



April 2, 2008

**PERSONAL AND CONFIDENTIAL**

Mr. Petter Turnquist  
Business Administrator  
Warren County School District  
185 Hospital Drive  
Warren, PA 16365-4885

**RE: Proposal of Actuarial Services**

Dear Mr. Turnquist:

It was good to meet you at the PASBO conference. Thank you for requesting a proposal for actuarial services for the district. I have attached our proposal, which explains the possible services being requested by the district, a summary of our understanding of the benefits to be included in the project, and fee quotes for the services. If you find that the services or benefits have not been accurately described, you can contact me and I will provide you with an updated or supplemented proposal.

If you weren't aware, Mockenhaupt Benefits Group has been a Business Associate Member of PASBO and a Service Associate Member of PSBA since 2004. While school districts have only recently had a need for the services of an actuarial firm due to new disclosure requirements under GASB, most other Pennsylvania local governments have been employing actuarial firms for many years to calculate and certify the costs of their locally sponsored pension plans.

We currently provide actuarial services to hundreds of boroughs, townships, cities, school districts, counties, authorities and regionals/COGs across Pennsylvania, including your neighbor, the City of Warren.

Please feel free to call me with any questions you may have. I would be happy to meet with you and any other district representatives in person to review the proposal if you would like. I look forward to hearing from you.

Sincerely,

Colleen A. Deer  
Vice President

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# Warren County School District

## Proposal for Actuarial Valuation of Retiree Medical Benefits For Compliance with GASB Statement No. 45 prepared by Mockenhaupt Benefits Group

### Overview of Valuation Report:

We will prepare an actuarial valuation that will present the liabilities and costs of the employer-paid “other post employment benefits” (OPEB) under the newly issued Statement No. 45 by the Governmental Accounting Standards Board. The valuation will provide the district with the estimated Actuarial Accrued Liability, actuarially required contribution (ARC) and OPEB expense of the retiree medical program and any other benefits provided to retirees. We can provide the valuation results under multiple assumptions or scenarios if desired (explained below).

### Information and Data Needed and Method of Data Transfer:

To prepare this report, we will need the following plan information (unless already provided):

- Benefit Summary or Contract Provision explaining OPEB coverage provided, eligibility requirements, and benefit amounts
- Type of Medical Plan (HMO, PPO, Indemnity, etc.)
- Basic Pension Plan information, such as retirement age and service requirements
- Current Premium Rates charged for plan covering retirees
- Any other benefits provided to retirees by district, such as life insurance, vision or dental coverage, retirement incentive, sick day buyback

We will need the following demographic information for actives and retirees as of the beginning of the current plan year:

- Name
- Date of Birth
- Date of Hire
- Sex
- Employee Group (teacher, administrator, secretarial, custodial.)
- Employment Status – Active, Retired or deferred
- Current Coverage Selected (single, family, h/w)
- Date of Retirement (if applicable)
- Spouse Date of Birth\*

\*for retirees eligible for dependent coverage only

### Assumptions and Options:

#### Interest Rate

We can prepare the valuation under two different interest rate assumptions. One will be based on the interest rate assumption used for a “pay as you go” plan, which is how the plan is currently administered, and the other as if you pre-funded the retirees’ health care costs. Typically the costs are quite different. This information could be used to consider whether the plan should be pre-funded.



### Breakdown by Employee Group

Our valuation will show the liability for all employees of the district by employee group, and in the aggregate.

### Other Assumptions

We may request feedback from the district in order to develop the other assumptions that we will use to calculate the liabilities. Such feedback may be related to retirement patterns and opt-out experience.

### **Proposed Fees:**

<b>Service</b>		<b>Fee</b>	<b>Authorization</b> (enter "✓" & initials)
<b>1</b>	<b>Actuarial Valuation Report</b> ( <i>aggregate liability for all district employees and retirees of medical benefits; assumes electronic data transfer with little or no manual data entry; results displayed in total and by EE group</i> )	<b>\$5,500</b>	
<b>2</b>	<b>Include separate results for hypothetical "funded" plan</b>	Add \$200	
<b>3</b>	<b>Manual data entry (if necessary) of census and individual retiree contribution amounts</b>	Add \$110/hour	

### **Certification and Authorization**

If any adjustments or changes to the above fees or services become necessary due to unforeseen circumstances, the party requesting the change, whether Mockenhaupt Benefits Group or Warren County School District, will notify the other party of the change and obtain consensus before proceeding further.

As the authorized representative of the Warren County School District, I hereby authorize the projects and services indicated by a check (✓) above to be provided by Mockenhaupt Benefits Group at the corresponding fee.


\_\_\_\_\_  
Warren County School District representative signature


\_\_\_\_\_  
Date

\_\_\_\_\_  
Print Name

\_\_\_\_\_  
Title

As the authorized representative of Mockenhaupt Benefits Group, I hereby offer to provide the projects and services indicated in this proposal at the fees indicated.

  
\_\_\_\_\_  
Mockenhaupt Benefits Group representative signature

  
\_\_\_\_\_  
Date

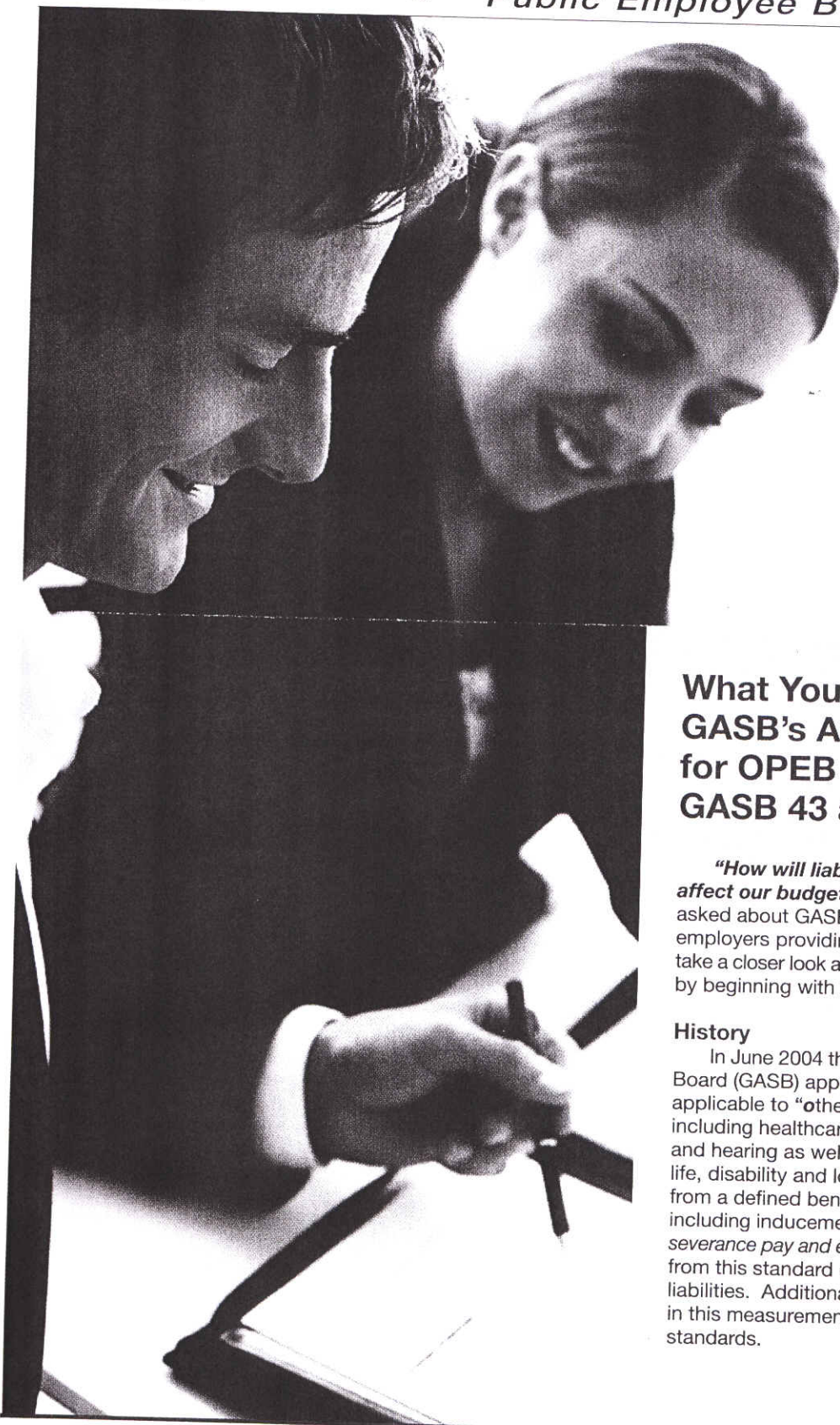
  
\_\_\_\_\_  
Print Name

  
\_\_\_\_\_  
Title

By William C. Asay, CEBS  
President  
(412) 394-9332  
[bill.asay@MBGbenefits.com](mailto:bill.asay@MBGbenefits.com)



Bill Asay, CEBS, is a public pension plan expert having worked in the industry for close to three decades. As President and Chief Operating Officer of Mockenhaupt Benefits Group, he and his team service over 500 municipalities annually. Bill is a frequent speaker on issues relating to the design and administration of retirement programs and has written numerous articles on public pension plans and retiree medical plans. He is a member of the International Society of Certified Employee Benefit Specialists and the International Foundation of Employee Benefit Plans.



## What You Need to Know About GASB's Accounting Standards for OPEB Benefits: GASB 43 and GASB 45

***"How will liabilities from our retiree medical plan affect our budgets?"*** This is a common question often asked about GASB 45 from Pennsylvania governmental employers providing retiree healthcare coverage. Let's take a closer look at this question and determine the answer by beginning with some background...

### History

In June 2004 the Governmental Accounting Standards Board (GASB) approved the final accounting standards applicable to "other postemployment benefits" (OPEB) including healthcare benefits like medical, dental, vision and hearing as well as non-healthcare benefits such as life, disability and long-term care if provided separately from a defined benefit pension plan. Termination offers, including inducements to terminate employment (*such as severance pay and early retirement incentives*) are excluded from this standard unless they affect the OPEB benefit liabilities. Additionally, pension benefits are not included in this measurement because they are covered by other standards.

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The two GASB statements affecting OPEB benefits are:

**GASB 43** Financial Reporting for Postemployment Benefit Plans other than Pension Plans

**GASB 45** Accounting and Financial Reporting By Employers for Postemployment Benefits other than Pension

### Current Funding

Most Pennsylvania OPEB benefits, as well as those across the country, are funded on a "pay as you go" basis. What this means to most governmental employers is that they pay the current premium, or portion of the premium, based on various agreements made with their employees over the years. Unless employers complete a study to measure liabilities during negotiations, officials typically have no idea what the actual benefits cost may total. Over the years, many elected officials have said that the only liability they were concerned with was the premium necessary for the following year in order to finalize their budget. The GASB does not require OPEB benefits to be funded like a pension plan; however, keep in mind that the liabilities **must** be measured whether the governing body wishes to continue to fund the benefits on a "pay as you go" basis or pre-fund the plans.

### Actuarial Valuation

GASB's primary objective is to ensure that the long-term cost of retiree health care and non-health care benefits be determined on an actuarial basis. Many of the assumptions and variables used in your pension plan actuarial calculations are also used in your OPEB studies. However, the tools are specific to health care plans. For employers with 100 or more total members an actuarial valuation would be done to calculate the "annual required contribution" (ARC). For employers with fewer than 100 members an alternative method is also allowed.

### Substantive Plan

Typically, one of the biggest challenges is to determine the "Substantive Plan," the plan as understood by both the employer and plan members. Governmental

employers have granted benefits through many means including collective bargaining agreements, individual negotiations, arbitration awards and others.

Often, benefits for a single employer have been granted through various union contracts where plan specifics differ from contract to contract. Another problem is when municipal collective bargaining agreements (CBA) don't contain enough detail to properly interpret the plan. For instance, I have seen many municipal CBAs that have included language such as, "The Borough agrees to pay healthcare for retirees and spouses at retirement" or "The Township agrees to pay Blue Cross benefits until age 65." The CBA doesn't include

specific eligibility requirements or restrictions. In both of the examples, the CBA doesn't say if it only pertains to Normal Retirement retirees or to all retirees. Would vested deferred participants or disabled participants begin to receive a benefit when retirement commences? Would early retirement retirees be eligible when they begin to receive retiree payments? Would it be restricted to medical insurance or would vision and dental also be

included?

A specific benefit structure must be included in the Substantive Plan in order for it to be properly valued and the OPEB accounting requirements be met. I'd suggest that the employer take this opportunity to formalize each separate commitment in a formal plan document, specifically the terms of the plan as understood by the employer and the members. This action will lead to smoother administration and fewer future legal expenses.

### Implicit Rate Subsidy

Another area typically misunderstood is what the GASB refers to as the "implicit rate subsidy" - the cost difference between an active and a retired member's rate. Most employers who cover active and retired employees under the same plan are charged the same premium for all members. If the retiree must reimburse the employer for the cost, the premium is usually based on the same schedule. *(The retiree group will generally be older than the corresponding active member group.)*

It is commonly understood that average yearly claims for most health insurance coverage increase as age increases. Older members tend to use the health care system more often and their individual claims may tend to be more expensive. The OPEB valuation is required to recognize the estimated difference between the rates that would apply if only active members were covered and the rates that would apply if only retired members were covered. In essence, even if the retiree is paying the full premium determined on a combined basis, the employer may have an OPEB liability because of the implicit rate subsidy. Your specific situation will determine the potential liability.

### What does the actuary calculate?

Actuaries typically calculate:

- **Past Service Liability** - The accrued liability for benefits earned prior to the valuation date (the unfunded amount is amortized over a period of up to 30 years).
- **Current Normal Cost** - The current year's cost.
- **Future Service Liability** - The anticipated cost for future years

However, the annual accounting cost will only include the Normal Cost and the amortization of unfunded Past Service Liability.

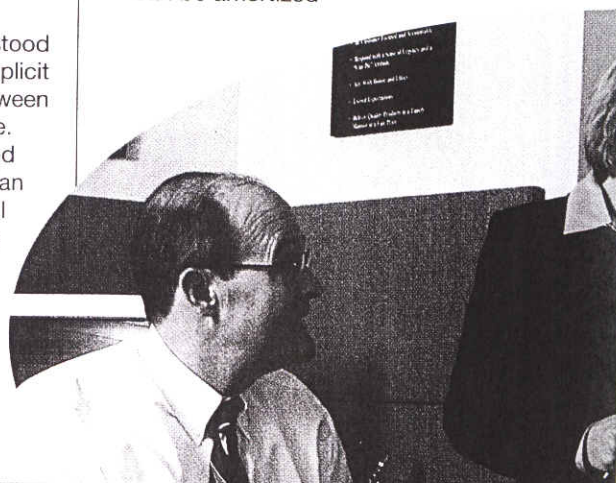
### What does all of this mean?

To help illustrate calculations, I'll provide the following example: Tom and Mary had a son; they plan for him to attend the university of his choice after high school graduation. They estimated and calculated the tuition (*liability*) needed to be \$180,000.

Tom and Mary never begin to fund this plan; and, after 10 years, they calculate the liabilities like GASB 45. Their child is now 10. Since nothing has been saved, this college program was on a "pay as you go" basis of accounting. As of Jan. 1, 2007 the program would be:

- **Past Service Liability** - \$100,000 which can be amortized

**"GASB's primary objective is to ensure that the long-term cost of retiree health care and non-health care benefits be determined on an actuarial basis."**





- **Current** Normal Cost - \$10,000
- **Future** Service Liability - \$70,000
- Tom and Mary's Annual Expense is the amortization of the past service liability + the Normal Cost.
- Funding this amount on an annual basis would be a reasonable way to ultimately reach their goal.

Obviously Tom and Mary are not required to fund this liability until the tuition is due ("pay as you go"), however, their unfunded liability will continue to increase each year and their credit rating could suffer.

The OPEB valuation, although infinitely more complicated than the example, would reflect the funding status of the plan and reflect the liabilities, at a specific date. Although GASB 45 does not require the employer to pre-fund the liabilities, it does require the calculations to be made. The employer's financial statement will disclose an annual expense determined as if the Annual Required Contribution (ARC) is made, along with a liability for any accumulated net deficit. That liability will grow as long as the ARC exceeds the "pay as you go" amount. In addition, should your entity wish to consider the issuance of bonds in the future, the rating agencies will require this information.

### Funding Mechanisms

It is always beneficial to fund plan members' OPEB benefits at the time the benefit is earned. However, this has not been the custom. Pre-funding the benefit does more than just match funding to the benefit earned. The assumed valuation interest rate will have an impact on the total benefit cost. If you fund the plan on a "pay as you go" basis, the valuation interest rate used will reflect only rates available for the employer's general investments and will typically result in a much lower rate of return than allowed for a funded plan. If the plan is funded and you are able to set a long term investment strategy, expected long term rates of return should be higher and may therefore be assumed.

If an employer is pre-funding some or all of the liabilities and it would like to benefit from the difference between short and long-term interest rates, the assets must be in an OPEB qualifying trust or equivalent arrangement. To qualify under GASB 43 there must be an agreement between plan members and beneficiaries through the substantive plan in which:

- Employer contributions to the plan are irrevocable.
- Plan assets are dedicated to providing benefits to their retirees and beneficiaries in accordance with plan terms.
- Plan assets are legally protected from employer or plan creditors.

It is essential that the employers or persons involved in the above functions serve in a fiduciary capacity and act accordingly.

The different investment mechanisms emerging lend various degrees of comfort in their compliance with the requirements of GASB 43. Voluntary Employee Benefits Association (VEBA), under IRC § 501(c)(9), appears to be a safe alternative. A few governmental employers are also considering IRC § 115 trust. Although these integral governmental trusts may offer an alternative, there continues to be some question as to whether they comply with the requirement of GASB 43. If you intend to pre-fund your OPEB benefits be sure to retain a qualified advisor and consult your solicitor. You may also want to carefully scrutinize the investments being offered in conjunction with your applicable state codes before determining an investment strategy.

### Implementation Dates

Most of the employers reading this newsletter will represent single employer plans. Their required schedule for GASB 45 implementation is:

Annual Revenues in the First Fiscal Year Ending After June 15, 1999	Effective for Fiscal Years Beginning After
Phase 1 \$100 Million or more	Dec. 15, 2006
Phase 2 \$10 million or more, but less than \$100 million	Dec. 15, 2007
Phase 3 Less than \$10 million	Dec. 15, 2008

The Government Accounting Standards Board encourages the early implementation of the standards. It also makes sense to have the

liabilities calculated if you are negotiating a collective bargaining agreement prior to the required dates.

### Defined Benefit v Defined Contribution

Most of this article has dealt with employer plans that are of a defined benefit in nature. GASB 43 and 45 do include requirements for defined contribution plans, but the affects are limited, and actuarial valuations are not required.

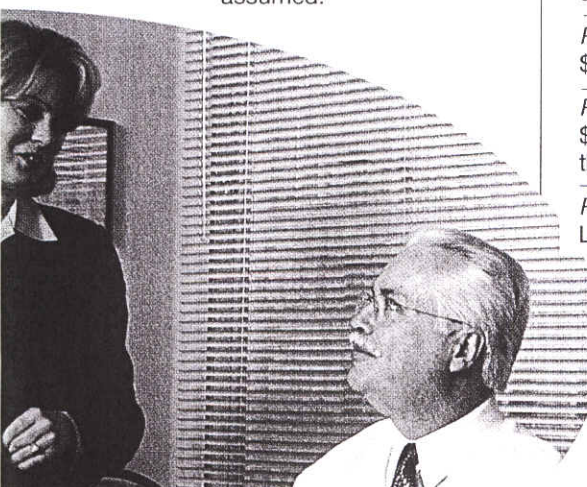
### Cost Control Methods

Placing cost controls on your plans may be very painful, and changes may cause employee concern. However, it is important to consider cost containment options. Plan structure must be analyzed very carefully to determine what changes are important to both the employer and employees. Some areas that may be reviewed include:

- Pre-funding of the plan to enable the use of long-term interest rates. We have discussed this method previously.
- Reducing the cost of the current benefit offering. This would include cost shifting measures such as raising deductibles, co-insurance, co-payments, and out of pocket limits; redesigning the prescription benefit to integrate with Medicare Part D; and many others.
- Modify eligibility for current and/or future employees. This would include such things as increasing the years of required age, service or both to receive a benefit. You may consider a change in the benefit duration.
- Limit or eliminate benefit programs for future retirees or benefits for future hires.
- Change from a defined benefit to a defined contribution program.

Since Pennsylvania municipalities administer their own pension benefit structures independently from a statewide system, they must realize that some pension benefit changes can have a direct impact on their OPEB cost. Benefit changes like reducing the normal retirement age and adding an early retirement benefit could provide the municipality with a very large unintended consequence.

Obviously, altering the benefit structure is problematic and must conform to Pennsylvania labor laws. You should involve your solicitor, labor attorney, actuary and healthcare professionals before altering any of your plan provisions.





## Mockenhaupt Benefits Group...Your Long-Term Partner in Planning

Mockenhaupt Benefits Group understands the business of public employee benefits...and, we should since we've been assisting local government clients with their needs for over 40 years.

*In fact, we service over 500 municipalities and more public employee pension plans than any other consulting firm headquartered in Pennsylvania.*

We also employ the most experienced consultants in the industry and are often called upon to provide pension seminars for the state and various associations throughout the commonwealth.

Our clients also quickly find that our treatment is personal. When you partner with us, you'll receive a dedicated consultant who knows the laws and regulations applicable to Pennsylvania governmental plans and insurance programs. We pride ourselves on our experience, knowledge of public employee benefits and personal service.

We also understand that managing plans isn't your only concern. That's why you can rely on us to handle your questions, problems, administrative responsibilities and legislative changes. And, because our costs are much more affordable than many of our competitors, you'll save money, time and stress by depending on us.

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# Newly Issued Accounting Standards for Postemployment Benefits other than Pensions

By Herb Loomis

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## Introduction

In August, the Government Accounting Standards Board (GASB) released **Statement #45, Accounting and Financial Reporting by Employers for Postemployment Benefits other than Pensions (OPEB)**. This new standard will affect the reporting and disclosure requirements of state and local government employers providing non-pension post-employment benefits such as retiree health and life insurance. Government employers providing post-retirement health insurance will typically show a significant cost increase in annual financial statements. In many instances, the difference will be dramatic.

## Effective Dates

The effective date of GAS #45 depends upon the governmental employer's revenues (*earlier implementation is encouraged*):

Annual Revenues	Effective for Fiscal Years Beginning After
At least \$100 Million	Dec. 15, 2006
From \$10 Million to \$100 Million	Dec. 15, 2007
Under \$10 Million	Dec. 15, 2008

These dates allow time to prepare for compliance; however, employers should now begin to have the cost effects analyzed and to consider appropriate action to optimally manage plan costs. Employers should especially be aware of the cost implications when plan changes are being negotiated.

## The Significance of GAS #45

The basic principle underlying the new standard is that post-employment benefits represent a form of deferred compensation for employee services rendered.

This premise leads to the concept that the cost of OPEB should be assigned to the period in which the services occur rather than with the later periods, after retirement or termination, during which the benefits are provided. The same concept underlies the existing standard for pensions, GAS #27, Accounting for Pensions by State and Local Government Employers. Accordingly, it is no accident that GAS #45 for non-pension postemployment benefits parallels in many respects the pension standard.

However, government employers with significant levels of OPEB coverage will typically see a much greater change in the amount they must recognize as the "Annual Required Contribution" (ARC) because most OPEB benefits are currently funded and expensed on a pay-as-you-go basis.

By contrast, at the advent of GAS #27 in 1998, state and local government pension plans were already typically being funded based upon the results of actuarial valuation methods that spread the cost over employment service. Applicable minimum funding requirements and GAS #27 standards were often so compatible that the ARC used in expense determination could be the same as the minimum funding requirement. This will not be the case with unfunded OPEB plans.

## Required Valuations

Periodic actuarial valuations will generally be required to determine the appropriate expense amount and required disclosures. A valuation at least every two years will be required for a plan with at least 200 members (*active, deferred and retired*). Plans with less than 200 members will need a valuation at least once every three years. A more frequent valuation may be necessary if factors such as design changes with a potentially significant effect on plan costs occur. An alternate measurement method in lieu of an actuarial valuation is available for plans with less than 100 members. Though GASB describes the method as "simplified" and "potentially usable by nonspecialists," the calculations are quite complex. The

illustration of the method in Appendix F to the standard takes up 17 pages.

The permitted actuarial cost methods are the same as for GAS #27. Likewise, the parameters regarding selection of assumptions and amortization patterns are very similar, except for additional assumptions such as health care cost trend rates, which do not affect pensions. It is important to note, however, that if an employer with OPEB also sponsors a pension plan, the standard does not require the same actuarial cost method be used for both. This allows employers and their advisors more flexibility at arriving at a suitable approach. If an OPEB Plan is funded, and the funding requirements comply with the parameters required for determining OPEB costs under GAS #45, the same method is to be used for expensing and funding.

## To Fund or Not to Fund

The advent of the standard may suggest a fresh evaluation of whether OPEB benefits should be pre-funded rather than on a pay-as-you-go-basis. Because pay-as-you-go contributions will generally be smaller, often much smaller, than the annual OPEB cost, a net OPEB obligation liability will gradually be built up. The size of the Net OPEB Obligation in the financial statement disclosures could affect bond ratings and the cost of borrowing.

But this is not the only reason to consider pre-funding. The annual OPEB cost is likely to be considerably higher for an unfunded plan than for a funded plan with the same benefits because of the required basis for selecting the investment return (discount rate) assumption. The standard requires that the investment return assumption be the estimated long-term yield on the investments used to finance the OPEB. Where no assets are being accumulated, the required rate is the expected return on employer assets, which are usually limited to fixed-income investments of short duration. On the other hand, if the employer is contributing the

(CONTINUED ON PAGE 2)



## ACCOUNTING STANDARDS

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annual required contribution to an irrevocable trust, the expected rate of return on plan assets can be used. Assuming that plan assets were invested in a diversified portfolio similar to a pension plan, the investment return assumption could be higher. A higher investment return assumption leads to a lower actuarial cost and a lower annual required contribution (ARC) under the accounting standard.

### Employer-Provided or Subsidized Benefits

The standard relates to plans where the employer covers all or part of the cost of the benefits, not coverage fully paid by retirees. But be aware that an employer may have an OPEB cost under GAS #45 for a post-retirement plan even where the retiree is charged the "full" premium! This can happen if active and retired employees are

covered by the same health plan and the premium charged is calculated based upon the overall experience of the group rather than the experience of retirees only. In this case, the employer will generally be subsidizing the cost for the retirees who elect coverage because health care expenses typically increase by age. Because retirees will be older in age, on average, than active employees, annual retiree claims will typically be higher than active member claims. As a result, premiums for insurance covering both active and retired employees will be higher than if only actives were covered. GAS #45 will require that the subsidy be estimated and included in the determination of OPEB cost.

### GAS #43 Changes Plan Accounting

Funded (*but not unfunded*) OPEB plans will also be affected by **Statement #43, Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans.**

This is a companion statement to GAS #45 much in the same manner that GAS #25, covering reporting by Pension Plans, was to GAS #27. Statement #43, only applies to plans being funded through trusts or other third-party arrangements. For example, pay-as-you-go arrangements, or the accumulation of assets that are not irrevocably committed to providing postemployment benefits would not be subject to this separate standard. At the current time, local government employers generally are not prefunding health or other postemployment benefits and would not be subject to Statement #43. However, GAS #45 may very well result in more employers deciding to prefund at least a portion of the cost in the future. The effective dates for GAS #43 are exactly one year earlier than for GAS #45.

## LEGISLATIVE UPDATES

### 2003-2004 Legislative Session Wrap Up

The most significant legislation passed this session relative to pension funding, was Act 81 of 2004, which authorized filing revised 2003 actuarial reports to increase the amortization period for investment losses incurred in 2001 and 2002. The filing deadline for the revised reports was September 30, 2004. Those reports could be used to reduce the MMO payments for 2005 and 2005. Act 81 also increased the amortization period for actuarial losses resulting from killed-in-service benefit entitlements.

Act 43 of 2003 was passed in December 2003, reducing the service requirement for vesting in County pension plans to five years and adding two new class options (benefit multipliers).

Several other pension-related bills were passed in the last week of the legislative session. Act 169 of 2004 was signed into law on Nov. 29, 2004 amending Act 15, the Pennsylvania Municipal Retirement System (PMRS) law. This was a much anticipated

change to the PMRS rules regarding the mandatory participation of permanent part time employees in the retirement system. Municipalities will now be permitted to elect whether or not to include part-timers, and provisions were established to handle existing part-time employees for plans currently participating in the system.

Two bills passed that amend the state domestic relations law and could impact on governmental pension plans. Act 144 of 2004 abolishes common-law marriages contracted after Jan. 1, 2005. This could affect surviving spouse death benefit entitlements in certain plans. And Act 175 of 2004 adds language specifying the method for determining the marital portion of benefits under defined benefit pension plans. This new language may provide much needed guidance in preparing Domestic Relations Orders in divorce proceedings.

The State Securities Act was amended by Act 128 of 2004, which essentially provides for municipal pension plans under Act 205 to be under the same rules as public school districts regarding Prohibited Advisory Activities and Prohibited Transactions.

Many were surprised that the DROP legislation (HB 2269) did not pass. The House passed HB 2269 on June 29, 2004, but the bill died in the Senate at the end of the session without ever coming out of committee. The bill would have amended Act 205 of 1984, authorizing what are referred to as DROP (deferred retirement option provision) plans, statewide for municipal pension plans. DROP plans allow retirement-eligible participants in defined benefit plans to "retire" from the plan, but continue to work while their monthly retirement benefit checks are set aside for them in the plan. Then when they actually leave employment, they begin collecting the monthly check, but also receive the payments that accrued during the DROP period in a lump-sum. This is the second legislative session that this bill has failed to become law.



# Retiree Medical Liabilities May Soon Hit Your Financial Statements Like a "Ton of Bricks"

By Colleen A. Deer

Senior Consultant

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If you offer medical benefits to your retirees, you may not want to postpone your actuarial study until the required implementation date under GAS #45. If you do, you may be surprised when you receive your first audit report with the new disclosure (see *Newly Issued Accounting Standards for Postemployment Benefits other than Pensions*). The liabilities, which in most cases, have no offsetting assets, will likely be far greater than most employers anticipate.

## Benefits of Early Assessment

The benefits of early assessment of Other Post-Employment Benefit (OPEB) liabilities far outweigh the false sense of financial security some may find in putting off the inevitable. The most pressing reason to calculate OPEB costs and liabilities now is for negotiating purposes. The true cost of retiree medical benefits, for example, has been largely ignored or overlooked as part of employee benefit packages. With the pending requirement to report this future liability as a cost that accrues over an employee's working career, like pension costs, it is critical that both sides of the bargaining table acknowledge it as such.

Governmental employers, including local governments, counties, school districts, authorities and states, have an opportunity to make a preliminary assessment of their OPEB costs and perhaps implement cost-containment or even cost-saving measures before the formal actuarial valuation is prepared for GAS #45 implementation. Certainly these measures can be achieved in negotiations through cost-sharing arrangements and benefit limitations. However, simply incorporating a more detailed explanation of benefits, eligibility and coverage into the written document or contract can help avoid expensive unintended benefit costs. Unclear OPEB documentation also makes it difficult for the actuary to make a projection of the benefit costs.

## Discrepancies in the Interpretation of Retiree Medical Benefit Coverage

Let's say a contract simply states that "The employer will continue to pay

premiums for an employee's medical benefits after retirement until Medicare eligibility." Presumably, "retirement" refers to when the employee retires under the eligibility requirements in the employer's pension plan. If employees can retire at age 55, the expectation is that the employer would be obligated to pay for the employee's health insurance for a maximum of 10 years. Ten years of health insurance premiums for each retiring employee would be relatively expensive. But, consider the possible other entitlements that may also be expected under this somewhat vague benefit provision. If the pension plan has a provision that allows employees to elect early retirement at age 50, they may believe that their medical benefits would be covered from age 50 to 65 if they retire early. The same could be assumed for disability and deferred vested retirees leading to many more years of medical coverage than expected or intended. Might an employee believe that the continuation of premiums would be at whatever coverage (single, family or husband/wife) the employee was under before retirement? What if the employer changes providers or plans after an employee retires? Does this language preclude the employer from moving retirees to the new plan? And, does "Medicare eligibility" mean when the employee becomes eligible, or could it be interpreted that if the spouse was covered, premiums will be paid until each become eligible for Medicare? The number of ways in which the language in this example could be misinterpreted or exploited is endless.

Usually discrepancies in the interpretation of retiree medical benefit coverage don't become an issue for many years after the provision is first written into a contract. Many times, this type of benefit is agreed to at a time when no one in the foreseeable future will be entitled to it, thus creating the perception that there would be little cost. The language is finally put to the test when the first few employees actually request the coverage.

## 'An Ounce of Prevention is Worth a Mound of Grievances, Attorney Fees, and Benefit Costs'

As they say, 'an ounce of prevention is worth a mound of grievances, attorney fees, and benefit costs,' or something like that. There are many other aspects of the new OPEB disclosure requirements to consider, such as whether or not to start funding the liabilities (like pension plans). Government

employers that provide or are considering providing retiree medical benefits or other benefits such as life insurance, prescription drug plans, vision or dental insurance should contact their actuary and auditor very soon to begin assessing how the cost of these benefits may impact on their financial status, borrowing ability/capacity, and credit/bond rating. Discussion of these costs should take place before the next contract negotiations.

Governmental employers, including local governments, counties, school districts, authorities and states, have an opportunity to make a preliminary assessment of their OPEB costs and perhaps implement cost-containment or even cost-saving measures before the formal actuarial valuation is prepared for GAS #45 implementation.

## Contact Information

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Specializing in Public Employee  
Benefit Consulting and  
Actuarial Services



## IN BRIEF

Balance of 2004 MMO must be deposited to pension plan by Dec. 31, 2004

Check on pending pension legislation and other important news and information or download prior issues of the PEER from our website at [www.mockenhauptbenefits.com](http://www.mockenhauptbenefits.com)

### **Act 81 Follow-up:**

We received many questions from clients asking about the number of municipalities electing to submit revised 2003 actuarial reports under Act 81 to reduce pension costs. According to the Public Employee Retirement Commission, there were 350 revised reports submitted and accepted for pension plans from 235 municipalities. There are roughly 2,200 defined benefit plans under Act 205 statewide. However, only defined benefit plans that had an unfunded liability and actuarial losses from 2001 and 2002 due to investments were eligible to re-file.

### **2004 State Aid Unit Value Holds Up Under Pressure**

Contrary to what most people in the business (including us) expected, the 2004 state aid unit value came out at \$2,911, a slight increase from the 2003 value of \$2,894. Preservation of the unit value amount, despite significant increases in funding needs and the number of plans requesting funds statewide, is being attributed to a 17.5 percent increase in revenues to the state aid pool. This is the largest increase in revenue in 17 years, over which period the average yearly increase was only 3.4 percent (and three of those years it decreased).

**Next issue:** *The Guiding Principles of Pension Plan Administration* and another Client Profile

***Do you have a suggestion for an article for a future newsletter? Call us at (800) 405-3620***



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## IT'S HERE...

As you know, the time's arrived for many public school districts to begin calculating and reporting the costs and liabilities of the medical and other benefits they provide to employees after retirement under GASB 45. Most employers will need to hire an actuary to calculate these liabilities. Mockenhaupt Benefits Group is a Pittsburgh, PA based firm with over four decades of experience working with local government retirement plans. We'll not only provide you with the numbers related to your other post-employment benefits (OPEB), but we'll also partner with you to provide a solid plan for controlling or reducing the impact of these costs on the district's financial status.

## EARLY PLANNING AND PREPARATION ARE KEY TO HANDLING GASB 45

The effective date of GASB 45 depends upon your annual revenue (as measured for the fiscal year ending June 30, 1999).

School districts with annual revenue:

- Over \$100 million must begin reporting OPEB (other post employment benefits) costs under the new standard for the July 1, 2007 fiscal year;
- From \$10 - \$100 million start with the July 1, 2008 fiscal year;
- And, under \$10 million, the July 1, 2009 fiscal year.

While these dates allow some employers time to prepare for compliance, now is the time to begin to have the liabilities calculated and consider appropriate action to optimally manage your plan costs. Early planning will be especially helpful to identify cost implications for future contract negotiations.

Once you're started, keep in mind that plans with 200 or more members will need to have an actuarial valuation completed once every two years to measure liability; those with less than 200 will do so once every three years.



## MOCKENHAUPT BENEFITS GROUP... YOUR LONG-TERM PARTNER IN PLANNING

Mockenhaupt Benefits Group understands the business of public employee benefits...and, we should since we've been assisting local government clients with their needs for over 40 years. In fact, we work with more public employee pension plans than any other consulting firm in Pennsylvania and employ the most experienced consultants in the industry.

Here, our treatment is personal. When you partner with us, you'll receive a dedicated consultant who knows the laws and regulations applicable to Pennsylvania governmental plans and insurance programs. We pride ourselves on our experience, knowledge of public employee benefits and personal service.

We also understand that managing plans isn't your only concern. That's why our clients rely on us to handle their questions, problems, administrative responsibilities and legislative changes. And, because our costs are much more affordable than many of our competitors, our clients save money, time and stress by depending on us.

## CONTACT US TODAY TO GET STARTED...



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