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The Elephant in the Room:

Unfunded Public Employee Health Care Benefits and GASB 45

Public Employee Benefits Series: Part 3

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Executive Summary

The Government Accounting Standards Board (GASB) recently released two Statements that will profoundly affect American governmental finance. These Statements establish clear, stringent standards for the measurement and disclosure of a massive unfunded liability: the health care benefits provided to retired government employees. By requiring governments to properly account for this liability, the new GASB rules will force a national debate on government employees' non-pension post-employment benefits.

Statement 45, *Accounting and Financial Reporting by Employers for Post-Employment Benefits Other than Pensions*, and its companion Statement for pooled stand–alone health care plans, Statement 43, demand budgetary transparency at every level of government. The picture will not be pretty. Published estimates of the total OPEB ("Other Post-Employment Benefits") liability for the nation's 88,000 state and local governments have been quoted at ***$1 trillion.*** Policy makers must confront a decision that private-sector employers, from the largest corporations to the self-employed, have already faced: Should post–employment benefits be funded, reduced, or eliminated?

This paper will review Statement 45's potential impact on governments and review existing disclosures in financial reports as well as bond offering statements. The paper will discuss the Statement's impact on budgets and governmental operations, including collective bargaining. Funding options under Statement 45 will be detailed, including the advantages and disadvantages of irrevocable trusts and OPEB bonds. The paper will also discuss the impact of Medicare Part D subsidies received by governments, as well as the bond rating implications of policy decisions surrounding OPEB. Finally, the paper will discuss case law that has already come before state courts related to restructuring of benefits.

MAJOR FINDINGS

Because of Statement 45, governments must:

1. **Measure their liability** - Projecting the OPEB liability using financial disclosures is difficult as governments differ in the level and kinds of benefits they offer, the ages of those who are eligible for these benefits, the level and mechanisms for funding, and the trend rate assumptions underlying the estimate. The Commonwealth of Massachusetts - *exclusive* of authorities, municipalities and separate districts - has disclosed a **<u>$13.3 billion liability</u>** to pay for post-employment benefits already earned by current employees, retirees and survivors. **The Commonwealth must decide whether to fund this liability, and if so, how.**
2. **Consider OPEB costs when applying Massachusetts General Law Chapters 32A and 32B** – Governments across the Commonwealth in recent years reduced payrolls via employee retirement incentive programs. However, the reduction in payroll was often compensated for by an increase in pension and OPEB costs. The Legislature should recognize that changing retirement ages, vesting, contribution percentages and other variables will affect OPEB liabilities.

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3. **Consider their options** - Available options can be grouped in two categories: **Administrative Reforms** and **Benefit Adjustments**.

Administrative Reform Options

- ***Create an Irrevocable Trust, as a Separate Investment Trust Within or Similar to the Pension Reserves Investment Management (PRIM) –*** A new investment trust, similar to PRIM, could be used to take advantage of the higher rate of return afforded by an irrevocable trust. However, the Commonwealth could consider taking an even bolder move:
- ***Consolidate OPEB Management for all State and Municipal Entities under One Manage****r* - There are 106 separate public pension plans in the Commonwealth, each with different administrative structures. There are many other health benefit collaborative and local entities. The Commonwealth could adopt a different, potentially less expensive approach by consolidating OPEB management for all governments under one domain. The Group Insurance Commission (GIC) of the Commonwealth has a long and successful history of aggressively managing the costs of health care for its members. Consolidating these separate health benefit entities into either a GIC-like commission for municipalities or the existing GIC could play an important role in holding down costs and managing beneficiary claims. However, traditionally, Commonwealth government has been centered on local decision-making, embodied in the town meeting. Creation of a municipal GIC would require even more reform of General Laws Chapter 32B than might be needed under other alternatives.
- ***Amortize the Unfunded Pension Obligations over a Longer Time Horizo*****n** Under the current plans, the pension plans will reach fully funded status in 2023 for the state system and 2028 or earlier for the local systems. Sufficiently funding pensions is important for many reasons, not the least of which is that Massachusetts public employees do not contribute to or receive retirement benefits from Social Security. However, bringing both the pension and OPEB systems up to fully-funded status based on the current schedules may strain governmental budgets, encouraging some entities to slow the rate at which then fund their pension plans.

Benefit Adjustment Options

- ***Change the Health Insurance Benefit Structure –*** Restricting health insurance would be politically difficult, given the sweeping health insurance reform and its goal of universal coverage. However, some governments, and certainly private industry (which has a decade and a half of history implementing similar standards), have or will consider it. An option the Commonwealth could consider includes the possibility of offering a defined contribution health care plan or a voluntary employee benefit association mechanism in the future or for future hires, effectively capping costs.
- ***Increase Cost Sharing –*** Most governments will consider requiring employees and retirees to bear more of the OPEB cost. Currently, the Commonwealth funds 85 percent of its health care pay-as-you-go (PAYGO) costs, while employees fund 15 percent. A 5 percent swing to a 20 percent employee contribution could yield millions of dollars of additional funds available for future benefits. The Commonwealth has shifted contribution rates before, including during the most

recent fiscal crisis earlier in this decade. However, such a change would likely not apply to retirees, reducing the immediate benefit from cost sharing.

- ***Municipalities must consider OPEB costs in all collective bargaining agreements*** - For the Commonwealth, healthcare benefits are not part of union negotiations. However, for municipalities and other governments in the Commonwealth, they are. In some cases, rates are set with individual unions within the same government. All governments need to know what their liability is and to be able to do a sensitivity analysis on that liability for various changes in the benefit package.
- ***Consider the Utah Model for Unused Sick Time and Vacation at Retirement***—Unused sick and vacation compensation at retirement was worth over $500 million as of June 30, 2005 for the Commonwealth. Most employees like to "cash out" these accrued benefits at the end of their tenure. But the Commonwealth and the municipalities could explore whether the portion that can be paid out at separation, as an option could be used instead to fund an irrevocable OPEB trust

Other Findings

- Projecting the OPEB liability using financial disclosures is difficult, as governments differ in the level and kinds of benefits they offer, the ages of those who are eligible for these benefits, the level and mechanisms for funding, and the trend rate assumptions underlying the estimate.
- Unlike the treatment typical for non-governmental entities, GASB does not allow governments to offset their Medicare Part D subsidies against the actuarially required contributions of OPEB costs.
- Case law in other states has increased the flexibility of their legislatures to restructure OPEB liabilities.
- In addition to OPEB restructuring, other possibilities exist for dealing with OPEB costs, but these alternatives require time, money and ingenuity.

This paper will review and discuss the following:

- Statement 45's potential impact on governments;
- Existing disclosures in financial reports and bond-offering statements;
- The Statement's impact on budgets and governmental operations, including collective bargaining;
- Funding options under Statement 45, including the advantages and disadvantages of irrevocable trusts and OPEB bonds;
- The impact of Medicare Part D subsidies received by governments;
- The bond rating implications of policy decisions related to OPEB;
- State court cases and decisions concerned with the restructuring of benefits.

Governments across the Commonwealth need to take the first steps and measure their liability. Based on that assessment, governments then need to consider their options and negotiate with key stakeholders. Presently, retiree health care costs are paid on a pay-as-you-go basis directly out of the state budget; whereas the state and employees' retirement contributions are paid into trust funds that pay out benefits to retirees and the long-term disabled. The Commonwealth and most municipalities are still in the process of contributing in order to fully fund their pension plans.

The unfunded healthcare liabilities revealed by GASB 45 represent another potential drain on state and municipal budgets for years to come *if governments decide to fund it.* Difficult decisions and careful planning will be required to manage these liabilities going forward and to ensure financial stability. **The key for management is not to feed the hysteria by only focusing on the total unfunded liability amount—management must focus on finding alternatives to deal with the liability, using all resources at its disposal, particularly amortizing this amount over the maximum allowable period of 30 years.**

There are many viable approaches available to the state, municipalities and separate authorities. As the Commonwealth and municipalities vary significantly in the extent of their OPEB liabilities, OPEB funding status, employee demographics, budgets, and other obligations, the solution or combination of solutions that are adopted may differ substantially, but are likely to include some of the preceding findings.

Introduction

Government Accounting Standards Board (GASB) Statement Number 45, *Accounting and Financial Reporting by Employers for Post Employment Benefits Other than Pensions*, represents a sweeping change in governmental accounting and financial reporting. This standard has propelled the GASB into the realm of public policy for governments. For the first time, state and local governmental entities are required to disclose the full cost of non-pension-related retirement benefits. Many governmental units are now debating fundamental questions:

1. How did this become an obligation?
2. What are the ramifications of disclosing this obligation?
3. Should our government fund this obligation?
4. If we fund it, what will this do to our tax rates?
5. What about the rest of our daily operations—the core services that we must provide?
6. Is there any problem *not* disclosing these numbers?

These questions and many more must be addressed by governments not just in the Commonwealth of Massachusetts, but across the country in the coming years. GASB 45, and its related Statement Number 43, *Financial Reporting for Post Employment Benefit Plans Other Than Pension Plans,* requires governments to disclose the full future cost of the retiree health care and other post-employment benefits, such as the value of employer-provided life insurance earned by current employees and retirees to date. If these future costs are not fully funded, then the governments must disclose a liability. Similar to private industry, choosing not to fund these costs may be worse than funding them, as the unfunded liabilities will continue to mount as the years go by. The potential liabilities are substantial. Published estimates of the entirety of the 88,000 state and local governments OPEB liabilities have been estimated at $1 trillion.[1] When private industry was forced to disclose these costs, General Motors revealed that OPEB costs equaled $1,500 per car. These and similar revelations have led many private sector firms to substantial restructure OPEB benefits.

The Commonwealth recently disclosed the extent of the OPEB liability it faces. For its nearly 141,000 employees, retirees and survivors, the Commonwealth's cost to fund the post-employment benefit promises it has made over the years is $13.3 billion. This estimate excludes the component units, such as the MBTA and the Turnpike Authority, and also the municipalities. Should the Commonwealth decide to fully fund this cost on an annual basis, investing contributions into an irrevocable trust, this liability drops to nearly $7.5 billion due to a higher investment rate of return.

How Did the Problem Get to Be So Big?

An estimated 15.9 million full-time equivalent people worked in state and local government in July 2005, representing between 10 and 15 percent of the U.S. labor force.[2] Government employment has several distinguishing features that make OPEB costs per person higher. First, while they are working, public sector employees are more likely to be eligible for health benefits during their employment (between 82 and 84 percent of public sector workers versus 69.3 percent of private-sector workers). Second, more public sector employees take the coverage that is offered: 87.4 percent of local government employees and 90.4 percent of state government employees compared to only 84.2 percent of private sector workers.[3] Third, once they are retired, public sector workers who have had health insurance coverage are more likely to have it provided in their retirement. Ninety-two percent of state governments offered health benefits to retirees under age 65 in 2002, up from 76 percent in 1997, while 86 percent offered health benefits to retirees ages 65 and older, up from 69 percent in 1997.[4]

Fourth, the level and cost of retirement benefits offered by the public sector is significantly higher than the private sector. In 2004, 10.9 percent or $3.80 per hour of a government employee's compensation was associated with retirement and social security benefits while only 9.6 percent of total compensation or $2.26 per hour was associated with retirement benefits for private sector employees.[5] Note that Commonwealth employees are not subject to social security as the state's pension plan was in existence before social security was implemented. In 2003, total health insurance costs per person (employees, COBRA enrollees and retirees) were higher for state and local government than for private sector. Costs for single and family coverage are $3,844 and $8,755, respectively, in the governmental sector as compared to $3,529 and $8,429, respectively, in the private sector. In addition, governmental employers cover a higher share of the health insurance costs (85.8 percent and 78.5 percent for single and family plans, respectively, for the government, as compared to 76.9 percent and 71.5 percent for the private sector).[6]

One factor commonly believed to contribute to higher health care is that public sector employees are relatively less well paid. While this may be true once physical risk is taken into account, it does not appear to be true when comparing employees with similar educational demands.[7] An interesting aspect of the cost of benefits is that there is no uniformity. For example, on the municipal level in the Commonwealth, a minimum of 20 hours a week is necessary to receive benefits. However, there are special "carve outs" for certain school employees (such as cafeteria workers) and certain board members (including selectmen). Part of the complexity of General Laws Chapters 32 for pensions, 32A for Commonwealth employees' health care and 32B for municipal employees is the plethora of these special exceptions.

While information is limited at the municipal level, some data is available on recent OPEB costs for state governments. Forty-one states reported some contributions toward retiree health insurance beyond expenditures for sick-leave conversion credits. Of this total, 30 financed the costs on a pay-as-you-go basis. The other 11 had a pre-funding arrangement, and their funded levels were often lower than those for pension benefits. Aggregate state spending on OPEB totaled $4.4 billion, of which over $3.8 billion (86 percent) were pay-as-you-go. The remaining 14 percent represented actual state contributions to plan assets, not the assets' OPEB expenditures. Overall, states were at risk of having large future cash outflows if retirees continued to increase relative to workers and post-employment medical cost inflation continued to outpace the general inflation rate.[8]

Beyond homeland security, healthcare is the key issue facing Americans today. Healthcare costs are growing at a pace far exceeding inflation. We are an aging population that is living longer and demanding high levels of healthcare. These factors are helping drive costs higher. Containing health care costs in the public sector may be complicated by many factors. State and local government workers have significantly higher unionization rates than do private-sector workers. In 2004, 37.2 percent of state and local government employees were members of a union compared with 8.2 percent among private sector employees.[9] Decision makers in the Commonwealth have recently restructured the provision of healthcare for the medically uninsured, but will now have to make bold judgments on how to deal with these promises and these costs for their employees, retirees and survivors.

Why Is This Problem Becoming Public Now?

OPEB costs are *not* new costs. Routinely, OPEB benefits have been offered to employees based on services rendered. Entities that have offered these pre–defined benefits have funded them and disclosed them in financial documents on a pay-as-you-go basis. Namely, the reported costs for non-pension benefits were recorded when paid to retirees and survivors. Evolving accounting standards have progressively changed the level and extent of disclosure for both public and private entities. (See Appendix II for a detailed discussion of the evolution of accounting standards through GASB and FASB Bulletins)

Beginning in 1967, accounting standards have required private industry to disclose the cost of benefits attributable to an employee's years of service with regard to deferred compensation. In 1980, the Financial Accounting Standards Board (FASB) released accounting standards that required accumulated pension benefits to be recorded at actuarial value. Investments within these pension plans were to be recorded at fair value.[10]

As the Governmental Accounting Standards Board had not yet been created, these new standards applied to both public and private entities. The GASB was founded in 1984 to deal specifically with public sector accounting standards.

Meanwhile, FASB continue to refine and extend the accounting standards for the private sector. In 1987, it fully incorporated actuarial assumptions and returns, which serves as the foundation for the non-pension-related accounting and reporting of defined benefits that exists today. In 1990, FASB formulated the healthcare portion of benefits accounting. (See the impact of their actions below.)

In 1990, GASB issued its first set of standards for OPEB costs for the public sector, requiring the disclosure of benefits and accounting principles. Most governmental entities responded by disclosing their OPEB costs on a pay-as-you-go basis. In 1997, GASB released their standards for public sector pension accounting, GASB Statement 27, *Accounting for Pensions by State and Local Government Employers.*

In 1999, GASB required full accrual accounting for pensions for the first time. It also signaled that the GASB was willing to tackle OPEB liabilities in the near future. In 2004, after years of drafting and review, GASB issued Statement 45, which specifically addressed OPEB liabilities. GASB 45 requires the following:

1. A Comprehensive Array of Costs: OPEB costs include not only health care costs, but also dental, vision, life insurance, disability, and long term care.
2. Accrual Standards: The OPEB liability represents the unfunded actuarial accrued liabilities computed using full accrual methods. The OPEB liability is increased by normal employee costs and decreased by employers' contributions to the plan and certain changes in value of the investment portfolio.
3. ARC Disclosure: The entity must disclose an actuarially required contribution (ARC). The ARC includes the normal cost for the year plus an amortized portion of the total unfunded actuarial accrued liabilities (or funding excess) of the plan.
4. Limited (But Generous) Amortization: The total amortization period cannot exceed 30 years.
5. Frequent Valuation: Valuations of any assets in a plan are to be estimated annually, while the valuation of the liability must be made at least every two years except for the smallest plans, which are triennial. These small plans with fewer than 200 employees may also use alternative measurement methods.
6. Pension-like Disclosure: Financial report disclosures are similar to pension disclosures.
7. Disclosure of Rate Subsidies: The implicit rate subsidy paid by current employees to retirees and survivors must also be disclosed.

8. Staged Implementation: Implementation is staggered with the largest governments implementing in FY2008, medium-sized governments (with revenues between $10 million and $100 million) in FY2009 and all others in FY2010.

The standard does not explicitly address three issues. First, GASB 45 *does not* expressly require contributions to an OPEB plan. However, if there are no contributions, the OPEB liability will continue to grow on the government's statement of net assets (or its balance sheet.) This growth may add additional pressure when dealing with rating agencies, if the government does not have a plan to deal with it and if the government's peers are managing the liability effectively. Second, for entities like the Commonwealth that budget largely on the cash basis, *there is no budgetary impact with the implementation of GASB 45*, unless the entity changes its annual contribution. Finally, statutory accounting in many states, including the Commonwealth, reflect OPEB costs on the cash basis. So, if there is no contribution, there is no statutory expenditure under the Commonwealth's statutory basis of accounting.

How Large will the new OPEB Annual Costs and Unfunded Liabilities Be?

The OPEB standard calls for a computation of the OPEB liability. The difference between it and the value of any OPEB assets is the unfunded liability. Governmental entities will then be required to report annual expenses that are a combination of the current pay-as-you-go (PAYGO) expenses and an amortization of the unfunded liability. The Fitch rating agency estimates that the new OPEB actuarially determined annual contributions could surpass current expenses by fivefold to tenfold.[11] Standard & Poor's echoed these concerns and suggested that the unfunded OPEB liabilities might, in some instances, exceed the unfunded pension liability.[12] Because of aggressive management of health care costs by the Group Insurance Commission (GIC), the initial annual contributions calculated by the Commonwealth is only a little over two to three times the 2006 expected benefit premiums paid to retirees.

In addition to the Commonwealth, several governments have now estimated and disclosed OPEB liabilities. The table below lists a number of larger entities. What can be observed is the considerable variation in the unfunded liability per participant. However, OPEB liabilities cannot be judged by these numbers alone. To fully analyze the impact of this liability, the assumptions used in the calculation, the size of the employee, retiree and survivor population must be known and the government's portion of the contribution to OPEB costs versus the employee's contribution must be disclosed. An analysis must also include the discount rates and the medical cost trends used in each valuation. Appendix A contains more detailed information on the data elements that are required to estimate OPEB costs. Amounts in the table below are gross of any Medicare Part D offsets taken into account before the release of the GASB technical bulletin addressing the practice.

Government	Participants	FY05 Operating Budget Expenditures ($M)	Liability ($M)
Commonwealth of Massachusetts	140,729	$23,779.1[13]	$7,561.5 - $13,287.0[14]
City of Newton, Massachusetts	4,902	$240.8[15]	$240.9 to $654.2[16]
City of Duluth, MN	1,883	Undisclosed	$310.9[17]
State of Maryland	249,061	$24,804.9[18]	$22,903[19]
State of Delaware	Undisclosed	$3,395.2[20]	$3,106[21]
State of New Jersey	Undisclosed	$36,086.0[22]	In excess of $20,000[23]
City of San Diego	14,585	$1,900[24]	$978.3[25]

Note that Newton disclosed a range of liabilities. This is necessary due to the provisions of Statement 45. The lower bound estimate represents a valuation based on an irrevocable trust arrangement, while the higher bound assumes a non–trust, or free cash flow funding scenario.

Again, it is less important to focus on the total unfunded liability than it is to decide if and how rapidly to fund contributions.

The Corporate Experience

As exemplified in Newton, there is a wide range of potential costs depending on assumptions and funding scenarios. Similarly, the potential ramifications may vary. To help better understand the range of options available to governmental agencies, it is helpful to examine the response of the private sector to recognizing future OPEB costs.

Since 1967 with the release of Accounting Principles Board Opinion Number 12 *Omnibus Opinion*–1967, private industry has had to disclose the cost of benefits attributable to an employee's years of service with regard to deferred compensation. (See Appendix C for a more detailed description of the evolution of accounting standards related to OPEB costs.)

In 1990, FASB addressed the health care portion of benefits accounting in Statement 106, *Employers Accounting for Postretirement Benefits Other Than Pensions*. FASB 106 is the basis for much of GASB Statement 45. The OPEB liabilities revealed by the new standards were substantial:

> According to their annual reports, Chrysler took a one-time $4.7 billion charge against its first quarter 1993 earnings, Ford, for calendar year 1992 took a $7.5 billion one-time charge, and General Motors took a one-time charge of $23.5 billion to account for the FASB 106 change.[26]

The OPEB underfunding remains large: According to a December 2005 report by Standard & Poors, the under-funded OPEB liability of the Standard & Poors 500 equaled $292 billion, nearly double the same companies' pension liability as measured in the various companies' 2005 audited financials. Ford and General Motors accounted for 32 percent of the underfunding, according to the report, owing $94 billion in OPEB costs.[27]

Several academic studies have sought to measure the impact of SFAS 106. They have touched on some common themes, most notably the three major decisions that firms made to address the new rule. First, companies considered whether to comply by adopting the standard early or on time. Firms that chose to adopt SFAS 106 early tended to perceive that the market was overestimating their OPEB liabilities.[28] In addition, only 10 percent of 1991 adopters amended their OPEB plans, while 31 percent of 1992 adopters and 38 percent of 1993 adopters did so.[29]

Second, firms determined whether to take the entire accumulated post-retirement benefit obligation as a liability in the year of compliance ("immediate recognition") or to spread out the process ("prospective recognition"). Immediate recognition may have been selected to strengthen managers' bargaining position with labor unions. About half (51 percent) of the immediate recognizers in the study's sample were at least partially unionized. By contrast, only 37 percent of prospective recognizers had this characteristic.[30]

Third, firms made a series of reporting assumptions about their parameters. Firms with larger OPEB obligations and more leverage used more aggressive discount rates and health care cost trend rates, which helped to reduce the OPEB total. Conversely, firms that amended their plans and had extreme earnings-price ratios tended to make conservative assumptions, which helped to raise the OPEB total.[31]

OPEB Financial Statement Disclosures

Having examined the effects of accrual-basis OPEB accounting on the private sector, we now consider GASB 45 disclosures. For a better sense of how the OPEB liability is to be measured by an actuary, see Appendix A.

Alaska: An Early Adopter with a Heavily Funded Plan

Because of its financial strength due to its mineral revenues, the State of Alaska has funded post-employment benefits since the 1980s. Alaska implemented FASB standards instead of GASB standards as GASB standards were not adopted at the time. In the State's 2005 Comprehensive Annual Financial Report (CAFR), Alaska disclosed its participation in a separately audited plan (amounts are in thousands):

> Postemployment healthcare benefits are provided to retirees without cost for all employees first hired before July 1, 1986, and employees who are disabled or age sixty or older, regardless of initial hire dates. Employees first hired after July 1, 1986, with five years of credited service (or ten years of credited service for those first hired after July 1, 1996) must pay the full monthly premium if they are under age sixty, and receive benefits at no premium cost if they are over age sixty or are receiving disability benefits. Police and fire employees with 25 years of membership service also receive benefits at no premium cost.
>
> Prior to July 1, 1997, postemployment healthcare benefits were provided by the payment of premiums to an insurance company.
>
> Beginning July 1, 1997, the Retiree Health Fund (RHF), a pension trust fund of the state, was established. The RHF is self-funded and provides major medical coverage to retirees. Retirees of three other state plans also participate in the RHF. The retirement plans retain the risk of loss of allowable claims. The RHF issues a financial report that may be obtained from the Division of Retirement and Benefits, P.O. Box 110203, Juneau, AK 99811-0203.

> The Schedule of Funding Progress for the State of Alaska for postemployment healthcare benefits follows (in thousands):

Acturial Valuation Year Ended June 30	Acturial Value of Plan Assets	Actuarial Accrued Liabilities (AAL)	Funding Excess (FE)/(Unfunded Actuarial Accrued Liabilities) (UAAL)	Funded Ratio	Covered Payroll	FE/(UAAL) as a percentage of Covered Payroll
2001	$1,476,115	$1,466,201	$9,914	100.7%	$781,286	1.3%
2002	1,740,149	2,341,721	(601,572)	74.3%	818.543	(73.5%)
2003	1,894,575	2,654,108	(759,533)	71.4%	860.513	(88.3%)

> The state's annual contributions for pension and post-employment healthcare benefits for the fiscal years ended June 30, 2005, 2004, and 2003 were $109.3, $65.1, and $58.8 million respectively. The annual pension cost was $112.1 million for FY05, $45.7 million for FY 04 and $41.9 million for FY 03. For FY 04 and FY 03, the state contributed 100 percent for each of those years resulting in a zero net pension obligation (NPO). For FY 05, the state contributed 50 percent of the actuarial determined rate, which resulted in a NPO of $56.5 million, of which $55.2 million is for governmental funds. This is the first time the state has incurred an NPO. The NPO disclosed above does not include the discretely presented component units that are separately audited.[32]

Note that Alaska had not completed a post-employment benefits calculation in time for the State's FY2005 comprehensive annual financial report. This is permissible under GASB 45, as long the valuation is at least performed biennially. As the 100.7 percent funding ratio indicates, OPEB was fully funded in 2001. However, this position has deteriorated in recent years to the point where the liability is currently only 71.4 percent funded and the unfunded liability represents 88.3 percent of covered payroll, a tenuous position. The dramatic change in position is due, as least in part, to the sharp decline in annual contributions.

Orlando, Florida: Another Early Discloser from a PAYGO Entity

Though not quite GASB 45 compliant, as it did not disclose an amortization schedule, the City of Orlando, Florida, disclosed the following in its 2004 CAFR:

> Based on GASB approval of Statements 43 and 45 which set forth the guidelines and a future implementation timetable (for the City in 2007/2008) for treatment of Other Post Employment Benefits (OPEB), the City had an actuary calculate future funding requirements in 2004. The purpose was to enhance the City's understanding of the obligation and to revisit potential policy implications associated therewith. Based on this information, the City has taken steps (and is addressing related union contract language through negotiations) to discontinue this benefit to employees hired after January 1, 2006. This estimate, using the entry age normal method, included normal pension-related actuarial assumptions and a decreasing estimate of health care cost increases (ranging from 14% to 5% over a 10- year period). The calculation produced an unfunded obligation of $139,900,000 and an incremental annual cost (to make contributions to a separate trust fund) of $8,700,000 annually.[33]

Maryland: The Consequences of Not Disclosing OPEB in Bond Offering Documents

Many governments or their debt-supported or guaranteed authorities need to consider disclosure in bond official statements, particularly if they are constantly in the debt market. For most governments, the unpaid ARC and the entirety of the liability not only will be a material amount, but also constitute a disclosure event in bond documents. As the Securities Exchange Commission (SEC) is concerned with transparency and integrity of financial data, it is imperative that an issuer's OPEB data be fairly stated and disclosed promptly.

Maryland, however, did not disclose its liability of nearly $23 billion (gross of the Medicare Part D subsidy) in an April 2006 bond offering statement, six months after the valuation was made public. The state has set aside $100 million for OPEB, a tiny fraction of the OPEB liability. When interviewed by the *Bond Buyer*, Cecilia Januszkiewicz, Maryland's secretary of budget and management, justified the state's lack of detailed disclosure by saying: "[E]verybody knew the state had an OPEB liability and had already started putting money aside to pay for it…. We have a triple-A bond rating from each of the bond rating houses, we discussed with them these liabilities, we discussed what we were doing about them, and we got the triple-A rating…. They reaffirmed our triple-A rating, so I mean what more can we say?"[34]

Martha Mahan Haines, chief of the SEC's Office of Municipal Securities, quoted in the same *Bond Buyer* article, took a different view of Maryland's actions. She stated that "issuers should include material information about OPEB liabilities in disclosure documents as soon as they are known, even if the final numbers are not yet available. GASB's effective dates for inclusion in financial statements do not justify withholding information from investors."[35]

To date, Maryland has not been questioned on its actions publicly. However, the SEC's stance comes from a 1999 Massachusetts Turnpike Authority case involving the Central Artery Project. In that case, the SEC found that the cost increases for the Central Artery Project should have been disclosed, because there was "a substantial likelihood that a reasonable investor would consider it important in making his or her investment decision." The SEC found the Authority and then-chairman James J. Kerasiotes negligent in not disclosing the projected cost overruns in the bond documents. However, the SEC did not impose fines and other penalties on the Authority or Kerasiotes.[36] Clearly, issuers of bonds need to be very careful as to the timing and the extent of disclosure when even draft OPEB numbers become available to management.

Newton, Massachusetts: A Comparison of Pre-GASB 45 and a Pro-forma GASB 45 Disclosure

As noted previously, the city of Newton, Massachusetts, disclosed a liability of $240.9 million if it had set up an irrevocable OPEB trust and $654.2 million without a trust. Within its summary of significant accounting policy in its 2005 Comprehensive Annual Financial Report (CAFR), it reported:

> **Post Retirement Benefits**
> In addition to providing pension benefits, the City provides health and life insurance coverage for all retired employees and their survivors, including those retired under the Massachusetts Teachers Retirement System (MTRS). Health insurance coverage is provided in accordance with Massachusetts General Law Chapter 32. The City funds 80% of retiree health insurance premiums, including the reimbursement of 80% of Medicare part B premiums and 50% of a $5,000 term life insurance premium. The City recognizes its share of the cost of providing such benefits on a pay-as-you-go basis. For the fiscal year ended June 30, 2005, this expenditure totaled approximately $11,068,742 for 2,429 eligible retirees and/or survivors.

> The City has obtained an actuarial valuation of its obligations for post retirement health benefits. As of June 30, 2005, the actuarially determined present value of earned post retirement health benefits is approximately $654,205,000. The actuarial assumptions included a 2.0% rate of return on investments (net of investment expenses) and an inflationary rate of 9.0% for fiscal year 2006; 8.5% for fiscal year 2007; 8.0% for fiscal year 2008; 7.5% for fiscal year 2009; 7.0% for fiscal year 2010; 6.5% for fiscal year 2011; and 6% annually thereafter. Based upon the June 30, 2005 study, the City's Annual Required Contribution (ARC) for the fiscal year beginning July 1, 2005 is $45.6 million. There are currently no funds being set aside to fund this liability.[37]

However, the city specifically notes that it has not implemented GASB 45. Upon implementation, it would disclose an entirely different set of notes. A prospective disclosure is contained in Appendix B.

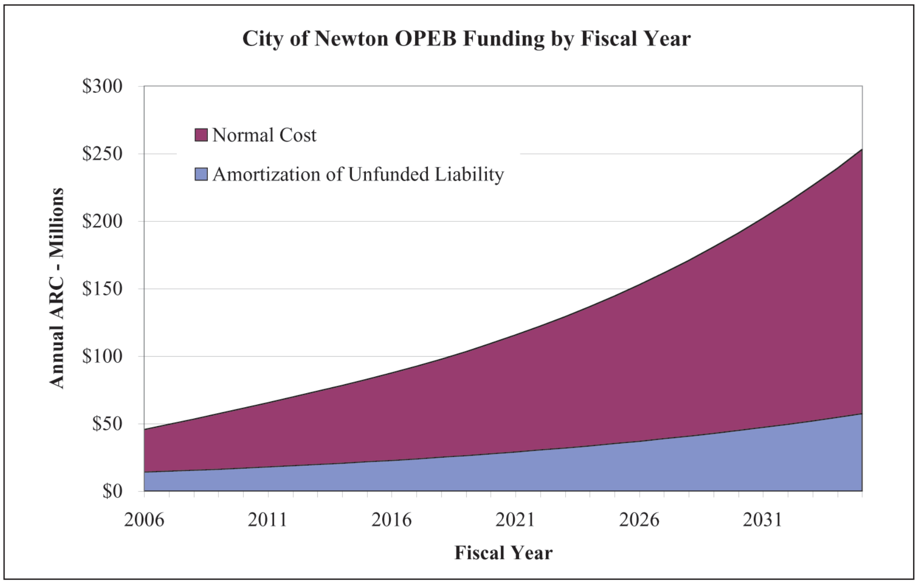
Under the current system without an irrevocable trust, the amortization schedule portrayed in Appendix B calls for a contribution of $45.6 million in 2006. If it continues to fund only its normal cost of $31.7 million in 2006, Newton will have to record an increase in the OPEB obligation on its Statement of Net Assets for the unfunded amount of $13.9 million (the difference). The liability will increase each year that the payment is less than the normal cost plus the amortization.

Should the city of Newton decide to create an irrevocable trust and fund the OPEB liabilities, then actuarial assets would be reflected in the initial table and the Schedule of Funding Progress. More importantly, the creation of the trust in conjunction with fully funding the ARC with cash contributions on an annual basis would be required in order to utilize the long-term investment return/discount rate of 8 percent versus a short-term rate of 2 percent. The effect of this change shrinks the net OPEB obligation dramatically from $654.2 million down to the lower number of $240.9 million. The higher investment return lowers the estimated OPEB obligation, which then allows the annual amortization and ARC to decline considerably, further improving its reported financial position.

The cash inflows and outflows plus any amortizations and retained earnings on invested assets would flow to its Statement of Activities (its income statement.)

OPEB Budgetary Impacts under Various Funding Situations

PAYGO



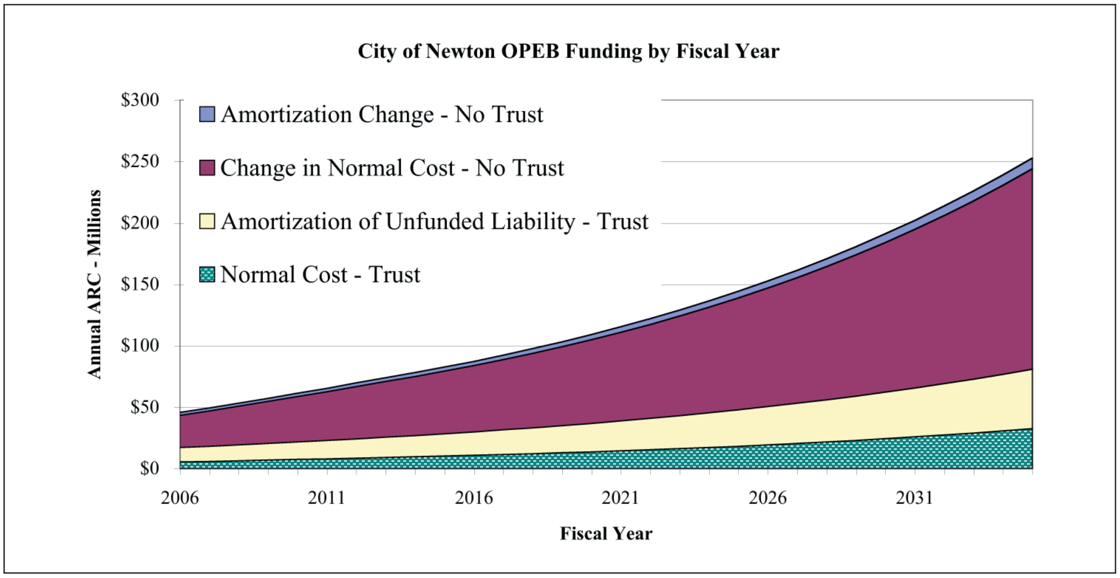
Governments in Massachusetts do not budget on a GAAP basis. Rather, they use a modified cash method. Budget expenditures are cash outflows, so budget decisions are based on expected cash flows out into the future. Since GASB 45 does not require that post-employment benefits be funded, governments can continue to follow PAYGO with no effect on the budget. However, the unfunded OPEB liability will be disclosed in the Statements of Net Assets. Assuming there is an unfunded OPEB liability, then the use of PAYGO means that the actual OPEB payments are less than the ARC. So the OPEB liability on the balance sheet will grow markedly over time as it represents the cumulative annual differences between contributions made and the ARC.

The city of Newton offers a good example of how dramatic the change can be over time. From 2004 to 2005, the actuarial accrued liability grew from nearly $520.5 million to $654.2 million, an increase of over $133.7 million, or nearly 26 percent. In contrast, the General Fund Spending from 2004 to 2005 was only 4 percent.[38] Unless the Board of Aldermen in Newton decides to dramatically change the way that their post-employment benefits are funded or offered, this liability will likely grow at a rate far above that of the operating budget.

This is illustrated above, using Newton's amortization schedules of its liability. Newton assumed an escalation of its "normal" cost of 10 percent in 2007, ranging down to an ultimate rate of 6 percent in 2014. Normal costs are the additional retiree benefit costs incurred due to employees working during a particular year. As can be seen, Newton is paying the majority of its costs, if it chooses to fund only the normal cost. However, since the normal costs are growing at a far faster rate than 2.5 percent, new growth in tax revenues will have to pay these bills. A liability will still exist for the unfunded actuarial liability, which is growing itself at 5 percent per year. At 2036, at current assumptions, $57.1 million will still be owed to participants for 2006 costs (the blue segment in the graph). The key policy decision here is when and how it will be able to pay for the mounting OPEB liability.

Partial to Full Funding and the Effect of Revocable and Irrevocable Trusts

If a government funds more than its PAYGO costs, it is considered to be, at least, partially funded. Depending on the vehicle that is holding these funds, the government may be able to make a case to use a higher rate of return. A higher rate of return can dramatically lower the liability. In Newton's case, the unfunded rate of return used was 2 percent, applicable investment return. The funded rate of return used was 8 percent, a rate undoubtedly similar to its rate of return on its pensions, which would cut the liability by more than 63 percent, from $654.2 to $240.9 million.



Partial funding creates challenges in estimation since the rate of return calculation will depend on a weighted average of assets to total ARC. Hybrid funding may be an answer for some governments, but again, funding must be maintained.

As can be seen in the two graphs, if Newton fully funds OPEB, the bottom two slices are far less in later years than if unfunded. Partial funding would move the amortization curve somewhere in the middle.

The key to achieving this lower amortization is to fund it with contributions. GASB defines a contribution as payments to retirees or beneficiaries, associated payments to insurers or an irrevocable asset transfer to a trust, or a similar arrangement in which plan assets are dedicated to providing benefits to retirees and their beneficiaries. Governments cannot designate assets, or earmark surplus or other resources to finance benefits. They must contribute cash and to achieve a lower liability, and that contribution *must be irrevocable.*

If a revocable trust is used, OPEB contributions may be construed as earmarked, as they could always be used for other purposes upon trust termination. If a government has a right to remove contributions for other purposes, or discontinue funding, the government runs the risk of decreasing its rate of return to that of its un-invested cash. Governments will have to balance flexibility versus rate of return carefully in making these difficult policy decisions.

The Impact of Medicare Part D

One of the more controversial elements of Statement 45 is the treatment of the Retiree Drug Subsidy Provisions of the Medicare Part D subsidy received by governments (or their health care trust fund or shared services entity) if they offer plans that exceed the provisions of Part D drug coverage. The FASB in 2004 issued a "staff position" that is essentially authoritative for corporations and nonprofits, allowing for an offset amounting to the present value of the expected Part D subsidies to an entity's OPEB liability. The initial reduction upon implementation would be treated like any other actuarial or experienced gain. However, GASB has taken a different approach. GASB released a technical bulletin on June 30, 2006 that describes the Medicare Part D subsidies as a voluntary "non-exchange" transaction. This means there are no required goods or services delivered by the government directly related to the revenues being generated—effectively, there is no quid pro quo. Because of the non-exchange nature, GASB has stated that the receipt of Medicare Part D subsidies is recorded solely as a revenue event, and furthermore, it is not predictable. Therefore, that the expected future subsidies cannot be used to offset a government's OPEB liability.

The impact of the GASB's proposal is dramatic. In the case of the State of Maryland, the difference is over $2.5 billion in present value. The discounted stream of Medicare Part D subsidies equal over 11 percent of Maryland's total actuarial liability of $22.9 billion. Under FASB's interpretation, the State of Maryland would record a 2006 ARC of $311 million, net of the projected Medicare Part D subsidy. However, under GASB's proposed approach, the ARC would be $345 million, a significant increase.

The President of the National Association of State Auditors, Comptrollers and Treasurers responded favorably to the GASB proposal, commenting that "members believe that the technical bulletin will be helpful to preparers of financial statements since it provides necessary and appropriate guidance to governments and OPEB plans regarding the financial reporting issues related to receipts of Medicare Part D payments. We agree that payments to an employer constitute a voluntary non-exchange transaction between the federal government, and the employer and the guidance prescribed … is appropriate for these receipts." The comment letter went on to say that one member did not agree with GASB's position, calling it an inadequate reason to treat the subsidy differently than FASB.[39] The letter indicated that should this proposal be implemented as proposed, then the governments that have implemented FASB procedures in the absence of GASB guidance and are funding their OPEB liabilities may see an increase in their OPEB liability valuations.

To OPEB Bond or not to OPEB Bond

For government liabilities, decision makers must weigh if it makes economic sense to spread these costs over time and, if so, over what time horizon and with what financing method. Many governments nationwide have issued pension obligation bonds to fund the pension plan today, while paying for the costs over a longer period using either fixed or variable debt. Similar to pension bonds, the OPEB bonds that have been issued are taxable, affording investment flexibility of proceeds. Governments considering bonds may view the following benefits:

1. The investment rate of return outweighs the interest expense generated by the bonds, thereby creating a legal arbitrage play;
2. The OPEB bonds may have a minimal effect on the total debt of the government and its debt rating;
3. There is a legal basis under state and local statutes to issue the bonds;
4. There are allowable investment vehicles that can support the payment of OPEB liabilities for the life of the bonds;
5. Other avenues to reduce OPEB costs are not as economically attractive.

However, OPEB bonds can present economic challenges not found in regular pension bonds. Pension payments are relatively stable and predictable with a long history of funding payments and actuarial calculations. The OPEB liability is subject to considerable uncertainty, particularly due to the rising cost of healthcare. *Barron's* magazine in March 2006 remarked, "[F]orecasting the future liabilities of pension plans is relatively easy, predicting health-care liabilities is anything but. The upshot: Retiree health-care bonds could by very risky for the issuer. States issuing the bonds might have to pay higher rates on subsequent bond issues for bridges, roads and schools—even if their ratings are unaffected by the new debt—simply to attract more buyers." The *Barron's* author believes that the tax-exempt interest rate on non-OPEB bonds may be adversely affected by the total debt outstanding and the interest rate on the OPEB taxable bonds; however, this effect has not yet been documented. The article further quoted senior vice president J. Richard Johnson of Segal, Co. (an actuarial firm), "You don't know who is going to get sick or who is going to have the million dollar claims. You are chasing a moving target."[40]

Pension obligation bonds are similar in structure to OPEB bonds. In Massachusetts, only three governments, Worcester, Brockton and Dracut, have issued pension bonds. The Executive Office for Administration and Finance posted on its website, on June 23, 2006, updated rules regarding pension obligation bond issuance, beyond local and Commonwealth legislation. These rules include:

1. A comprehensive plan approved by the Secretary of Administration and Finance
2. Required evidence of recognition of risk prior to seeking approval from the Executive Office for Administration and Finance
   This includes municipal appropriating authority approval of the bonds by a two- thirds vote. Any bond issuances in process as of June 26, 2006 would have to include this bold disclaimer (emphasis *not* added):

   > THE USE OF PENSION OBLIGATION BONDS MAY INCREASE THE POTENTIAL LOSSES ASSOCIATED WITH PENSION FUND INVESTMENTS. THE COMMONWEALTH IS NOT RESPONSIBLE FOR ANY LOSSES INCURRED BY A MUNICIPALITY DUE TO THE ISSUANCE OF PENSION OBLIGATION BONDS, OR FOR ANY INCREASE IN UNFUNDED ACTUARIAL ACCRUED LIABILITY DUE TO DEFICIENT INVESTMENT RETURNS.

3. Approval by the Executive Office for Administration and Finance based on ratings, structure, present value savings (of at least 4 percent) and pension fund management. Financial capacity and reserves are also reviewed. Municipalities with low credit ratings will not be allowed to sell pension obligation bonds.

Other criteria are also mentioned including marking to market for the bonds within 60 days and other general conditions.[41] Many of these provisions will be difficult hurdles for municipalities to clear.

While OPEB bonds have attractive features, they may not be the solution to all of a government's OPEB woes. First, the sale of these bonds reflects the government's decision to fund its OPEB liability. Many governments may choose not to fund this liability. Second, the healthcare cost trend rate automatically increases the risk of issuing OPEB bonds with the goal of fixing future costs. If health care cost trend rate exceeds the needs extinguished by the issuance of the bonds, the government will have to fund the difference by other means. Third, any OPEB bond issuance will have to be timed right to take into account the economic factors above. Indeed, there may be a market for taxable municipal debt, but it is different than traditional non-taxable municipal issuances. Taxable refunding bonds or ones with call provisions are even rarer. Government will have to recognize that while OPEB bonds may allow for a net positive arbitrage between the taxable issue and the trust's investment returns, it may not solve all funding issues. Specifically, the investment return may, in some years, be less than the cost increases of health care, thereby *increasing* its OPEB costs during a period of economic weakness. Finally, funding OPEB limits the government's financial flexibility associated with these costs. A government may find it difficult to change the terms of an OPEB plan or deal with intergenerational issues once it is well funded.

The Early OPEB Bond Issues

The City of Gainesville, Florida sold the first OPEB bonds in July 2005. The $31 million taxable issue was rated A+ by the Fitch ratings service. Fitch raised the City's existing pension bonds to similar ratings with the sale.

The State of Wisconsin sold taxable pension bonds in 2003 and used the $1.8 billion proceeds to wipe out its long term "soft obligations." The state sold the bonds in a record low-interest-rate environment, far below the rate of 8 percent charged by its retirement system. According to a recent *Bond Buyer* article, the transaction saved the state in excess of $140 million in the last fiscal biennium and will generate at least 30 percent in net present-value savings over the life of the debt: "While other states grapple to comply with the new accounting and reporting rules on OPEBs, the state has little to worry about on that front because it calculated the cost of the unfunded liability of its only benefit in that category—the ability to convert unused sick leave to a lump-sum payment—and it was fully funded with the 2003 pension sale." The article quotes Wisconsin's capital finance director Frank Hoadley, who hopes that rating agencies will give the state more credit for the state's relatively healthy pension funding status: "We get danged pretty heavily for not having a rainy-day fund or other reserves, or for not having stronger liquidity, but when you add pension and OPEB ratios into the mix, the state is much better off than many others on a comparative basis."[42] Regardless of Wisconsin's success in fully funding OPEB, it cannot be a model for most states because the State's non-pension benefits offered to retirees are limited to unused sick time.

Ratings Implications Even If Governments Do Not Bond

Despite Wisconsin's successful management of its "soft" liabilities, it is unclear if ratings of issuers will be affected by OPEB disclosures. At a recent *Bond Buyer* conference on OPEB in Chicago, a panel of rating agency analysts cautioned that they will look at the OPEB liability of a government and how the government will manage it. They will look at the liability as a percentage of budget and whether the plan an issuer adopts will "be as meaningful" as the actual liability number, said panelist Amy Doppelt, a managing director at Fitch Ratings. Moody's Investors Service analyst and vice president Douglas Benton cautioned that "there should be a long-term plan, and [OPEB bonds] should not be used to plug a short-term budget problem."[43] Fitch Ratings has covered the OPEB issue extensively, issuing four special reports since 2003. In a 2005 report, Fitch analysts remarked:

> [I]n Fitch's opinion, the prudent accumulation of assets in a trust account outside the general fund and well in advance of pay-as-you-go cost escalations can avoid or forestall liquidity problems or tax capacity concerns that might lead to credit deterioration… Fitch will view OPEB liabilities, like pensions, as soft liabilities that fluctuate based on assumptions and actual experience… [I]ndefinite deferrals are damaging to credit quality. [O]PEB accumulated costs are legal or practical commitments that form a portion of fixed costs. Long-term deferral of such obligations is a sign of fiscal stress that will be reflected in ratings.[44]

If Fitch's report is indicative of a typical rating agency's stance on OPEB, governments should think about the size of the estimated unfunded OPEB liability but also the speed and approach to funding it. Eventually, OPEB costs are funded—in a PAYGO fashion, through consistent payment of a government's ARC, or by a more aggressive funding schedule as might be achieved through OPEB bonds. Rating agencies traditionally look not only at a budgetary view but also at a government's entire management structure and the management of its liabilities. If a government does not fully fund the ARC, a liability will accrue to its balance sheet, raising doubts for the rating agencies about what the government will do to pay for this liability. As the liability grows through inaction, rating agencies may perceive that inaction as a situation that may breed inflexibility. Governments should view pre-funding of OPEB liabilities (either paying into a trust in advance of implementation of GASB 45 or paying more than the ARC) as generally attractive from a rating agency perspective.

Managing OPEB Benefits through Restructuring

Government and private industry are under increasing pressure to manage health care and other post-employment costs. Unlike corporate pension plans, there is no Employee Retirement Income Security Act of 1974 (ERISA) or a Pension Benefit Guaranty Corporation (PBGC) to bail out defined-benefit health care plans either for private industry or for government, so governments must consider how to handle these obligations themselves. Several alternatives are available, some being the following:

1. Doing nothing and continuing in whatever fashion the government currently manages OPEB, or
2. Partially or fully funding OPEB at a higher cost to taxpayers, or at a cut to current programs and services (if alternative revenues cannot be raised,) using either current cash flow or bonding mechanisms as discussed previously, or
3. Capping, curtailing, or eliminating benefits to current or future workers.

The third alternative, restructuring benefits, is more difficult than it might first appear. Many believe that a contract has been made with governmental workers for health insurance and other post-employment benefits in exchange for lower current pay. What was not fully appreciated in this contract are the significant costs that would need to be paid when the employees are in retirement. The OPEB disclosures are causing governments to revisit this social contract and shift their traditional emphasis on the short-term, budgetary view to a longer-term decision-making perspective. However, the employees feel that the retirement obligations should be paid in full.

In May 2003, GASB held a public hearing on the OPEB exposure drafts that became Statements 43 and 45. Labor union representatives testified, a rarity at a GASB hearing, urging that the exposure draft be set aside and arguing that it could lead to the curtailment of long-standing government defined-benefit plans. The unions had carefully studied the exposure draft and seemed prepared to fight the costs to them if OPEB were enacted.

The labor unions' willingness to fight became apparent during the Christmas shopping season of 2005. Thirty-thousand New York City transit workers went on strike illegally, primarily to protest the restructuring of benefits. Other than raising the workers' portion of pension contributions from six to eight percent, workers were being asked to contribute *for the first time* to their health care costs. The Metropolitan Transit Authority was asking workers to contribute only *1.5 percent* to their current and retiree health care costs. The strike ended in a few days, but as of the date of this publication, the basic grievances had not been solved. The New York City transit workers strike is a harbinger for governments across the country.

While the Commonwealth does not collectively bargain health care with unions, the municipalities and authorities in the Commonwealth do, and are at some risk. In comparison to the New York City transit workers, Commonwealth employees currently contribute ten times that amount (15 percent) toward healthcare costs. Most workers in private industry contribute far higher than 15 percent, (if not the entirety) of their health insurance premiums. Like private industry, employee and retiree health care costs have become "the third rail" of government. How can a government then restructure these costs?

Michigan: Lowering OPEB Liability by Increasing Employee Contributions

A few states have already attempted to change their OPEB benefits. In 2000, the State of Michigan amended retiree health care plans, increasing co-payments and deductibles for retirees as well as the out-of-pocket maximums for prescription drugs—two major cost drivers for OPEB. In 2005, six public school retirees in the State of Michigan sued the Michigan Public School Employees' Retirement Board, the Michigan Public School Employees' Retirement System, the Department of Management and Budget and the Treasurer of Michigan, charging that the modifications violated Michigan's constitution. The constitution prohibits the enactment of a law that impairs an existing contractual obligation. The Michigan Supreme Court ruled for the state, holding that health care benefits do not constitute "accrued financial benefits" subject to protection of impairment or diminishment. The Court also held that Michigan's statute that established health care benefits had, in effect, created a contract but that the subsequent legislative changes were insubstantial. Hence, the constitutional prohibition against impairment of contract had not been violated.[45]

Utah: Funding OPEB Using Accumulated Sick Leave and Vacation Time

In another case, the State of Utah in 2006 was sued by the Utah Public Employees Association on behalf of five anonymous plaintiffs, charging that the Utah legislature had changed the rules of vesting and contributions in a 2005 bill. Utah has had an innovative program since 1979, allowing a 100 percent contribution of unused sick time to the employee's portion of OPEB costs. Many government employees are permitted to accumulate substantial sick leave and vacation leave and receive monetary compensation at retirement, raising the employee's final compensation and long-term retirement benefits, so the Utah plan encourages employees to voluntarily lower their accumulated sick and vacation time.

In subsequent years, the Utah legislation was modified to include a partial cash payout. In 2004, the Legislature reverted back to the 1979 legislation, allowing use of the entire 100 percent for medical and life insurance benefits. The plaintiffs contended that the change in the 2005 legislation was, in effect, an unconstitutional taking of employees' unused sick leave by retroactively devaluing already vested rights. The value of this change for the plaintiffs was probably significant, in that they cumulatively had banked more than 8,000 hours of unused sick leave prior to January 1, 2006. The Court held that the legislative change was not an unconstitutional taking and that the plaintiffs did not have a property interest in the specific use of unused sick leave. As to vesting, the Court found that Utah statute and case law was ambiguous at best, concluding "that the State's offer was to exchange the unused sick leave for a benefit upon retirement, but not necessarily any particular benefit. The various changes… did not intend to bind the State forever to redeem 100 percent of the unused sick leave hours for any one use, and in particular not necessarily for medical and life insurance."[46]

Utah's program is an innovative solution to the sick leave and vacation accumulation and to the funding of OPEB. Commonwealth of Massachusetts employees can receive up to 20 percent of unused sick time as compensation at time of separation. As a consequence, the state faces a $544 million liability for total unused sick and vacation time as of June 30, 2005. Human nature though would suppose that most employees would want to "cash out" their benefits on retirement, rather than thinking about the long term health care issue. However, the Utah approach could be an attractive option for it to consider.

Rhode Island and New York City: Considering Funding OPEB Trust Funds from One-Time Gains and the Tobacco Settlement

Rhode Island Governor Carcieri proposed in his 2007 budget using a "Retiree Health Care Trust Fund" to deposit $100 million of proceeds from securitizing (selling bonds in lieu of directly receiving) tobacco master settlement payments that the state expects to receive sometime after 2023. The Governor further proposed that the state's Investment Commission (similar to the Commonwealth's Pension Reserves Investment Management Board) be used to pool state and municipal assets to help realize cost efficiencies and economies of scale in funding the statewide OPEB liability.[47] In New York City, Mayor Bloomberg is proposing a similar trust, funding it with anticipated one-time surpluses from real estate taxes, the city's personal income tax, and a delay in pension funding in 2006 and 2007 that should amount to $1 billion each year.[48]

Duluth, Minnesota: Cutting Services to Sustain OPEB

Other governments are looking at the expenditure side. In Duluth, Minnesota, the mayor has decided to cut services. A *USA Today* front page story estimated Duluth's cost at $8,000 per household for its free lifetime benefits for retiree health services. Quoted in *Fortune Magazine*, Duluth's mayor remarked: "The city will be bankrupt in ten years if we continue to go down the path we're going. We're at a point now where our level of personnel in police and fire is getting dangerously low… The cost is just too high now, and we can't afford to give it out in the future." The Mayor has also frozen hiring, resulting in 80 unfulfilled positions, risking his own political future in order to save the fully paid health benefit. In contrast, Minneapolis, the largest city in the state, has no OPEB liability since it does not offer any post-employment medical benefits.[49]

Ohio: Modifying the OPEB Plan Terms

Ohio has aggressively funded its OPEB liability. The state amended its retiree health plan so that only employees with 30 or more years of service are eligible for full coverage.[50] In making the revision, it has invoked Section 145.58 of its Revised Code and noted that, despite the importance of retiree health benefits, its primary concern must be the pension program. Employees who are members of the Ohio Public Employees Retirement System (OPERS) contribute 4 percent of their salary to their health coverage. The state and the municipalities that are members of (OPERS) have contributed 100 percent of their share over the last five years. The plan is 85 percent funded for the 3,702 governments that participate. Ohio offers a mixture of defined benefit and defined contribution plans, as well as a voluntary employee benefit association.

Other states have also pursued plan amendments. Alabama has increased the premium payment obligation for certain employees, including smokers and individuals with short service periods. Similar amendments have been passed in Delaware and Georgia, as well as cities like

Orlando and Arlington, Massachusetts.[51] Clearly, the Commonwealth could look toward the Ohio model as a potential statewide solution for its OPEB.[52]

Using Caps and Conversions to Limit Expenditures

Other potential solutions on the expenditure side are caps and conversions. The federal government has effectively capped the government's liability associated with prescription drugs in Medicare Part D. A similar measure could be used to contain overall retiree benefits costs. Capping the state's OPEB liability affords the government additional flexibility in: (1) fixing the cost of OPEB and (2) allowing the cap to be selective to future employees instead of current employees or different classes of employees. Cost caps can also be used to limit a government's cost of retiree health care per retiree. Caps are recognition that there is a problem, but by using a cap rather than a percentage, the problem will not spread beyond current conditions.

Probably the most dramatic measure that still includes a health care plan is to convert from a traditional defined benefit plan to a defined contribution plan. The conversion shifts the risk entirely to the employee or retiree. Under GASB 45, in a defined contribution plan, the government would only have to disclose what it is required to contribute to the plan and how much it actually did, as it is not responsible for the investment performance or available payout from these plans. Conversions to defined contribution pension plans are starting to gather momentum in some states. Alaska, Florida, Colorado, Michigan, Ohio and Oregon have converted their pension systems from defined benefit to defined contribution.

Conclusion

The Commonwealth, exclusive of its municipalities and separate authorities, has a $13.3 billion OPEB problem if it decides not to fund its OPEB costs. In 1987, when the Commonwealth began to amortize its pension liability, it had a $7.4 billion unfunded liability.[53] Today, the state employees retirement system is 82.8 percent funded with a $3.4 billion liability. Over the years, it has continued to fund its pension liability systematically and rationally. This gives us confidence that the Commonwealth will find solutions to the OPEB problem.

Because of Statement 45, governments must:

1. **Measure their liability** - Projecting the OPEB liability using financial disclosures is difficult as governments differ in the level and kinds of benefits they offer, the ages of those who are eligible for these benefits, the level and mechanisms for funding, and the trend rate assumptions underlying the estimate. The Commonwealth of Massachusetts - *exclusive* of authorities, municipalities and separate districts - has disclosed a **$13.3 billion liability** to pay for post-employment benefits already earned by current employees, retirees and survivors. **The Commonwealth must decide whether to fund this liability, and if so, how.**
2. **Consider OPEB costs when applying Massachusetts General Law Chapters 32A and 32B –** The Legislature must consider OPEB costs when applying Massachusetts General Law Chapters 32A and 32B. Governments across the Commonwealth in recent years reduced payrolls via employee retirement incentive programs. However, the reduction in payroll was often compensated for by an increase in pension and OPEB costs. The Legislature should recognize that changing retirement ages, vesting, contribution percentages and other variables will affect OPEB liabilities.

3. **Consider their options** - Available options can be grouped in two categories: **Administrative Reforms** and **Benefit Adjustments**.

Administrative Reform Options

- ***Create an Irrevocable Trust, as a Separate Investment Trust Within or Similar to the Pension Reserves Investment Management (PRIM)* –** A new investment trust, similar to PRIM, could be used to take advantage of the higher rate of return afforded by an irrevocable trust. However, the Commonwealth could consider taking an even bolder move:
- ***Consolidate OPEB Management for all State and Municipal Entities under One Manage****r* - There are 106 separate public pension plans in the Commonwealth, each with different administrative structures. There are many other health benefit collaborative and local entities. The Commonwealth could adopt a different, potentially less expensive approach by consolidating OPEB management for all governments under one domain. The Group Insurance Commission (GIC) of the Commonwealth has a long and successful history of aggressively managing the costs of health care for its members. Consolidating these separate health benefit entities into either a GIC-like commission for municipalities or the existing GIC could play an important role in holding down costs and managing beneficiary claims. However, traditionally, Commonwealth government has been centered on local decision-making, embodied in the town meeting. Creation of a municipal GIC would require even more reform of General Laws Chapter 32B than might be needed under other alternatives.
- ***Amortize the Unfunded Pension Obligations over a Longer Time Horizo*n** Under the current plans, the pension plans will reach fully funded status in 2023 for the state system and 2028 or earlier for the local systems. Sufficiently funding pensions is important for many reasons, not the least of which is that Massachusetts public employees do not contribute to or receive retirement benefits from Social Security. However, bringing both the pension and OPEB systems up to fully-funded status based on the current schedules may strain governmental budgets, encouraging some entities to slow the rate at which then fund their pension plans.

Benefit Adjustment Options

- ***Change the Health Insurance Benefit Structure* –** Restricting health insurance would be politically difficult, given the sweeping health insurance reform and its goal of universal coverage. However, some governments, and certainly private industry (which has a decade and a half of history implementing similar standards), have or will consider it. An option the Commonwealth could consider includes the possibility of offering a defined contribution health care plan or a voluntary employee benefit association mechanism in the future or for future hires, effectively capping costs.
- ***Increase Cost Sharing* –** Most governments will consider requiring employees and retirees to bear more of the OPEB cost. Currently, the Commonwealth funds 85 percent of its health care PAYGO costs, while employees fund 15 percent. A 5 percent swing to a 20 percent employee contribution could yield millions of dollars of additional funds available for future benefits. The Commonwealth has shifted contribution rates before, including during the most recent fiscal crisis

earlier in this decade. However, such a change would likely not apply to retirees, reducing the immediate benefit from cost sharing.

- ***Municipalities must consider OPEB costs in all collective bargaining agreements*** - For the Commonwealth, healthcare benefits are not part of union negotiations. However, for municipalities and other governments in the Commonwealth, they are. In some cases, rates are set with individual unions within the same government. All governments need to know what their liability is and to be able to do a sensitivity analysis on that liability for various changes in the benefit package.
- ***Consider the Utah Model for Unused Sick Time and Vacation at Retirement***— Unused sick and vacation compensation at retirement was worth over $500 million as of June 30, 2005 for the Commonwealth. Most employees like to "cash out" these accrued benefits at the end of their tenure. But the Commonwealth and the municipalities could explore whether the portion that can be paid out at separation, as an option could be used instead to fund an irrevocable OPEB trust.

Other Findings

- Projecting the OPEB liability using financial disclosures is difficult, as governments differ in the level and kinds of benefits they offer, the ages of those who are eligible for these benefits, the level and mechanisms for funding, and the trend rate assumptions underlying the estimate.
- Unlike the treatment typical for non-governmental entities, GASB does not allow governments to offset their Medicare Part D subsidies against the actuarially required contributions of OPEB costs.
- Case law in other states has increased the flexibility of their legislatures to restructure OPEB liabilities.
- In addition to OPEB restructuring, other possibilities exist for dealing with OPEB costs, but these alternatives require time, money and ingenuity.

In Closing

Governments routinely make many promises with regard to benefits to attract and maintain employees. It is one way that they can compete with private industry for employees in this age of cutbacks and managing to stock prices and rates of return. Before GASB 45, many governments did not fully understand the ramifications of those promises. Now they will.

Beyond health care costs, the largest issue facing government today is brain-drain. A recent issue of *Governing Magazine* quoted a Rockefeller Institute study from 2002 that noted that 46.3 percent of government workers were 45 or older, compared with 31.2 percent of private-sector workers. Government aggravated the age imbalance in its workforce by hiring expansively in the 1960s and 1970s and slowing down hiring in the last 20 years due to tight budgets.[54] In the Commonwealth's actuarial valuation, it was noted that the average age of its employees is approximately 46. The average employee of the Commonwealth has served 12.75 years, making that employee already vested for OPEB benefits. As the older employees retire, governments are going to have to staff up in a short period, while competing in the same talent pool with private industry.

Government has traditionally competed on compensation, including benefits. Contrary to prevailing opinion, public sector employees are paid both higher salaries and have richer benefits than those in the private sector, partly because they are being compensated for a higher level of education and, sometimes, physical risk. In addition, higher participation rates in the public sector drive up the average employee benefit costs.[55] If the state wishes to continue attracting skilled employees, it will have to continue to assemble attractive packages of pay and benefits. However, to do so in an era of tight budgets, it must make smart and tough decisions on how to handle employee health care benefits.

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Appendix and Endnotes

Appendix A: Measurement of the OPEB Liability

Most governments will have to hire actuaries to complete valuations for these disclosures and to update the footnote as required biennially. Governments with less than 200 participants need only to value their obligations on a triennial basis. It is expected that the Commonwealth of Massachusetts (and other large states) will perform an annual valuation of its liability in line with its annual pension valuation.

There are various data elements that are needed for a successful OPEB liability computation. It is wise for a government to gather this information in advance of engaging an actuary in order to reduce costs and speed the calculation. A good rule is to use as much data and assumptions as possible from a government's pension valuation, as they are already recognized as valid.

Items needed include the following:

Census Data—In essence, who is included and who is not. The census needs to include counts of active employees, retirees, survivors, and employees who have left service but are vested. The data needs to include dates of service, dates of separation, age, marital status, and sex. For large governments, such as the Commonwealth, with the many nuances of its General Laws Chapter 32A, an accurate census can be difficult to complete.

Plan Provisions—A major building block of the valuation is the "substantive plan." The well-documented plan needs to answer the following:

1. Who is eligible for benefits?
2. When are they eligible?
3. What is the contribution rate for all classes of employees and the government?
4. Is it a defined contribution or defined benefit?
5. What are spousal, dependent and death benefits?
6. What is the role of Medicare and especially, part D?
7. What are the all the various medical plan deductibles, maximums, caps, floors, co-pays, drug benefits and provider variables?
8. What are all the non-major medical OPEB items, including, but not limited to, dental, vision, life insurance, public transit, even higher education benefits?

Sources of Data—Most sources of data are contained within a government's benefits management structure, human resources structure or retirement board. However, reconciling the numbers from one system to another is a key element to a successful valuation. An actuary also will need to assess medical claims data for a reasonable range of time periods before the date of valuation. In the Commonwealth's case, five years of data were evaluated.

The Actuarial Computation—An actuary will assimilate all of this data into a complex model. The actuary needs to work with the government to choose the best methods and assumptions to yield fairly stated results. Methods and assumptions include the following:

1. Actuarial method
2. Discount rates for governments with irrevocable trusts, without trusts and for partially funded or insured plans
3. Medical rate trends
4. Prescription drug trends
5. Mortality rates
6. Retirement and disability rates
7. Turnover rates
8. Morbidity rates
9. Age adjustments due to marriage from standard tables
10. Valuation methodology
11. Amortization period and pattern

The actuary will calculate the unfunded actuarial accrued liability and the annual required contribution for the government taking these and other factors into account. If a government is partially or fully funded using an irrevocable trust, assets and investment return will be used to calculate the liability.

Selecting an Actuary—Many actuaries can calculate a pension liability. However, few actuaries have medical cost trend experience. A successful valuation that is acceptable to auditors will have a health care actuary as part of the team. Like other services of this caliber, a competitive bid process will likely be needed.

Appendix B: OPEB Disclosure

Employers will have to disclose in the footnotes to their basic financial statements the following:

1. Description of the plan or each plan (the substantive plan described above)
2. The funding policy of the government for OPEB costs
3. Annual OPEB cost and net OPEB obligation (or asset if fully funded or over-funded)
4. Calculation of the ARC and adjustments to it including interest, contributions and beginning and end of the year obligations
5. A table listing by fiscal year the annual costs, percentage contributed and net obligation at the end of the year
6. Funded status and funding progress, including a schedule of funding progress by fiscal year, including the actuarial value of assets, the actuarial liability, the unfunded amount, the funded ratio, covered payroll and the actuarial liability as a percentage of payroll. This schedule is required supplemental information and is audited.
7. Actuarial methods and assumptions

Separately audited OPEB plans are governed by Statement 43 rather than 45. This standard goes into force a year in advance of Statement 45. Should governments be members of a separately audited OPEB plan, the plan would have to disclose the following:

1. A statement of plan net assets—a balance sheet of the plan
2. A statement of changes in plan net assets—a year to year statement of increases and decreases in the plan
3. Footnotes, including descriptions of the plan, policies, reserve requirements, membership assessments, funded status and actuarial methods and assumptions.

Participants in one these plans would disclose in their own financial statements the actual contributions in comparison to their shares of the plan's ARC.

A Possible GASB 45 Compliant Footnote for the City of Newton

Note X. Postemployment Benefits Other than Pensions

Plan Description. The City of Newton administers a single-employer defined benefit health care plan. In addition to providing pension benefits, the City provides health and life insurance coverage for all retired employees and their survivors, including those retired under the Massachusetts Teachers Retirement System (MTRS). Health insurance coverage is provided in accordance with Massachusetts General Law Chapter 32.

Funding Policy. The City funds 80 percent of retiree health insurance premiums, including the reimbursement of 80 percent of Medicare part B premiums and 50 percent of a $5,000 term life insurance premium. For the fiscal year ended June 30, 2005, this expenditure totaled approximately $XX,XXX,XXX for 2,473 active employees, 2,429 eligible retirees and/or survivors. Plan members receiving benefits contribute 20 percent of their premium costs. In fiscal year 2005, total member contributions were $XX,XXX,XXX.

Annual OPEB Cost and Net OPEB Obligation. The City's annual other postemployment benefit (OPEB) cost (expense) is calculated based on the *annual required contribution of the employer (ARC)*. The City has engaged an actuarial firm to calculate the ARC and its overall OPEB liabilities. It has elected to increase its amortization of the unfunded accrued liability annually by 5 percent. The normal cost is expected to increase at the same rate as the assumed ultimate health care trend rate. The contributions were computed assuming that the contribution is paid on July 1, at the start of the fiscal year. The following table shows the components of the City's annual OPEB cost for the year, the amount actually contributed and changes in the City's net OPEB obligation:

Annual Required Contribution	$45,587,103
Interest on net OPEB obligation	X
Adjustment to annual required contribution	Y
Annual OPEB cost (expense)	45,587,103 + X + Y
Contributions made	Z
Increase in net OPEB obligation	45,587,103+ X + Y - Z
Net OPEB obligation – beginning of year	654,205,000
Net OPEB obligation – end of year	$699,792,103+ X + Y - Z

The City's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for fiscal year 2006 and the two preceding fiscal years were as follows:

SCHEDULE OF FUNDING PROGRESS

2.0% Discount Rate

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b)–(a)	Funded Ratio (a)/(b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll [(b)-(a)]/(c)
July 1, 2005	$0	654,205,000	654,205,000	$0	n/a	n/a
July 1, 2004	$0	520,494,247	520,494,247	$0	n/a	n/a
July 1, 2003*	$0	210,988,403	210,988,403	$0	n/a	n/a

* at 8.0%. The comparable values at 8.0% for July 1, 2005 and July 1, 2004 are $240,890,000 and $193,425,000 respectively

Funded Status and Funding Progress. As of June 30, 2005, the actuarial accrued liability for benefits was $654,205,000, all of which was unfunded. The covered payroll (annual payroll of active employees covered by the plan) was $XX,XXX,XXX and the ratio of the unfunded actuarial accrued liability to the covered payroll was XX.X percent.

The projection of future benefit payments for an ongoing plan involves estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required in the supplementary information following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Methods and Assumptions. Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the City and plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefits and costs between the City and plan members to that point. The methods and assumptions used include techniques that are designated to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

The following simplifying assumptions were made:

Retirement age for active employees. Based on the historical average retirement age for the City, active plan members were assumed to retire at age 65, but subject to provisions of the City's retirement system.

Marital status. Active participants are assumed to keep their current marital status upon retirement.

Mortality, Turnover etc. General Employees: Representative values of the assumed annual rates of withdrawal and vesting, disability, death and service retirement are as follows:

		Death		Service Retirement	
Age	Disability	Male	Female	Male	Female
25	.02%	.04%	.02%		
30	.03	.04	.03		
35	.06	.08	.05		
40	.10	.11	.07		
45	.15	.15	.11		
50	.19	.21	.17	1.0%	1.5%
55	.24	.30	.25	2.0	5.5
60	.28	.49	.39	12.0	5.0
62	.30	.59	.47	30.0	15.0
65	.30	.76	.58	40.0	15.0
69		.95	.73	30.0	20.0

Years of Service	Rates of Withdrawal
0	15.0%
1	12.0%
2	10.0%
3	9.0%
4	8.0%
5	7.6%
10	5.4%
15	3.3%
20	2.0%
25	1.0%
30+	0.0%

Deaths after retirement: The RP-2000 Healthy Annuitant Table. For the period after disability retirement, the RP-2000 Healthy Annuitant Table set forward two years is used.

Age	Disability	Death		Service Retirements
		Male	Female	
25	0.20%	.04%	.02%	
30	0.30	.04	.03	
35	0.30	.08	.05	
40	0.30	.11	.07	
45	1.00	.15	.11	1.0%
50	1.25	.21	.17	2.0
55	1.20	.30	.25	15.0
60	0.85	.49	.39	20.0
62	0.75	.59	.47	25.0
65	0.00	.76	.58	100.0
69		.95	.73	

Years of Service	Rates of Withdrawal
0	1.5%
1	1.5
2	1.5
3	1.5
4	1.5
5	1.5
6	1.5
7	1.5
8	1.5
9	1.5
10	1.5
11+	0.0

Police and Fire: Representative values of the assumed annual rates of withdrawal and vesting, disability, death and service retirement are as follows:

Deaths after retirement: The RP-2000 Healthy Annuitant Table. For the period after disability retirement, the RP-2000 Healthy Annuitant Table set forward two years is used.

Healthcare cost trend rate. The expected rate of increase in healthcare insurance premiums was based on projections by the City in consultation with its actuary. A rate of 9.5 percent reduced by half a percent per year to an ultimate rate of 6 percent was used.

Health insurance premiums. 2006 health insurance premiums for retirees were used as the basis for calculation of the present value of total benefits to be paid.

Inflation rate. The expected long-term inflation assumption was X.X percent.

Payroll Growth Rate. The expected long-term payroll growth rate was assumed to equal the rate of inflation.

Based on the historical and expected returns of the City's short-term investment portfolio, a discount rate of 2 percent was used. In addition, the projected unit credit was used. The amortization period is 30 years of the unfunded actuarial liability.[56]

Appendix C: The Evolution and Impact of OPEB Accounting Standards

OPEB costs are not new costs. Routinely, OPEB benefits have been offered to employees based on services rendered. Entities that have offered these pre-defined benefits have funded them and disclosed them in financial documents on a pay-as-you-go basis. Namely, the reported costs for non-pension benefits were recorded when paid to retirees and survivors.

Since 1967 with the release of Accounting Principles Board Opinion Number 12 *Omnibus Opinion*–1967, private industry has had to disclose the cost of benefits attributable to an employee's years of service with regard to deferred compensation. In March of 1980, the Accounting Principles Board's successor organization, the Financial Accounting Standards Board (FASB) released Statement 35, *Accounting and Reporting by Defined Benefit Pension Plans*. As the GASB had not been established yet, FASB required that governments apply Statement 35's provisions to its pension plans. Statement 35 had provisions to record accumulated pension benefits at actuarial value. Investments within these pension plans were to be recorded at fair value. However, Statement 35 had a fundamental flaw—it did not consider future changes in costs, particularly salary increases.

During the time that Statement 35 was implemented in 1980, many governments voiced their dissatisfaction with the FASB, arguing that it was unequipped to address the bankruptcy of New York City in the late 1970s and a number of other looming crises.. In 1982, FASB issued Statement 59, *Deferral of the Effective Date of Certain Accounting Requirements for Pension Plans of State and Local Governmental Units—an amendment of FASB Statement No. 35*, upon a request of the newly formed National Council on Governmental Accounting (NCGA). FASB addressed pension reporting through Statement 87, *Employers' Accounting for Pensions*. FASB moved ahead with changing pension reporting in 1985 with its landmark Statement 87, *Employers' Accounting for Pensions*, which fully incorporated actuarial assumptions and returns. Though it has been somewhat superseded, it was the foundation for the non-pension-related accounting and reporting of defined benefits that exists today.

In 1990, FASB finished the health care portion of benefits accounting in Statement 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*. FASB 106 is the basis for much of GASB Statement 45.

While FASB initially dealt with both private and public sector accounting issues, GASB was founded in 1984 to deal specifically with public sector accounting standards. Upon its creation, GASB immediately began to work on pension and OPEB standards. In 1990, GASB issued Statement 12, *Disclosure of Information on Post-employment Benefits Other Than Pension Benefits by State and Local Governmental Employers*. Though the accounting principles were not defined, disclosure was required of benefits provided and the accounting principles followed. Most governmental entities responded by disclosing their OPEB costs on a pay-as-you-go basis. GASB released their standards, GASB Statement 27 *Accounting for Pensions by State and Local Government Employers* in 1997 and GASB Statement 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments* in 1999. These two standards required full accrual accounting for pensions for the first time. Their adoption also signaled that the GASB was willing to tackle OPEB liabilities in the near future.

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