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City of Alexandria, Virginia

MEMORANDUM

DATE: MARCH 3, 2006

TO: THE HONORABLE MAYOR AND MEMBERS OF CITY COUNCIL

FROM: JAMES K. HARTMANN, CITY MANAGER

SUBJECT: BUDGET MEMO # 8 : ACCOUNTING FOR POST-EMPLOYMENT RETIREE BENEFITS NEW MANDATES FROM THE GOVERNMENTAL ACCOUNTING STANDARDS BOARD (GASB 45)

In mid-2004, the Governmental Accounting Standards Board (GASB) issued new state and local government accounting and financial reporting requirements related to accounting for "Other Post-Employment Benefits (OPEB)." These new mandates require governments to measure, account for, and report the long-term liabilities related to post-employment promised and provided benefits (i.e., benefits for an organization's current and future retirees such as health and life insurance). Prior to the issuance of this new mandate (named "GASB 45"), in the employee benefit area state and local governments were only expected to measure, account for, report and fund long-term pension costs and liabilities.

Retiree health and life insurance costs have been simply reported on a pay-as-you-go cash basis by nearly all state and local governments in the United States. The City is projected to spend about $2.1 million in retiree health and $0.1 in retiree life insurance in FY 2006. The estimated long-term liability for the City government is over $82 million (calculated much like an actuary calculates the long-term liability of pension costs). The City School system costs would be significant and in addition to that $82 million. While these are large sums, because the City government's and City School's retirement health benefits are less than many of our neighboring jurisdictions in Northern Virginia, the liability in those other jurisdictions will likely be multiples of the City's. While the City government has measured its potential liability, many state and local governments have not yet taken any sort of measurement actions.

In following the lead of the Financial Accounting Standards Board (which required public corporations to account for OPEB starting in the 1990's), GASB has recently promulgated this new set of accounting standards which will have a major financial impact on all state and local governments in the years ahead. The City follows GASB accounting standards, as it is required to do so by the Virginia Auditor of Public Accounts, and it is expected to do so by the bond rating agencies in order to receive an investment grade rating on its bonds. While most of the GASB's various accounting mandate impacts relate to better financial reporting, GASB 45 will have a widespread and material financial and policy impact on state and local governments -- as occurred 40 years ago when the national accounting standards first required pension costs and long-term liabilities to be fully accounted for. The following summarizes the issues related to GASB 45, and its impact on the City:

- How any liability is expected to be funded and over what time period is not absolutely clear, as this GASB regulation is new.

- This new GASB mandate (the reporting element and not the funding) needs to be implemented for cities our budget size in the audit and comprehensive annual financial report that is issued for FY 2008. GASB does not set funding requirements, but its reporting requirements sometimes trigger funding expectations.

- How much and over what period of time the current unfunded liabilities will need to become funded is not clear. However, it appears that ratcheting up the funding the liability in the budget over a number of years is a likely expectation.

- The bond rating agencies have recently sent the message to state and local governments that at the time of the ratings meeting (between the bond rating agencies and issuers), that the bond rating agencies will be looking for some sort of recognition of the OPEB issue and a start towards funding. Moody's has stated, *"In general a state or local government's effectiveness and initiative in OPEB liability management probably will influence our overall assessment of the government's management strength."*

- A liability can be amortized over a 30-year period so that a sudden financial impact can be spread out over time.

- The combination of GASB 45, the expectations of the bond rating agencies (see Attachment I for the view of Standard & Poor's), the emerging expectations of Wall Street, and those of the Securities and Exchange Commission (see Attachment II for March 2, 2006, article) will result in state and local governments not only measuring and reporting OPEB but needing to start to fund these largely unmeasured and unfunded costs.

- While some of GASB mandates related to long-term liabilities have not triggered an expectation of action by the bond rating agencies and investors, it has become clear over the last few months that state and local governments will be expected to start to set monies aside and start to fund the long-term liabilities.

- The views of all the bond rating agencies (Standard & Poor's, Moody's Investors Service, Fitch Ratings) are all similar.

- The City's calculation of $82 million reflects:

$21 million	Retirees - health
45 million	Active employees - health
5 million	Retirees - life insurance
10 million	Active Employees - life insurance
$82 million	Total Estimated "Unfunded Actuarial Liability"

- If that unfunded liability was amortized over a 30-year period, then the annual payment into such a fund by the City would be some $8.4 million in FY 2007 and then gradually increase above that amount each year for 30 years.

- This $82 million calculation is about a year old and is likely to be understated given recent trends in the cost to the City have exceeded the actuary's assumed 9.5% annual health care cost inflation rate.

- This $82 million assumes that any set aside funds will be set up in a separate investment fund and that an assumed 6% rate of return would occur. If not set up in a separate investment fund, GASB 45 requires a lower discount rate such as 3% to be used. That use of a lower discount rate would raise the City's unfunded liability to over $150 million.

- As a rule of thumb, any increase in annual costs above that assumed by the actuary when the $82 million calculation was undertaken will have a 40/50 to 1 impact on the unfunded liability. So for example, if $0.1 million in added retiree benefits above the 9.5% assumed growth rate occurred then the unfunded liability would jump $4 million to $5 million. Conversely, actions taken to reduce cost increases to less than 9.5% would have a similar but opposite positive effect.

- In recognition that there is an increasing expectation in the financial community that GASB 45 reported unfunded liabilities should be funded, the City's FY 2007 proposed budget reflects two items:

  1. The previously designated $7.2 million for compensated absences in the City's General Fund fund balance has been re-designated for "Post Retirement Employee Benefits." The designation for compensated absences was initiated in 1990, to deal with a pending GASB 11 accounting requirement. While the accounting requirement for compensated absences on a budgeting basis did become effective, the expectation that it would need to be fully funded never came to fruition. As a result, changing it to cover a more serious long-term liability such as post retirement benefits is in the City's best interest

  2. An additional $1.5 million from FY 2006 surplus revenues is proposed to be added to that designation bringing the total designation to $8.7 million by the end of FY 2006.

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- During FY 2007 a more specific multi-year funding strategy will be developed, and would also need to be incorporated into the City's overall Financial Policy Guidelines. Also a review of the structure of the City's retiree health insurance program will need to occur.

Finally, I want to emphasize that the retiree health care issue in front of the City is not one of eliminating the program (as some corporations have done), but the issue is to fund a sound and reasonable retiree health program over the long-term.

Attachments:

I. "*Funding OPEB Liabilities,*" Parry Young, Standard & Poor's, Government Finance Review, December 2005

II. "*Disclosures on OPEB Needed,*" Lynn Hume, The Bond Buyer, March 2, 2006

Attachment I

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Funding OPEB Liabilities

WHAT ARE YOUR OPTIONS?

BY PARRY YOUNG

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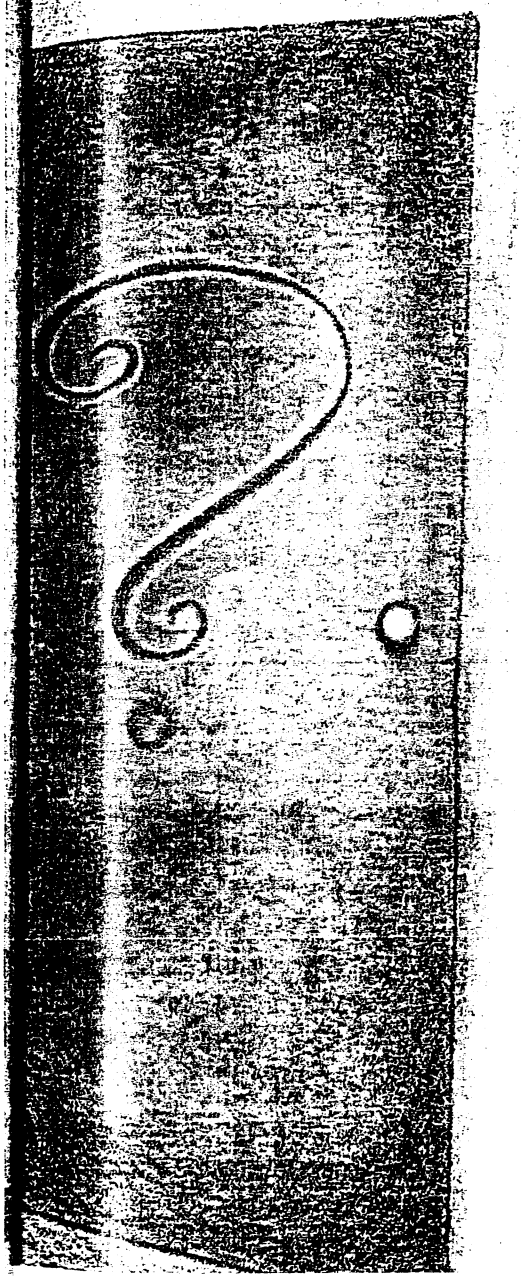

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The fulfillment of retiree pension and other benefit obligations has become a major concern globally in both the government and private sectors, driven in part by the demographic phenomenon of people living longer. In addition, life style choices have tended to lower the actual retirement age. These two factors have expanded the period during which pension benefits must be paid, resulting in burgeoning liabilities for employers. Adding to the problem has been the rapid increases in costs related to retiree health care. While state and local governments have been struggling to maintain adequate funding for pensions, buffeted not only by demographics but also by investment losses and recent benefit increases, a new challenge has appeared on the horizon in the form of changes in the financial reporting for and funding of other retiree benefit costs.

Last year, the Governmental Accounting Standards Board issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. These other postemployment benefits, known as OPEB, include health care, as well as all other retiree benefits that are not a part of a pension plan. Retiree health care is always considered OPEB. This class of postemployment benefit may also include a variety of options such as life insurance or other non-pension benefits. In essence, the new GASB requirements for OPEB tend to follow the reporting requirements for pension benefits because the benefits are similar in nature and both are a form of deferred compensation.

While OPEB costs have traditionally been accounted for and financed on a pay-as-you-go (PAYGO) basis, they will now be treated for accounting purposes on an accrual basis like pensions. Once a government determines its OPEB liability under the new standard, it will then have to decide how to manage it. Should the employer advance fund its OPEB liability under GASB 45 or continue to use the PAYGO method? If the advance funding choice is made, how will the resultant higher contributions affect the budget? Is the current benefit structure sustainable given the new approach? This article will present an overview of the new OPEB reporting requirements; the implications for employers, including some of the options that may be available for managing this liability; the effects of advance funding the liability; and certain managerial considerations that employers may have to face during the process of measuring their OPEB costs and obligations, and preparing for implementation of GASB 45.

THE NEW OPEB ACCOUNTING RULES

In its introduction to Statement No. 45, the GASB said that OPEB "are part of an exchange of salaries and benefits for employee services rendered." Further, from "an accrual accounting perspective, the cost of OPEB, like the cost of pension benefits, generally should be associated with the periods in which the exchange occurs, rather than with the periods (often many years later) when benefits are paid or provided." GASB believes that the reporting for the current PAYGO financing practice fails to:

- Recognize the *cost* of benefits in periods when the related services are received by the employer
- Provide information about the *actuarial accrued liabilities* for promised benefits associated with past services and whether and to what extent those benefits have been funded
- Provide information useful in assessing potential demands on the employer's future cash flows.[1]

The intention of GASB 45 is to overcome these deficiencies and provide more relevant and useful reporting. In addition, by requiring the financial reporting of OPEB expense as services are provided, issues related to intergenerational inequities will be addressed.

A simple example of the practical application of the new reporting standard can be found in looking at the OPEB cost structure of a fictitious, new city with a relatively young fire department. The city has promised lifetime health care benefits to the department's members in its labor negotiations. Currently, this retiree benefit costs the city nothing on the PAYGO basis, since there are no retirees. However, as the firefighters age and actually retire and collect health care benefits, suddenly the city will experience a new and growing budget item. Even for an older city, the current PAYGO OPEB costs may only be the tip of the iceberg, as these expenses subsequently mushroom — not only from the increasing number of retirees, but also from accelerating health care-related expenses. GASB 45 will lead governments to present a clearer picture by requiring that governments take into consideration for financial reporting purposes both current and probable future cash flows associated with promised benefits for services received to date.

Basically, the new standard requires that employers using single-employer or agent multiple employer defined benefit OPEB plans measure and disclose the annual OPEB cost on the accrual basis of accounting. This cost is equal to the employer's annual required contribution (ARC) to the plan with some adjustments. The ARC includes the normal cost for the year and an amount to amortize the total unfunded actuarial accrued liability (or funding excess) over a period of up to 30 years. Actuarial valuations are required at least every two years for plans with 200 members or more. Single employers with fewer than 100 members may use a simplified alternative measurement method.

The cumulative difference between the employer's annual OPEB cost and its contributions to the plan is called the net OPEB obligation. If there is a net OPEB obligation at the beginning of the period, the ARC is adjusted for both the interest on that obligation and past under- or over-contributions to get the final amount. The net OPEB obligation is calculated from the implementation of GASB 45 forward (retroactive application of GASB 45 is not required). Contributions may include direct payment of benefits, paid insurance premiums, and assets irrevocably transferred to a dedicated trust.

OPEB information will be included in the different sections of the annual financial report, similar to that for pensions. The government-wide statements will report the net OPEB obligation. The most recent funded status (actuarial value of OPEB assets divided by the actuarial accrued liability) will be found in the notes to the financial statements. Management's discussion and analysis will include any major changes for the year. Trends in actuarial data will be found in the required supplementary information.

IMPLICATIONS FOR STATES AND LOCALITIES

With completion of the GASB 45 actuarial groundwork, the employer will have a clear picture of its OPEB actuarial liability exposure. The question then becomes how to manage this liability. One general difference between pension and OPEB liabilities for state and local governments in the United States is that while most jurisdictions have offered defined benefit pension plans with basically similar terms and historically documented values, there is a wide disparity in the scope of benefits offered as OPEB and, therefore, the starting point for actuarial accrued liabilities will vary widely. Whereas one government may give lifetime health care benefits for retirees and spouses, another may offer little or no coverage. This dichotomy will mean that the actual financial effect of GASB 45 on various governments will be uneven. For example, one government may find that it can manage its benefits with little or no change in plan terms, while another government may conclude that a major overhaul in the retiree benefit structure is needed.

As the employer evaluates its position under the new OPEB reporting requirements, it can then develop a plan to manage its liability under the new rules. For those with minimal OPEB exposure, the accounting and financial effect will be minimal. For those with greater exposure, serious review and planning must be done to address the problem.

Once the actuarially based liability and annual OPEB cost (expense, derived from the ARC) are determined, management may want to decide if it will fund the plan or continue to handle it

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on a PAYGO basis. It is important to note that GASB does *not* require funding of OPEB. In most cases the GASB 45 ARC payment will be a multiple of the existing PAYGO amount. Depending on the size of the plan, including the number of employees and the level of benefits in relation to an entity's total budget, advance funding the plan under the new rules may add stress to the budget. On the other hand, continuing to pay only the PAYGO amount will result in a growing unfunded actuarial liability and net OPEB obligation. Before making a final decision on whether or not to fund the plan, management may want to take a step back and look at the entire slate of postemployment benefits to see if there are ways to lower the total liability and, further, the unfunded liability. (Since few OPEB plans have actual assets, usually when we say OPEB liabilities we mean unfunded liabilities.)

SELECTED STRATEGIES TO REDUCE OPEB COSTS

There are several strategies employers can use to manage their OPEB costs in light of the new GASB 45 requirements. Some may opt to reduce their exposure to OPEB liabilities through actual changes to the plan structure. These methods include the following:

Reduce OPEB benefits. An employer may be able to change the number of years for which a retiree is eligible to receive health care coverage; for example, a former lifetime benefit may be changed to end at age 65.

Offer new employees (or new retirees) a lower benefit level. The creation of different tiers of benefit levels has been a tactic used to manage pension benefit liabilities for many years.

Place a cap on employer-provided benefits. This could limit the total exposure to the employer for a variety of different benefits.

Convert a defined benefit plan to a defined contribution plan. A DC plan limits the employer's exposure in terms of the amount of contributions and shifts the risk of benefit fulfillment to the employee (in the DB model the employer has the risk).

There are also ways for employers to ease the pressure from cash outflows, such as introducing or increasing employee contributions to the plan, or increasing employee co-pays. Of course, the actual implementation of any of these options will present difficult managerial challenges.

ADVANCE FUNDING – WHAT'S IN IT FOR EMPLOYERS?

The advance funding of OPEB presents a vehicle for employers to build an asset base to offset the actuarial accrued liabilities and provide for payment of the benefits as they come due in future years. Contributions to a funded OPEB plan over time should be more stable, if initially higher, than under a PAYGO arrangement, in that PAYGO cash outlays are directly (immediately) affected by the vagaries of volatile health care costs. While advance funding of OPEB will not rein in actual health care costs, the flows into the plan should be more predictable because actuarially funded benefit plans usually attempt to stabilize contribution rates. However, due to the dynamics of the health care industry, actuarially determined contribution rates for OPEB will probably be more susceptible to change than contribution rates for pension benefits.

The growth in real assets through advance funding also will provide greater benefit security for employees/retirees, since progress of funding by tangible investments can be measured and monitored over time. As the asset base builds and the funding ratio increases, a larger share of the revenues into the plan will come from investment income, while the corollary portion from contributions declines. This relationship is part of the design and was the experience in the development of pension trust funds in the U.S. over the last century. Today, reasonably well-funded defined benefit pension plans may receive up to 60 to 70 percent of total revenues from investment income.

Another advantage to employers from advance funding OPEB comes from the potential ability under GASB 45 to use a higher discount rate to value liabilities than under the PAYGO method. The

use of a higher discount rate will result in lower actuarial liability and expense calculations. For employers that are expected to contribute amounts equal to or greater than the ARC, a discount rate based on the long-term expected rate of return on the OPEB plan's assets would be used. Plan assets would most likely be invested in a portfolio of securities designed to generate a higher long-term rate of return similar to pension trust funds — maybe in the 7 to 8 percent range. Employers that continue to have no plan assets would use a discount rate based on the employer's own investments, which might be in the 1 to 3 percent range. Employers that have some plan assets but are expected to contribute less than the ARC would use a blended rate. Thus, the full advance funding of OPEB would generate both real cost savings from investment earnings and more favorable liability calculations.

> From a rating standpoint, OPEB obligations, like other cost pressures without offsetting resources, affect not only debt and management factors, but also financial. If any changes resulting from OPEB have the effect of adversely affecting an employer's financial position or flexibility, then credit quality may suffer.

Some employers may choose to fund part of their OPEB actuarial liability through the use of bond proceeds. OPEB obligation bonds contain many of the same characteristics as their sister debt instrument, pension obligation bonds. These bonds are basically arbitrage funding, in that the proceeds are placed in a plan trust and invested in equities, bonds, and other instruments that are expected to return a higher rate of return than the interest cost of the bonds. Savings are projected to be generated through lower annual costs for pension obligation bond debt service compared to the cost to pay all or a portion of the pension fund's unfunded actuarial accrued liability. The principal risk of this strategy is that investment returns may not meet expectations over the long-term and the bond issue could have the effect of actually adding costs during periods of weak investment returns instead of generating savings. Another pension obligation bond issue is that, due to debt limitations set by either policies or statutes, this type of debt may use up bonding capacity that might have been applied to other projects. While pension obligation bonds issued in the early 1990s have on average met with success to date despite several rocky years, those sold in the late 1990s have been disappointing. The success of any pension obligation bond or OPEB obligation bond in the future will depend on conservative planning and fortuitous market timing.

MANAGEMENT CONSIDERATIONS RELATED TO OPEB CHANGES

As employers wrestle with policy decisions in response to information provided through implementation of the new OPEB reporting requirements, including the decisions to fund or not to fund and whether or not the existing benefit structure is to be maintained, they will be juggling multiple issues.

Competitive Position. The principal reason employers promise retirement benefits to employees is to help attract and keep qualified personnel. Like all employment sectors, state and local governments must offer to employees a combination of salary, benefits, and job satisfaction that will maintain adequate staffing to deliver the services required and at a level of quality expected by the community. To the extent that any diminution of benefits undercuts a government's competitive ability to hire good people, its mission may be compromised.

Affordability. When the OPEB valuations are completed, some employers may find that the advance funding of GASB 45 annual OPEB costs is just too expensive given the budget's resources. This is the point at which some of the options mentioned above to mitigate OPEB exposure may be considered. Are there feasible ways to lower the OPEB liability or should the old PAYGO practice simply be continued? Also under consideration will be any new revenue sources or areas where fees or taxes could be increased to cover the added costs. Given the recent pressures from other cost centers, including pensions, public safety, and health care (non-retiree), finding additional resources will be challenging in most cases.

Political Hazards. Even if increasing OPEB costs are "affordable," they may not be politically palatable. For example, private sector workers, as voters, who do not have as high a level of health care coverage as their local government employee neighbors, may resist any increases in government taxes or fees to cover higher OPEB contributions. Management will have to be sensitive to this issue.

Legal Issues. A major legal issue that is again being raised as part of the OPEB reporting change discussion is whether or not an employer can reduce this type of retiree benefit that has been promised to certain employees. Whereas many states have strong constitutional or statutory protections against taking away pension benefits that have been granted, the legal status of OPEB is frequently unclear. Also, pension protections have been bolstered by extensive case law over the decades. A further complicating legal factor is that most OPEB promises have been made through col-

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lective bargaining agreements and these benefits may or may not be continued upon contract renewal. Even in the absence of a written agreement, state and local government employers may have reportable OPEB liabilities if the benefits are based on any substantive plan (one that is understood by the employer and its employees). As the changes in OPEB reporting advance, it is likely that related attempts to alter benefits in some cases will end up in the courts.

Rating Considerations. Another issue facing employers in their OPEB choices will be how their decisions will affect their bond ratings. Standard & Poor's views unfunded actuarial retiree healthcare obligations as debt-like in nature, similar to pensions. While a history of audited pension liability trends have been incorporated into individual state and local debt ratings, OPEB actuarial liabilities, most yet to be quantified, present some uncertainties. Given that in many cases the OPEB actuarial liabilities are expected to be large and that liabilities also are expected to vary widely from employer to employer, the key to maintaining a stable credit profile for employers will be how they manage these liabilities. From a rating standpoint, OPEB obligations, like other cost pressures without offsetting resources, affect not only debt and management factors, but also financial. If any changes resulting from OPEB have the effect of adversely affecting an employer's financial position or flexibility, then credit quality may suffer.

The new accounting and reporting rules for retiree healthcare benefits under GASB 45 are going to cast a bright light on this corner of state and local government employee deferred compensation. Based on the evidence to date, the difference between financing these benefits under the old PAYGO method and the new advance funding method is going to be significant. Employers in some cases will have to go back to the drawing board to retool their benefit packages if they wish to advance fund these liabilities. In addition to the financial implications, employers may also be hit with a variety of related factors – including political, legal, and bond rating issues – in the course of their OPEB review, compliance, and planning. As OPEB obligations take on greater urgency, management must respond with thoughtful, long-term solutions. ▮

Note:

1. Governmental Accounting Standards Board Statement No. 45 – *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, Issued June 2004.

PARRY YOUNG is a director with Standard & Poor's. In this capacity he is an analyst in the ratings of state and local government bonds. Young served as an advisor to GFOA's Committee on Retirement and Benefits Administration from 1999 to 2004.

THE BOND BUYER

Thursday, March 2, 2006

Disclosures On OPEB Needed

Securities Law May Trump GASB Dates

BY LYNN HUME

"Issuers should include material information about OPEB in disclosure documents ... even if final numbers are not yet available," says the SEC's Martha Mahan Haines.

WASHINGTON — Municipal bond issuers may have to disclose information about their non-pension and other post-employment benefits in official statements for bond issues under federal securities laws before they are required to report them in annual financial statements under the Governmental Accounting Standards Board's new accounting and reporting requirements, according to Securities and Exchange Commission officials and bond lawyers.

Securities law disclosure obligations for issuers were discussed at the National Association of Bond Lawyers' Fourth Annual Tax and Securities Law Institute last week in Orlando, Fla., and in follow-up interviews

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Securities Law May Trump GASB Deadlines for OPEB Disclosure

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with those who attended the conference.

SEC officials and bond lawyers warn that many state and local governments are making a mistake by focusing solely on their future deadlines for complying with GASB's new accounting and reporting requirements for OPEB benefits.

Under these new requirements, which GASB detailed in its Statement No. 45 that was issued in June 2004, state and local governments will have to report for the first time, their unfunded actuarial accrued liabilities for health care and other non-pension post-employment benefits, as well as their annual OPEB cost. Historically, most governments have accounted for OPEB on a pay-as-you go basis, reporting only the cost of OPEB due in that particular year. Now they will have to switch to an actuarial method of accounting that takes into account unfunded liabilities.

"It's a significant issue with potentially sizeable financial burdens associated with it for state and local governments," said **Paul Maco**, a partner with **Vinson & Elkins** LLP and former SEC muni director. "The numbers can be pretty big."

In order to receive a clean opinion from auditors, governments must comply with the new GASB requirements on a phased-in basis, depending upon their financial size. The requirements are to take effect for the fiscal period beginning after Dec. 15, 2006, for governments with annual revenue greater than \$100 million, a year later for governments with annual revenue between \$10 million and \$100 million, and a year after that for governments with revenue under \$10 million.

However, under the federal securities laws, if governments have done any studies or calculations showing potential sizeable unfunded liabilities that could affect their finances and be material to investors, they have to disclose this information to investors whenever they issue new bonds, according to SEC officials and bond lawyers.

"Issuers should include material information about OPEB in disclosure documents as soon as it is known, even if final numbers are not yet available," **Martha Mahan Haines**, chief of the SEC's Office of Municipal Securities, said this week. "GASB's effective dates for inclusion of OPEB in financial statements do not justify withholding material information from investors."

Speaking at a panel session on accounting and disclosure issues at the NABL conference last week, Haines reminded bond lawyers that the **Massachusetts Turnpike Authority** and its former chairman, **James J. Kerasiotes**, settled securities fraud charges with the SEC in 2003 for failing to disclose, in connection with three muni bond issues, a huge cost overrun tentatively projected for the Central Artery/Ted Williams Tunnel Project, known as the Big Dig.

OPEB disclosure is "a significant issue with potentially sizeable financial burdens associated with it for state and local governments."

Paul Maco, Vinson & Elkins

According to the SEC, the MassPike staff, in 1999 before the three bond issues were sold, projected that costs increases could exceed \$1 billion for the Big Dig. The staff did not disclose the possible cost overruns in the official statements for the bond issues, believing they were speculative and needed further study. The staff began a major review of the costs. As a result, the bond documents indicated that the project was on budget and would only cost about \$5.5 billion to complete.

In enforcement documents, the SEC concluded that the cost increases initially projected by the staff were material to each of the bond offerings and should have been disclosed because "there is a substantial likelihood that a reasonable investor would consider it important in making his or her investment decision."

The commission said MassPike and its chairman were negligent in not disclosing the projected overruns in the bond documents. It ordered the authority and Kerasiotes to cease and desist from future securities law violations, but not impose any fines or other penalties on them.

The **District of Columbia** has been on top of its OPEB disclosure obligations, according to its bond documents. Although the district does not need to begin complying with GASB's OPEB requirements until its fiscal year 2008, it disclosed OPEB information in the official statement for \$331.2 million of general obligation bonds it sold last year after it had projected its unfunded liabilities.

In its official statement for the bonds, the district said: "Similar to most other jurisdictions, the district has funded these programs on a pay-as-you-go basis, but will be required to begin funding OPEB on an actuarial basis in 2008. The district, in its fiscal year 2006 Proposed Budget and Financial Plan, will set aside \$138 million in fiscal year 2006 to partially fund OPEB for district employees fi[rst] employed afte[r] Sept. 30, 1987.

"The district expects to do pay-go funding of \$4.7 million in 2007, and projects expending an additional \$81 million in fiscal year 2008, \$86.2 million in fiscal year 2009, and increasing amounts thereafter," the official statement continued. "After taking into account the \$138 million contribution, the district had, as of Oct. 1, 2005, an OPEB actuarial liability of \$562 million, assets of \$153 million, for an unfunded actuarially accrued liability of \$409 million."

John McNally, a partner at **Hawkins, Delafield & Wood**, disclosure counsel for the bond offering: "State and local governments should be aware that compliance with GASB is not sufficient for compliance with Rule 10b-5 [the securities anti-fraud rule]. The SEC has made that clear in a series of actions. Accordingly, if a state or local government is aware of their OPEB liability, notwithstanding that GASB would not require disclosure until 2008, Rule 10b-5 would require disclosure today in an official statement if the information was m[ater]ial to investors."

California, however, took a different tact in the preliminary official statement for \$800 million of general obligation bonds that it priced yesterday. The official statement noted that the state currently recognizes its OPEB costs on a pay-as-you-go basis and said that the cost of these benefits in fiscal year 2006-2007 is estimated to be "slightly over $1 billion, in comparison to an estimated $895 million in fiscal year 2005-06 and $801 million for fiscal year 2004-05."

The official statement also noted that GASB's OPEB reporting requirements become effective for the state in the fiscal year beginning July 1, 2007.

"The state plans to include the actuarial computation of its liability for post-employment health care benefits in the 2007-08 financial statements," the official statement said. "The 2006-07 Governor's Budget indicates that the State Controller's Office will contract for actuary services to determine the state's liability for these benefits. The 2006-07 Governor's Budget also indicates that such report, when made, may impact the state's credit ratings if the state does not reduce or adequately manage the unfunded liability."

The language in the preliminary official statement comes as the California Legislative Analyst's Office issued a report last week analyzing the state's fiscal 2006-07 budget bill that said the "state government's unfunded liabilities are likely in the range of $40 billion to $70 billion — and perhaps more."

Asked why the state did not include these estimates in the preliminary official statement for the bonds, **Andre Rivera**, manager of California's public finance division, said, "That's basically all of the information we had when we went out." Rivera said everyone knows the estimate for the state's unfunded OPEB liabilities will be huge but added: "We don't know exactly what it is. It's just an estimated number."

Told that SEC officials were advising issuers to include even estimates of unfunded OPEB liabilities in their bond documents if they are material to investors, Rivera said he would discuss the issue with his bond counsel and consider including more information in the final official statement for the bonds, which is to be issued next week.

Robert P. Ferer, a partner at **Orrick, Herrington & Sutcliffe** LLC in San Francisco who worked on the disclosure language, could not be reached for comment. ❑