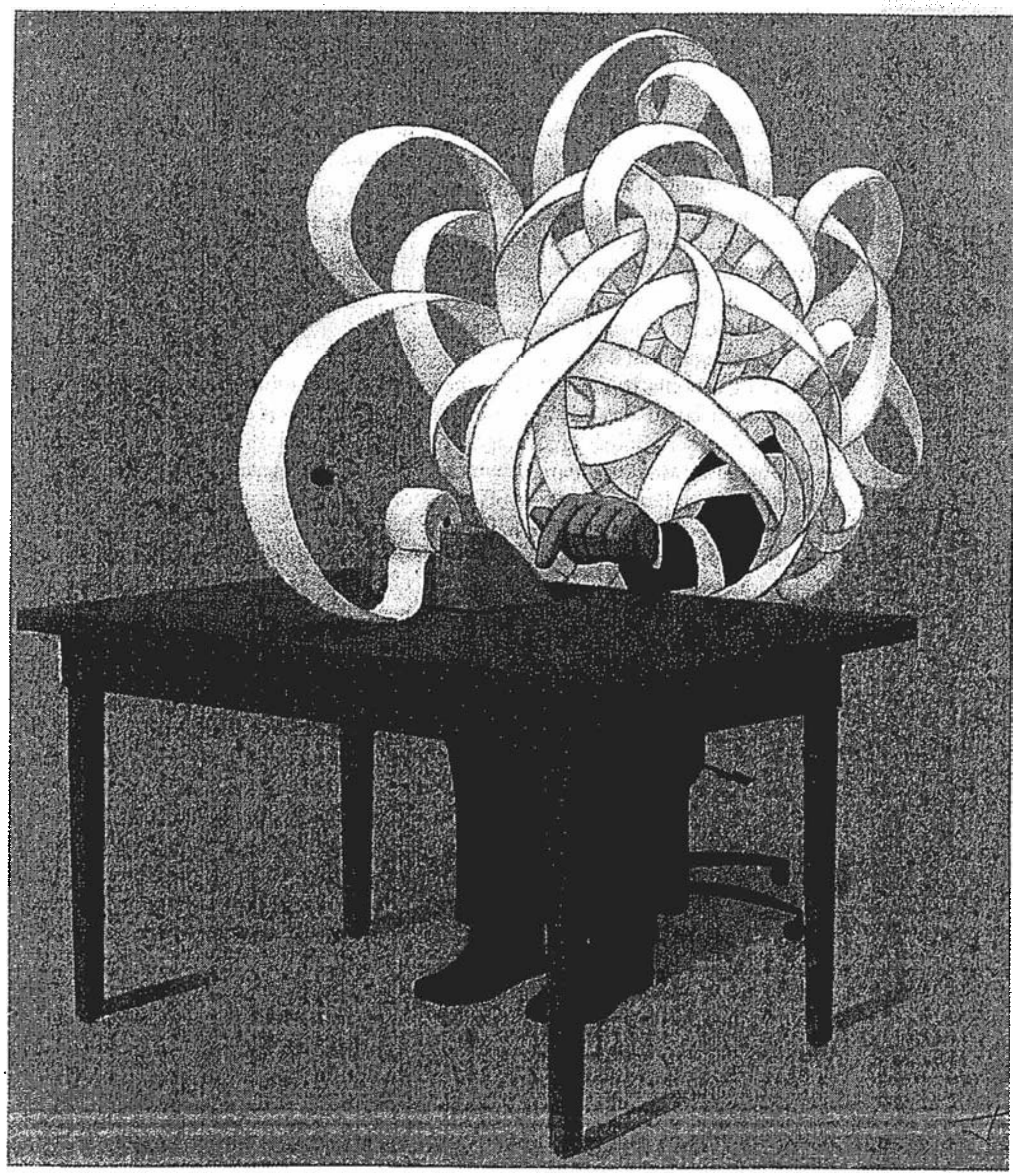
liability. Some jurisdictions, meanwhile, have decided to try to slide some of their liability onto the feds.

Trust Funding

Those public entities that have decided to begin pre-funding the liability are turning to the same vehicle they now use for pension obligations. In California, for example, the Public Employees' Retirement System (CalPERS) has created investment funds for governments that already participate in the CalPERS health care system, allowing localities to start putting money away for down-the-road health care payouts. Where necessary, states have passed or are in the process of developing legislation authorizing localities to create their own liability trust funds for "other post-employment benefits"—known as "OPEBs" in the accounting world.

Numerous states and localities have either begun to pay into such accounts or are in the final stages of working out how much to set aside. One of the first items of business for the new Massachusetts governor and legislature, for instance, is passing legislation to set up and begin funding an OPEB liability trust to cover that state's $7.6 billion obligation, says Eric Berman, who is part of a network of state officials who have been looking at the new rule. South Carolina Governor Mark Sanford has recommended that this year's budget include around $250 million to go into a dedicated OPEB trust fund to begin paying up his state's estimated $23.5 billion liability. Wisconsin, meanwhile, was prescient: Two years ago, it floated a bond to begin covering its post-retirement liabilities.

Localities, likewise, are facing facts. In New York City, Mayor Michael Bloomberg has said the city is ready to commit $2.2 billion of its current budget surplus to a down payment on its estimated $53.5 billion in OPEB liabilities. Plano, Texas, is already setting aside $7.6 million per year from its general fund to cover that city's $150 million OPEB hole. "We opted for advanced funding," says Plano CFO John McGrain. "We felt that it was fiscally sound reasoning for Plano to go ahead and do that." The city has set up an irrevocable trust in which to collect the OPEB's cash. McGrain acknowledges that Plano is lucky in one respect: It's not that generous when it comes to OPEBs and so isn't facing the same level of liability as many other jurisdictions.



JON KRAUSE

Setting Limits

The other widespread response to GASB 45 is to look at a range of options related to the benefits themselves—from scaling back, to boosting co-pays, to lengthening vesting periods or even to sloughing some of the long-term liability off onto someone else. The San Diego County Board of Supervisors, for instance, is trying to cut $50 million in annual health care subsidies for all post-March 2002 retirees. North Carolina has extended from five to 20 years the time it will take for state employees to become fully vested for

YOU'RE READY TO MAKE THE FUTURE A BETTER PLACE.

Success in the future requires collaboration—public, private, and nonprofit sectors working together. Walden's online Master of Public Administration and Ph.D. in Public Policy and Administration can help you influence those vital partnerships. With 37 years of experience in distance learning, Walden prepares leaders to navigate today's new landscape, where the boundaries between sectors are increasingly blurred. Make the decision that can help you turn your ideas into effective policy. Call or visit us online.

ADVANCED DEGREES ONLINE FOR PUBLIC ADMINISTRATORS

888-889-5326
WALDENU.EDU

WALDEN UNIVERSITY
A higher degree. A higher purpose.

A MEMBER OF THE LAUREATE INTERNATIONAL UNIVERSITIES NETWORK

Walden University is accredited by The Higher Learning Commission and a member of the North Central Association. www.ncahlc.org; 312-263-0456.

health care benefits. In Chicago, the city is trying to negotiate both higher employee health care contributions and benefit cuts with its transit workers.

The heightened profile of the cost of retiree benefits—a fallout from the accounting rule—is very much on the minds of those who represent public employees. "We're very concerned," says Bill Cunningham, a lobbyist for the American Federation of Teachers. "We have members who've retired or who are about to retire who believe they had a commitment from their employer. This is clearly a problem that is going to have substantive fiscal and political ramifications."

It's not only the rank and file who find themselves in a hot seat over benefits, though. For example, a few years back, the Nashville Metro Council promised that any of its members who serve at least two terms would be granted a lifetime's worth of health care benefits after they leave office. That's a commitment that CFO David Manning bets would have been of interest to voters had reporting on the long-range cost associated with the promise been required.

Meanwhile, some jurisdictions are considering strategies that have nothing to do with cutting benefits. In West Virginia, the state pension board recently approved a plan to shift prescription drug coverage for state retirees to Medicare Part D, which the board says will carve $3 billion off the state's estimated $8 billion OPEB liability.

Critics of that strategy argue that the fiscal and administrative complexity of such a switch may make it less attractive than it first appears and suggest caution in trying to push OPEB costs onto the feds. Underlying such notes of caution, of course, is the stark fact that Medicare itself is amassing trillions of dollars in unfunded liabilities, which could put its long-range fiscal viability in doubt.

Breaking Away

Despite the flurry of action in the field, there are still those jurisdictions that seem stuck in the "denial" phase of GASB 45. In Travis County, Texas, the chief auditor, Susan Spataro, has taken a defiant position on 45. In the first place, she argues, OPEBs in Travis County have always been handled on a pay-as-you-go basis, delivered year to year at the discretion of the county commission. For that reason, Spataro contends, they don't represent any long-range fiscal liability at all.

Furthermore, in trying to calculate the county's OPEB liability, her office—in concert with a variety of outside actuaries—has come up with numbers that are all over the map, ranging from $89 million to $380 million. Therefore, she thinks any number the county were to settle on and report in its comprehensive annual financial report would for all intents and purposes be false. "And it's a criminal offense to falsify a government record," says Spataro. So she's not planning on entering any number at all. Rather, she hopes to persuade the Texas legislature to pass a law pulling Texas out from under GASB rules and placing it under a system of generally accepted accounting rules developed and administered by the state.

Best Guesses

Estimated OPEB liabilities in selected states, as of September 2006

State	Amount (billions)
Alabama	$19.8
Alaska	7.9 or more
California	40 to 70
Illinois	43 to 53
Maryland	20
Massachusetts	13.2
Nevada	1.62 to 4.1
New York	47 to 54

Source: Associated Press

It's a novel argument and strategy for sure, says Massachusetts' Eric Berman. But Berman, like many who are in the throes of responding to the new rule, doesn't think such a "head in the sand" approach serves government or citizens very well.

According to Steven Gauthier, point man on GASB 45 for the Government Finance Officers Association, most jurisdictions are, like Berman's shop, stepping up and dealing with the future cost of OPEBs. "Most of my colleagues understand and agree with the fundamental notion that a financial statement should show you that you've incurred these obligations."

Jonathan Walters can be reached at jowaz22@gmail.com