



City of Newport GASB Statement No. 43

Dan Sherman
Director, Consulting Actuary

January 7, 2009

explore
excellencesm

buckconsultants
an ACS company 

Background

- Other Post Employment Benefit (OPEB) refers to any post employment benefit other than pensions
 - Medical
 - Long-term Care
 - Dental
 - Vision
 - Life Insurance and Disability (if not in pension plan)
- Post-employment benefits are part of the compensation for services rendered by employees; i.e., they are part of an exchange transaction
- Benefits are “earned,” and obligations accrue or accumulate, during employment

Background

- Payment is deferred until after employment
- Last deferred expense to be addressed by Governmental Accounting Standards Board (GASB)

Disclosures

- Annual Required Contribution (ARC) is the amount to be expensed for the year
 - Determined in a similar manner as the Pension Appropriation, accept it is not required to be in the budget
 - Normal Cost plus amortization of unfunded accrued liability
- Accrued Liability
- Assets – Balance Sheet and Income/Expense
- Unfunded Accrued Liability
- 10 year history
- Accumulated differences between the ARC and actual contributions creates an additional liability or asset

Actuarial Valuation – Plans Offered

- The actuary needs to understand your benefits
 - Eligibility
 - Benefits
 - Cost Sharing
 - Grandfather provisions, if any
 - Carriers
 - Medicare coordination
 - Beneficiary continuation provisions
 - Deductibles and co-insurance
- Plan documents
- Summary Plan Description (material handed to employees)

Actuarial Valuation – Assumptions

- Same demographic assumptions as used for Pension Valuations
- Discount rate for “Pre-funded” basis would be about 7.5% (represents the expected long-term return on a new trust fund)
- Discount rate for current “Pay-as-you-go” basis would be about 4% (represents the expected long-term return on current cash and short-term investments)
- Healthcare cost trend rates, initially about 9%, ultimate of 4% to 5%
- Expected portion of active employees electing: e.g. 80%

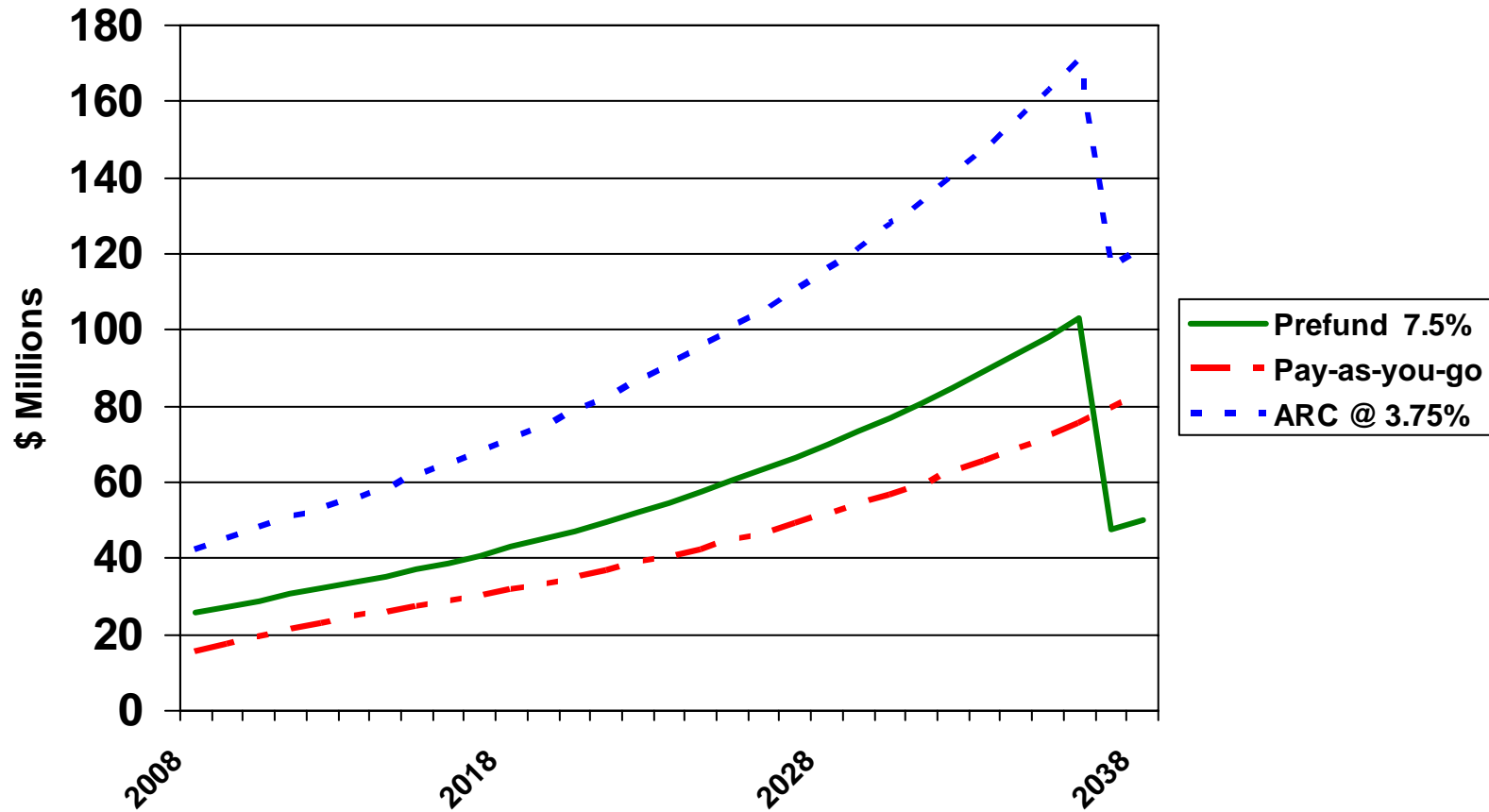
Disclosures – Pre-funded Approach

- Footnote Disclosures use a 7.5% discount rate assumption
 - Lower accrued liability and ARC
- If you fund less than the ARC then a Net OPEB Obligation (NOO) is created and placed on the balance sheet
 - This assumes you will increase the funding to be equal to the ARC over a short period of years
 - Contingent on the auditor agreeing with approach
- The following year, you would need to adjust the NOO with interest, amortization and for any differences between the new ARC and actual contributions

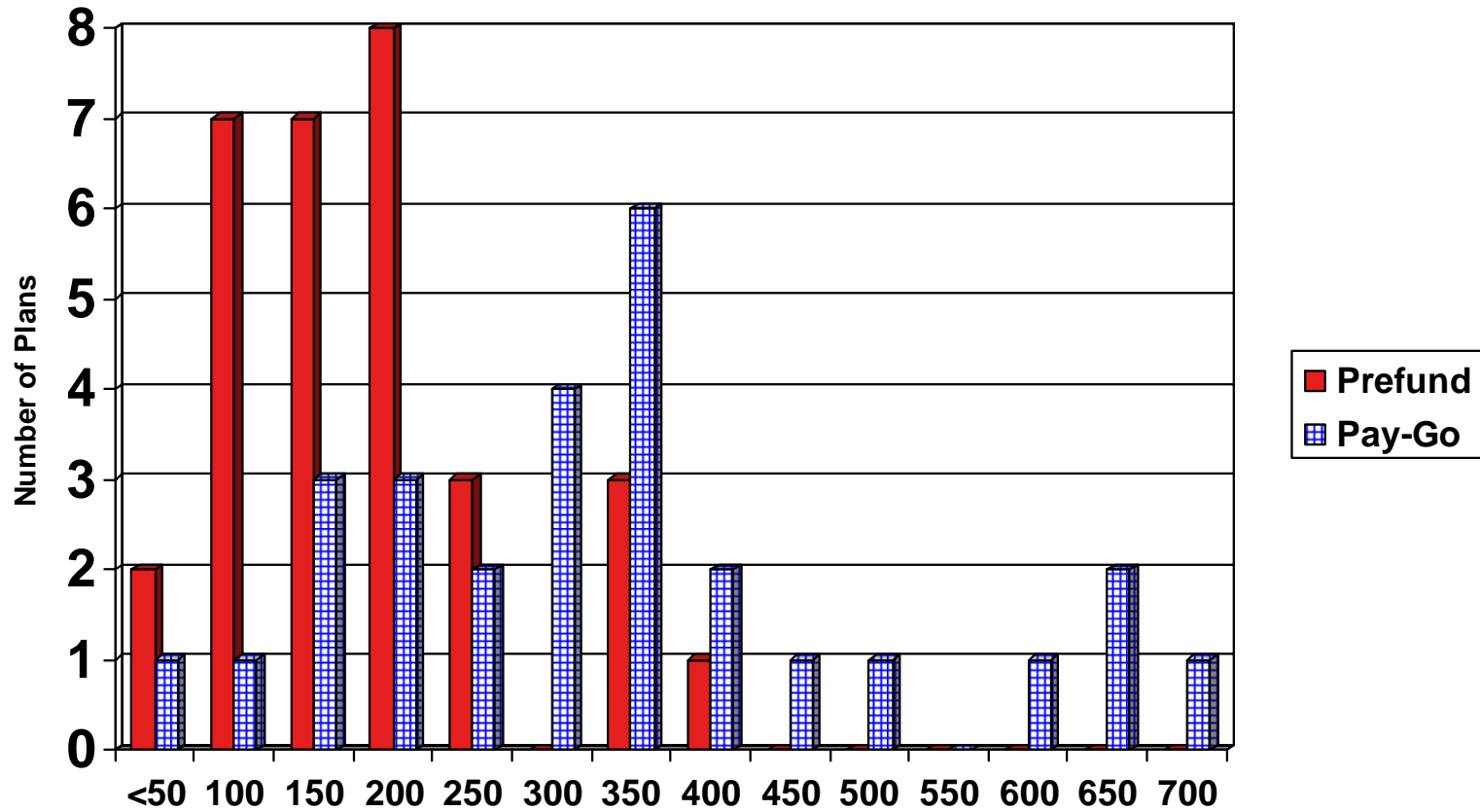
Disclosures – Pay-as-you-go Approach

- Footnote Disclosures at about 4% discount rate assumption
 - Much larger Unfunded accrued liability and ARC
- If you fund the Pay-as-you-go cost then a large Net OPEB Obligation (NOO) is created and placed on the balance sheet
- The following year, you would need to adjust the NOO with interest and for any differences between the new ARC and actual contributions

Sample ARC and Pay-as-you-go Forecast



Unfunded Liability as a % of Payroll



Prefund: 31 plans Pay-go: 28 plans

Pre-funding

- Advantages
 - More economical over time – investment returns will supplement employer and employee contributions
 - Increased security for employees and retirees
 - Helps maintain bond rating
 - Assists in budgeting – available assets act like a reserve to smooth large increases in medical costs
 - Keeps a new book liability under control
- Disadvantages
 - Higher short term cash outlay
 - Higher administrative costs
 - More complex

Pay-as-you-go

- Advantages
 - Lower current cash outlay
 - No administrative costs associated with a new separate Trust Fund
 - Easier to understand
- Disadvantages
 - No investment earnings to offset costs
 - Potential reduction in credit rating
 - Large Net OPEB Obligation on balance sheet
 - Maintains cost shifting to the next generation of tax payers

Expense and Balance Sheet Sample Entries

- ARC is entered on the Financials (not necessarily the budget) as an expense on the P&L
- Actual cash contribution is a credit against the ARC
- Net OPEB Obligation (NOO) is a Balance Sheet entry

Fiscal Year Ending	Annual Required Contribution	Interest on NOO	Amortization of NOO	OPEB Cost (1)+(2)-(3)	Actual Contribution	Change in NOO (4)-(5)	NOO Balance
2009	6,820	-	-	6,820	1,431	5,389	5,389
2010	7,150	189	293	7,046	1,605	5,441	10,830
2011	7,497	379	589	7,287	1,761	5,526	16,356
2012	7,860	572	889	7,543	1,955	5,588	21,944
2013	8,241	768	1,193	7,816	2,162	5,654	27,598
2014	8,640	966	1,501	8,105	2,293	5,812	33,410
2015	9,058	1,169	1,817	8,411	2,469	5,942	39,352

City of Newport

	Accrued Liability	Assets	Unfunded Liability
City	70,466,079	3,070,013	67,395,066
Library	1,871,742	81,573	1,790,169
Schools	<u>70,500,731</u>	<u>1,323,517</u>	<u>69,177,214</u>
Total	142,838,552	4,476,103	138,362,449

City of Newport

	Normal Cost	Amortization Cost*	Funding / ARC	Pay-As- You-Go
City	1,494,770	3,663,447	5,158,217	3,073,729
Library	70,962	97,310	168,272	44,336
Schools	<u>1,528,577</u>	<u>3,760,321</u>	<u>5,288,898</u>	<u>3,182,047</u>
Total	3,094,309	7,521,078	10,615,387	6,300,112

* Amortization over 30 years beginning in FYE07, with payments increasing 4.25% per year.

City of Newport - Forecast

Fiscal Year	Amortization			
<u>Ending In</u>	<u>Normal Cost</u>	<u>Cost</u>	<u>ARC</u>	<u>Pay-As-You-Go</u>
2009	3,094,309	7,521,077	10,615,386	6,300,112
2010	3,249,024	7,840,723	11,089,747	7,130,399
2011	3,411,475	8,173,954	11,585,429	7,946,604
2012	3,582,049	8,521,347	12,103,396	8,630,687
2013	3,761,151	8,883,504	12,644,655	9,060,839
2014	3,949,209	9,261,053	13,210,262	9,626,671
2015	4,146,669	9,654,648	13,801,317	10,172,442
2016	4,354,002	10,064,971	14,418,973	10,651,862
2017	4,571,702	10,492,732	15,064,434	11,227,177
2018	4,800,287	10,938,673	15,738,960	11,833,565
2019	5,040,301	11,403,567	16,443,868	12,472,705
2020	5,292,316	11,888,219	17,180,535	13,146,365

Challenges of Pre-funding

- A trust is required with provisions that the assets are used for the exclusive use of OPEB, and related expenses
- IRS rules include 3 mechanisms for establishing trusts on a tax advantaged basis
 - Voluntary Employee Benefit Association (VEBA)
 - Medical Accounts for Retirees
 - Government Trust under IRC Section 115 (Newport)
- Increases in appropriations sufficient to justify using the higher discount rate
- If you can not raise appropriations to the ARC, a discount rate between 7.5% and 4% would be required

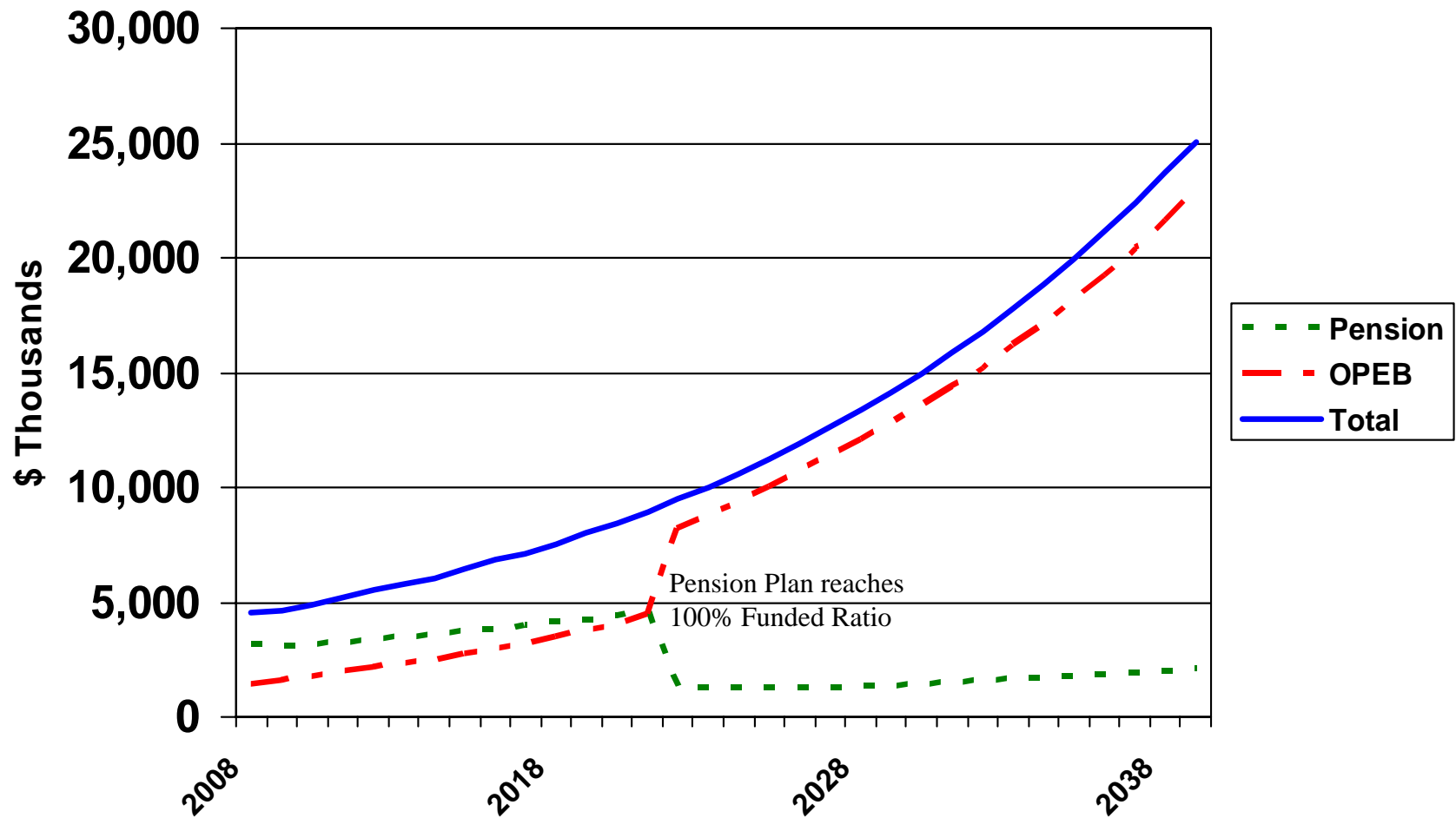
Challenges of Pre-funding – Section 115

- Governmental Trust is a trust that qualifies for exemption from Federal income tax under Section 115.
 - Established only for an essential government function and the income earned on the trust's investments have to accrue to the state or local government's benefit
 - A disadvantage to a governmental trust is that there is no explicit legal authority that addresses the use of the fund for the retiree health care obligation
 - However, Treasury Regulation 301.7701-1(a)(3) and several IRS Private Letter Rulings are favorable to using a Section 115 master trust to pre-fund OPEB obligations. The States of Minnesota and Vermont have established a trust for OPEB purposes.

Reactions across the Country

- Some States have already established trusts and are starting to pre-fund. A 2/17/06 report from California indicated 11 states have started pre-funding. For example, Ohio and Minnesota
- City of Gainesville issued OPEB bonds
- Benefit studies seeking to reduce the obligation, or at least keep it from rising as rapidly as in the past via multi-tiered plans
- Many are planning to shift the reductions in pension appropriations to OPEB when the pension plan reaches full funding

Sample Approach to Funding Both Pension and OPEB



Potential Plan Changes

- Increases in retiree co-share
- Increases in deductibles and co-pays
- Restricted availability
 - Must retire from the town with at least X years of service
 - If less than Y years of service with town, then a higher co-share by the retiree
 - No or reduced spousal coverage
 - Some plans no longer treat the retiree in the exact same manner as the employee
 - Eliminate plans
- Measuring the change in promise under GASB 45 provides insight to the value of the modifications

Q & A