

Florida Government Finance Officers Association 2009 Annual Conference

OPEB Treasures *Lessons Learned From Time Spent In The Trenches*

Wednesday, June 3, 2009
8:00 am – 9:40 am

PANEL DISCUSSION

Jennifer Manning, Budget Manager Martin County
Daniel O'Keefe, CPA, Moore Stephens, Lovelace, P.A.
James Rizzo, ASA, MAAA, Gabriel, Roeder, Smith & Company
Moderator: Doreen Lam, City Treasurer, City of Hollywood

1. Why did GASB make us do this?

One of many goals to the reporting model introduced in GASB Statement No. 34 is to report the financial position of governmental entities. To do this, all assets and all liabilities must be properly reported. With regard to OPEB, the rating agencies and the SEC were concerned that liabilities were not properly reported in government financial statements. One City, San Diego was determined to have an OPEB liability of over \$1 billion. In San Diego's 6/30/08 CAFR, they reflect an OPEB liability of approximately \$1.24 billion. Of this amount only 2.4% is funded. In addition, the City is funding only 50% of the Annual Required Contribution (ARC). The GASB believes that OPEB is part of an exchange of salaries and benefits for employee services rendered. There was one dissenting vote on the GASB. Paul Reilly objected to the statement for the requirement to account for health insurance premium rate differentials (implied rate subsidy) as OPEB when an employer otherwise provides no explicit OPEB benefits.

2. Are there different effective dates for smaller employers as compared to larger employers? What are the effective dates?

Governments are required to implement the provisions of GASB Statement No. 45 according to their size. Following the same parameters set forth in GASB 34, implementation would be required as follows:

- Phase I – 9/30/08
- Phase II – 9/30/09
- Phase III – 9/30/10

3. How generous are your OPEB benefits? What kind of subsidy do you provide (County and Sheriff)?

Very generous in comparison to other counties.

- Retired employees of the Board; Clerk of Court, Property Appraiser; Supervisor of Elections; and Tax collector who retire after 30 years of service or age 55 with 10 years of service that participated in our existing medical plan 75% of health coverage. Choice of single coverage or paying the difference for family
- IAFF employees and family is covered at 75%
- Sheriff subsidizes 75% or greater health care including family/dependents prior to 2001 after which 60% to 75% depending on years of service. Life insurance is subsidized at 50%

4. What data is required by the actuary?

- From the insurance company: census data on all members, claims data in total (and separately by retirees vs. actives if there are enough current retirees and their dependents for claims data to be credible), additional costs for self-insured health plans, and sometimes face value of life insurance for all actives and retirees
- From employer: premium rate charts, retiree plan benefits information, census data from employer's personnel/payroll system
- From the retirement plan (local plan or FRS): census data on all retirees regardless of whether covered and pension service credits for actives

5. How does our retirement plan affect these calculations and the data you need?

OPEBs generally begin when an employee retires (pursuant to the retirement plan).

- So we must know the retirement eligibility rules for early and normal retirement (including disability and sometimes death benefit eligibilities).
- We must know the pension service credits for all active employees in order to when they will become eligible to retire.
- We must apply actuarial turnover, disability, and retirement rate tables to know the likelihood that employees will retire at given ages, and mortality tables to know how long to expect retirees to live. These are generally the same tables used by the pension actuaries.

6. For the benefit of those who have not yet had their actuarial valuation completed, what can you tell us about how much work it took and where you had to collect the data?

- It was a significant amount of work, would recommend assigning a liaison to compile information needed by the consultant doing the actuarial reports. Try to avoid scrambling around at the last minute. "Get the ball rolling" send Data Request letter, Summary of Substantive Plan Provisions, get Rate Charts, Medical Data Request from medical carrier, Member Census Data, FRS data request information.
- Data collection:
 - Relying heavily on our IT department for reports
 - Accounting Department
 - 3rd Party Benefits Administrative Consultants & Insurance advisor
 - Human Resources department for any additional information
 - Insurance Providers

7. When is retiree life insurance an OPEB?

- If the employer pays all or a portion of the premium for retiree life insurance coverage, there is an explicit OPEB subsidy.
- If the retiree pays the group rate (usually between 20 cents to 60 cents per thousand), there is an implicit OPEB subsidy.
- Either way, data must be collected and the current and future subsidies must be actuarially modeled to develop the OPEB costs and liabilities.

8. Our life insurance is fully insured, of course, but our health plan is self-insured. How will that affect our actuarial work and our financial reporting?

- Self-insured health plans require additional data to be collected and additional work to develop the initial per capita costs as the baseline from which to make projections.
- The development of the "employer contribution" is very different and a lot more work for self-insured health plans than for fully insured health plans.

9. How do we select a discount rate?

- The overall rule is the same regardless of whether there is a qualifying trust fund paying the benefits and which is being fully funded each year or whether the benefits are pay-as-you-go out of the employer's general assets. It is the long-term expected return of the pool of assets that is expected to pay the benefits, taking into account the investment policy of that pool.
- So if there is a qualifying trust that is expected to pay the benefits for all time, then that trust's investment policy will drive the long-term expected return. This might be approximately 7% to 8% for a trust receiving the full annual required contribution from the employer each year.
- But if the benefits are simply paid out of the employer general assets, then the investment policy of the employer's own general assets drive the long-term expected return. This might be approximately 3.75% to 4.75%.

10. How long does it usually take to get our report?

That depends on how long it takes to collect all the data, complete and accurate. From beginning to end, we have seen it take a low of four weeks to a high of over a year.

11. With so much time between the valuation date and the reporting date, what happens if we make plan changes or if trends drop or we do an early retirement incentive program?

- If we know about any significant changes adopted before we complete the Report, we will incorporate them into the valuation.
- If significant changes occur after the report is completed but before the reporting date, GASB Statement No. 45 says a new valuation must be performed to fairly reflect the costs liabilities projected to the reporting date.
- If significant changes occur after the reporting date, they become "subsequent events".

12. Since you have unions, how have they factored into the OPEB liability?

- Our Fire Rescue contract allows employees to get full coverage for themselves and their dependents, which is subsidized by the County at 75%.
- Other uses for the valuation report:
 - The valuation report assisted us in realizing the costs in extending this additional benefit to the Fire Rescue staff's dependents.
 - The report can also assist management in decision-making during bargaining negotiations.

13. How was your experience with communicating all this with upper management and with elected officials?

- Making them aware of this liability was the prime objective; so far it has not created any adverse effect. Currently, their primary focus is dealing with major budget cuts from tax reform and property tax value decreases.
- When employees were asked how they would feel about a reduction in these benefits, they stated they would be very disappointed; but because of the fiscal realities, most felt it was better to have something in place, even if it were "slightly" lower.

14. How large was your Unfunded Actuarial Accrued Liability and your Annual OPEB Cost? J

| | Sheriff | BoCC, etc. | Total |
|-------------------------------------------------------|---------------|---------------|----------------|
| Unfunded Actuarial Accrued Liability (UAAL) | \$ 77,257,831 | \$ 91,943,682 | \$ 169,201,513 |
| Annual OPEB Cost (AOC; expense) | \$ 6,124,814 | \$ 7,664,123 | \$ 13,788,937 |
| Net OPEB Obligation (NOO; on Statement of Net Assets) | | | \$ 11,773,803 |

15. What are those numbers on a payroll or per-employee basis?

| | Sheriff | BoCC, etc. | Total |
|-------------------------------------------------------|------------|------------|------------|
| Unfunded Actuarial Accrued Liability (UAAL) | | | |
| Per Active Employee | \$ 152,082 | \$ 94,301 | \$ 114,094 |
| As a % of Expected Payroll | 254% | 180% | 208% |
| Annual OPEB Cost (AOC; expense) | | | |
| Per Active Employee | \$ 12,057 | \$ 7,861 | \$ 9,298 |
| As a % of Expected Payroll | 20% | 15% | 17% |
| Net OPEB Obligation (NOO; on Statement of Net Assets) | | | |
| As a % of Total Net Assets on Statement of Net Assets | | | 2% |

16. How does this liability affect the bond ratings?

We don't really know for sure. So far it has not affected us; but it could. We'll see.

S&P notes that "Postretirement liabilities are one of many factors we evaluate for a credit rating, and the liabilities' overall effect will be realized over time. We expect state and local government budgets to absorb the cost of these liabilities and address them along with other service costs. How they manage the liabilities, along with their capacity to fund these obligations annually--either on a pay-as-you-go or an accrual basis that includes payments for future benefits--will be an important element of our credit review."

17. What action steps can be taken to lower these costs and liabilities?

- Raise the retiree contributions or cut the benefits.
- Introduce a Medicare Advantage Plan to migrate retirees out of County and Sheriff plans.
- Establish a qualifying OPEB trust onto which the County and Sheriff would make contributions and out of which benefit subsidies would be paid.

18. What should we consider when deciding to pre-fund or not to pre-fund the OPEB liability?

- Is the entity primarily a business-type activity or a combination with governmental activities
- What is the outstanding publicly traded debt on the entities statement of net assets
- Does funding improve the financial condition of the entity
- What is the makeup of the entities OPEB liability, i.e. implicit rate and/or hard costs
- Will funding require a substantial increase in taxes or charges for services
- Could not funding the OPEB liability result in deficit net assets
- Would funding the OPEB liability reduce the entity's costs from trust fund earnings

19. What type of challenges is your county experiencing?

- External Factors
 - Property Tax reform
 - General Economic downturn of the country
 - Taxpayers desire to reduce government spending and not increase taxes
- Internal Factors
 - Elected Officials need to understand the liability requirement
 - Political pressures to reduce government but maintain level of service
 - Long-term revenue stream diminishing

20. How is your county funding OPEB?

- Internally designated funds instead of committing to an irrevocable trust.
- Incrementally adding cash each year
- Fiscal policy also designates remaining funds in our health benefit account to be added to OPEB internal account.

21. Even though the County had their actuarial numbers for year end, what other work was necessary to finalize your accounting entries?

For self-insured health plans, there is a lot of extra work at year end to develop the “employer contribution”. Claims paid/incurred, stop-loss reimbursements received/receivable, stop-loss premiums, administrative fees and other costs need to be collected for retirees for the fiscal year.

22. By the time you come in for the audit, the actuarial valuation has been completed. What happens if you find problems with the data used or the assumptions or the results?

Problems in the actuary report would be brought to the attention of management. Management would be asked to resolve the issues with the actuary and if necessary have a meeting between management, the actuary and the auditor. If necessary, the auditor might consider retaining a specialist to assist in evaluating the work of the plan actuary. If management is unable to resolve the issue, the auditor would need to consider the materiality of the matter to the financial statements. If material, the auditor would need to qualify their opinion regarding the disclosures and/or financial data presented.

23. As you look at the actuary’s report, what would send red flags up in your mind?

Some examples of areas that might be considered red flags include:

- Assumptions are contrary to historical data. For example, an actuary assumptions indicates that 75% of all employees will ultimately retire and participate in the entities health care plan upon retirement. Historical data indicates that only 25% of employees have retired and participated in the entities health care plan.
- The amount calculated as the unfunded accrued liability is either higher or lower compared to entities of similar size and demographics.
- Demographic information does not agree to other information obtained by the auditor during the course of the audit. For example, the actuary indicates that there are 250 full-time employees when in fact there are only 210.
- The projected earnings rate on investments appears to be either high or low.
- The provisions of the plan quoted in the actuary report are not correct.
- Required GASB disclosures are not presented in the actuary report.

24. How do you judge the reasonableness of the assumptions?

Because auditors may not have actuarial knowledge, they may rely on information provided by plan actuaries. As a result, AU section 336, *Using the Work of a Specialist* (AICPA, *Professional Standards*, vol. 1), will have particular importance to the auditor of state and local government financial statements. Some sample procedures the auditor should consider include the following:

- Obtaining an understanding of the actuary's objectives, scope of work, actuarial methods, actuarial assumptions, and source and calculation methodology of health care cost trends within the acceptable parameters of the GASB statements.
- Making appropriate tests of data provided to the actuary by considering the reliability and completeness of the plan census data and source of discount rates used.
- Evaluating whether the actuary's findings support the related assertions in the financial statements by understanding what benefits are included in the substantive plan, the policy for contributions, and how plan investments are valued.

25. What data testing do you perform?

The census data provided to the actuary by management would be tested for accuracy. Auditors must understand that actuaries are relying on the accuracy of information provided by management. They do not perform audit procedures to verify the accuracy of the information. If the information provided to the actuary is incorrect, their report will be inaccurate.

26. Some lessons learned? Jennifer, Dan, Jim --- Wrap-Up

Jennifer ---

- Understanding the requirements
- Time involved
- Ensuring liability is recorded correctly
- Reporting the correct Annual Required Contribution (including Stop Loss)
- Get reports Early
- Know what is required for your county.

Dan ---

Jim ---

- Appoint one person in finance as the quarterback.
- Hire an experienced and qualified actuary; not necessarily the lowest price.
- Get started early, for the initial and subsequent reports.
- For generous plans, consider:
 - Raising retiree contributions or cutting benefits in order to ensure sustainability and
 - Establishing a qualifying OPEB trust.