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November 2009

**STATE AND LOCAL  
GOVERNMENT  
RETIREE HEALTH  
BENEFITS**

**Liabilities Are Largely  
Unfunded, but Some  
Governments Are  
Taking Action**



**GAO**

Accountability \* Integrity \* Reliability

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Highlights of [GAO-10-61](#), a report to the Chairman, Special Committee on Aging, U.S. Senate

## Why GAO Did This Study

Accounting standards require governments to account for the costs of other postemployment benefits (OPEB)—the largest of which is typically retiree health benefits—when an employee earns the benefit. As such, governments are reporting their OPEB liabilities—the amount of the obligation to employees who have earned OPEB. As state and local governments have historically not funded retiree health benefits when the benefits are earned, much of their OPEB liability may be unfunded. Amid fiscal pressures facing governments, this has raised concerns about the actions the governments can take to address their OPEB liabilities.

GAO was asked to provide information on governments' retiree health liabilities. GAO described (1) what has been reported in state and local governments' comprehensive annual financial reports (CAFR) regarding OPEB liabilities, (2) actions state and local governments have taken to address retiree health liabilities, and (3) the overall fiscal pressures these governments face. GAO reviewed the CAFRs for 50 states and the 39 local governments with at least \$2 billion in total revenue. GAO also reviewed the actions taken to address retiree health liabilities by 10 state and local governments, selected based on geography and variation in approaches to address their liability. Finally, GAO simulated the fiscal outlook for the state and local sector and projected health care costs for state and local retirees.

[View GAO-10-61](#) or [key components](#).

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# STATE AND LOCAL GOVERNMENT RETIREE HEALTH BENEFITS

## Liabilities Are Largely Unfunded, but Some Governments Are Taking Action

### What GAO Found

The total unfunded OPEB liability reported in state and the largest local governments' CAFRs exceeds \$530 billion. However, as variations between studies' totals show, totaling unfunded OPEB liabilities across governments is challenging for a number of reasons, including the way that governments disclose such data. The unfunded OPEB liabilities for states and local governments GAO reviewed varied widely in size. Most of these governments do not have any assets set aside to fund them. The total for unfunded OPEB liabilities is higher than \$530 billion because GAO reviewed OPEB data in CAFRs for the 50 states and 39 large local governments but not data for all local governments or additional data reported in separate financial reports. Also, the CAFRs we reviewed report data that predate the market downturn. Finally, OPEB valuations are based on assumptions about the health care cost inflation rate and discount rates for assets, which also affect the size of the unfunded liability.

Some state and local governments have taken actions to address liabilities associated with retiree health benefits by setting aside assets to prefund the liabilities before employees retire and reducing these liabilities by changing the structure of retiree health benefits. Approximately 35 percent of the 89 governments for which GAO reviewed CAFRs reported having set aside some assets for OPEB liabilities, but the percentage of the OPEB liability funded varied. Among the 10 selected governments whose actions GAO reviewed in more detail, officials from the governments that were prefunding at least a portion of their retiree health liability reported using irrevocable trusts. However, these governments varied with regard to the source of the money used to prefund their retiree health liabilities and how they determined the level or amount to commit to prefunding each year. To address their retiree health liabilities, the governments GAO selected made three key types of changes to their retiree health benefits: changes to the type of retiree health benefit plan, to the level of government contribution, and to the eligibility requirements employees need to meet to qualify for retiree health benefits. Changes to the level of government contribution, such as reductions to the amount or proportion of health insurance premiums paid for by the government, was the most common benefit change reported. Some of the selected governments made more than one change to their retiree health benefit structure. The changes were most often applied to the retiree health benefits of newly hired employees or currently active employees.

State and local governments face unfunded OPEB liabilities and decisions about addressing liabilities amid increasing fiscal pressure. Assuming the continuation of current policies, by 2050 the size of the projected operating budget imbalance for the state and local government sector is 4.7 percent of gross domestic product, attributable largely to increases in health-related spending. Though Medicaid is the largest health-related expenditure, spending on state and local government retirees' health benefits is projected to more than double as a share of total operating revenues to 2.1 percent by 2050.

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## Abbreviations

ARC	annual required contribution
CAFR	comprehensive annual financial report
GASB	Governmental Accounting Standards Board
GDP	gross domestic product
NIPA	National Income and Product Accounts
OPEB	other postemployment benefits
SLGE	Center for State and Local Government Excellence
VEBA	voluntary employees' beneficiary association

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United States Government Accountability Office  
Washington, DC 20548

November 30, 2009

The Honorable Herb Kohl  
Chairman  
Special Committee on Aging  
United States Senate

Dear Mr. Chairman:

When state and local governments (referred to in this report as governments) provide health benefits to their retired employees, they may do so by paying for a portion of the costs of these benefits. Governments have typically funded their share of the cost of retiree health benefits when they are paid or provided to retirees (i.e., during retirement), as opposed to during active employment.<sup>1</sup> Under accounting standards issued in 2004, governments are required to account for the costs of postemployment benefits other than pensions—referred to as other postemployment benefits (OPEB)<sup>2</sup>—as employees earn the benefits and the costs are accrued, not when the benefits are paid or provided.<sup>3</sup> The largest OPEB is typically retiree health benefits.<sup>4</sup> Under the accounting standards, fiscal year 2008 was generally the first year that the largest governments were to begin reporting, in annual financial statements, the

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<sup>1</sup>For example, see Governmental Accounting Standards Board, “Other Postemployment Benefits: A Plain-Language Summary of GASB Statements No. 43 and No. 45,” and Elizabeth K. Keating and Eric S. Berman, “Unfunded Public Employee Health Care Benefits and GASB No. 45,” *Accounting Horizons*, vol. 21, no. 3 (2007): 245-263.

<sup>2</sup>OPEB include benefits such as health insurance, life insurance, and legal services. There are separate accounting standards for pension benefits.

<sup>3</sup>While compliance with the standards is necessary for governments to receive an unqualified, or “clean,” audit opinion under generally accepted accounting principles, the standards are not federal laws or regulations.

<sup>4</sup>For example, see The Pew Center on the States, “Promises with a Price: Public Sector Retirement Benefits,” and David Zion and Amit Varshney, *You Dropped a Bomb on Me, GASB* (Credit Suisse, March 2007).

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amount of government's obligation to employees who have earned OPEB;<sup>5</sup> these amounts are known as OPEB liabilities. While the standards include requirements for the reporting of governments' OPEB liabilities, they do not include requirements for funding OPEB, such as retiree health benefits.

Because state and local governments have historically funded retiree health benefits when paid or provided rather than when the benefits are earned, much of their OPEB liability may be unfunded. This has raised concerns about the fiscal pressures that state and local governments will face in the coming decades and leads to questions about the actions state and local governments can take to address their OPEB liabilities, such as changing their retiree health benefits.

In general, state and local retiree benefits are not subject to federal laws governing private sector retiree benefits. Nevertheless, there is a federal interest in ensuring that all Americans have a secure retirement. Additionally, reporting of governments' OPEB liabilities has brought renewed focus on how governments will address these liabilities. Given concerns about state and local governments' fiscal challenges and the potential erosion of retiree health benefits, you asked us for information on state and local governments' retiree health liabilities. This report describes (1) what has been reported in state and local governments' comprehensive annual financial reports (CAFR) about unfunded OPEB liabilities, (2) actions state and local governments have taken to address the liabilities associated with retiree health benefits, and (3) the overall fiscal pressures these governments face.

To describe state and local governments' unfunded OPEB liabilities, we reviewed the most recent CAFRs for the 50 states and 39 large local governments (cities and counties with total revenue of \$2 billion or more according to U.S. Census Bureau data). We determined that the state and local government CAFR data were sufficiently reliable for our purposes, which were to describe the total unfunded OPEB liability reported; the

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<sup>5</sup>The standard required implementation by the largest governments—defined as those with total annual revenues of \$100 million or more in the first fiscal year ending after June 15, 1999—for periods beginning after December 15, 2006. For the largest governments with fiscal years beginning in July, the month when most states begin their fiscal year, the standard applied for their fiscal year 2008 financial statements. Governments with total annual revenues of less than \$100 million have an additional year or two, depending on their total annual revenues, before they are required to begin reporting OPEB liabilities.

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total OPEB liability, assets, and unfunded liability for each of the individual governments for which we reviewed CAFRs; as well as the ranges of unfunded OPEB liabilities, assets, and funded ratios reported. To complement our CAFR review, we contacted experts on public retiree health benefits and reviewed various studies and data sets that looked at state or local governments' OPEB liabilities. Appendix I provides a more detailed methodology for that review and the limitations of our work.

To describe actions taken by state and local governments to address their retiree health liabilities, we reviewed information about actions taken by 10 selected state and local governments.<sup>6</sup> To select these governments, we reviewed available literature to determine what was known about the actions state and local governments have taken to address their retiree health liabilities. Based on that information, we selected the 10 state and local governments to obtain geographic diversity and variation in the approaches used to address retiree health liabilities.<sup>7</sup> Officials from the selected governments responded to questions about the governments' OPEB liability, retiree health benefits, and activities to address the retiree health liability. Additionally, to supplement officials' responses, we reviewed relevant information from the selected governments, such as laws and documents describing retiree health benefits. The information from our selected governments provides insight about state and local government actions to address retiree health liabilities, but cannot be generalized to other states or localities. To supplement our in-depth reviews of the actions taken by the selected governments, we reviewed the results of a 50-state survey conducted from December 2007 through March 2008 by North Carolina State University researchers and published in December 2008 by the Center for State and Local Government Excellence (SLGE).<sup>8</sup> The survey included questions about states' retiree health benefits and their current approaches and plans for addressing their retiree health liability. To assess the reliability of the survey results, we reviewed the survey methodology and interviewed the individuals

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<sup>6</sup>The selected governments include four states—Alaska, Nevada, New Jersey, and South Carolina—and six local governments, including three cities—Gainesville, Florida; New York City, New York; and Thousand Oaks, California—and three counties—Montgomery County, Maryland; Harris County, Texas; and Oakland County, Michigan.

<sup>7</sup>When selecting the governments, we also considered available information about the existence of collective bargaining among public employees, a factor that individuals told us could affect a government's management of its retiree health liability.

<sup>8</sup>Dennis M. Daley and Jerrell D. Cogburn, *Retiree Health Care in the American States* (Washington, D.C.: Center for State and Local Government Excellence, 2008).

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responsible for fielding the survey and analyzing the results. Based on our review, we determined that the data were sufficiently reliable to provide general aggregate information about the responses that were most or least common across the states related to their actions or plans for managing their retiree health benefits.<sup>9</sup>

To describe the fiscal pressures facing state and local governments, we used our model that simulates fiscal outcomes of the state and local sector in the aggregate for several decades into the future. The model is not designed to highlight the fiscal position of individual states; rather it projects the levels of aggregate receipts and expenditures of all state and local governments in future years based on historical spending and revenue patterns. Appendix II provides a detailed methodology for the model as related to projection of receipts and expenditures for the state and local government sector and projections of health care costs for state and local retirees. A January 2008 report provided a detailed description of how we constructed the model.<sup>10</sup> In January 2009 GAO updated information regarding the fiscal challenges facing the state and local government sector.<sup>11</sup>

We conducted our work from October 2008 through November 2009 in accordance with all sections of GAO's Quality Assurance Framework that are relevant to our objectives. The framework requires that we plan and perform the engagement to obtain sufficient and appropriate evidence to meet our stated objectives and to discuss any limitations in our work. We believe that the information and data obtained, and the analysis conducted, provide a reasonable basis for any findings and conclusions in this report.

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<sup>9</sup>For each state, the survey was sent to five officials potentially knowledgeable about retiree health care in their state. In cases where multiple officials from a state responded to the survey, their responses were averaged, and then rounded to the nearest whole number, to determine an overall state response. As such, we determined that the data were not precise enough for us to report the number of states with a particular response.

<sup>10</sup>GAO, *State and Local Governments: Growing Fiscal Challenges Will Emerge during the Next 10 Years*, [GAO-08-317](#) (Washington, D.C.: January 2008).

<sup>11</sup>GAO, *Update of State and Local Government Fiscal Pressures*, [GAO-09-320R](#) (Washington, D.C.: Jan. 26, 2009).

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## Background

The costs to state and local governments that offer retiree health benefits can vary based on several factors. These include the design of the retiree health benefits that governments provide, the eligibility requirements that retirees must meet in order to receive those benefits, and the degree to which governments contribute to the cost of the benefits for their retirees.

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## Funding Retiree Health Benefits

As we have previously reported, most governments have typically funded their share of the cost of retiree health benefits when they were provided (i.e., during retirement) as opposed to during active employment.<sup>12</sup> This practice is commonly referred to as pay-as-you-go.

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## Accounting for Retiree Health Benefits

Governments have typically accounted for the cost of their retiree health benefits on a pay-as-you-go basis, reporting just the amount paid each year for employees who have already retired. Recently adopted accounting standards, however, require governments to change the way they account for the cost of retiree health benefits, specifying that governments should account for these costs on an accrual basis. Under an accrual basis, the cost of retiree health benefits is recognized when an individual earns the benefits, not when the benefits are paid or provided. As such, a government would periodically estimate and report the value of benefits that are earned for both past and current employees as a liability in its financial statements. Specifically, in 2004, the Governmental Accounting Standards Board (GASB)—an independent, private sector organization that maintains standards for accounting and financial reporting for state and local governments—issued Statement 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, which requires state and local governments to measure, recognize, and report future obligations for providing OPEB, the largest of which is generally retiree health benefits. Under Statement 45, governments should periodically have an actuarial valuation performed, through which an actuary estimates the amount that will be needed to pay for future benefits, assuming that the current provision for benefits remains in effect.<sup>13</sup> More specifically, the actuary estimates the following

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<sup>12</sup>GAO, *State and Local Government Retiree Benefits: Current Status of Benefit Structures, Protections, and Fiscal Outlook for Funding Future Costs*, GAO-07-1156 (Washington, D.C.: Sept. 24, 2007).

<sup>13</sup>Changing the benefits offered will likely result in changes to an actuary's estimates of the amount that will be needed to pay for future benefits.

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values, which governments are to report in their financial statements and related notes.

- The “actuarial accrued liability” or “liability” reflects the value of benefits that are attributable to employees’ past service, assuming the current provision of benefits.
- The “actuarial value of assets” represents the actuarial value of cash, investments, and other assets that are set aside to fund OPEB.<sup>14</sup>
- The “unfunded actuarial accrued liability” or “unfunded liability” equals the excess, if any, of the liability over the assets. Thus, unfunded liabilities indicate the amount of benefits earned for which no assets have been set aside.
- The “funded ratio” is assets expressed as a percentage of the liability. The funded ratio indicates the extent to which a government has set aside enough assets to pay its liability. For example, a funded ratio of 80 percent indicates that there are enough assets to pay for 80 percent of the liability.
- The “annual required contribution” (ARC) is an estimate of the amount that if paid in full each year would be expected to fund currently accruing costs as well as a portion of any unfunded liability. Although referred to as a “required” contribution, accounting standards do not establish funding requirements—governments can choose to pay more or less than this amount.

Valuations of OPEB liabilities are inherently complex because they involve estimates of future events that affect the amount and timing of payments. Such estimates are developed through the application of actuarial cost methods and assumptions, such as health care cost growth, discount rates,<sup>15</sup> and worker and retiree mortality. For example, there are six GASB-approved actuarial cost methods and each method has a different approach to allocating the value of future benefits. Under some cost methods, governments accrue more liabilities in the early part of employees’ careers than later. Differences in the actuarial cost methods

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<sup>14</sup>The actuarial value of assets is not necessarily the same as the current market value of those assets. Rather, it is typically an average of the market value of the assets over a period of 3 to 5 years.

<sup>15</sup>A discount rate (also called the investment return assumption) is the rate used to adjust a series of future payments to reflect the time value of money.

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and assumptions used can result in significant differences in OPEB liability estimates, which can make it challenging to compare estimates across governments.

Implementation of the OPEB reporting standards is being phased in over a 3-year period, with the largest governments—governments with total annual revenues of \$100 million or more—to report their liabilities generally beginning in their fiscal year 2008 financial statements and apply other requirements of the standard. State and local governments are required to follow GASB standards to receive an unqualified, or “clean,” audit opinion on financial statements prepared in conformity with U.S. generally accepted accounting principles. Additionally, many state laws require local governments to follow GASB standards, and bond raters consider whether GASB standards are followed when assessing the fiscal health of state and local governments.<sup>16</sup>

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## Addressing Retiree Health Liabilities

While governments may continue to fund their retiree health benefits on a pay-as-you-go basis, one option for addressing their liability is to prefund some or all of the retiree health benefits before employees retire. By prefunding, governments can reduce the unfunded liability reported in their financial statements, take advantage of the compounding effects of investment returns on plan assets, and provide greater benefit stability for employees and retirees. To reduce a government’s liability, funds must be deposited into a trust or equivalent arrangement, as GASB Statement 45 only considers funds in such an arrangement as assets.<sup>17</sup> Several funding vehicles that can be established as trusts are available under the federal tax code to help facilitate state and local government efforts to prefund their retiree health liabilities. (See table 1.) While prefunding is generally more cost effective for a government in the long term, in the short term it will require a higher level of government contribution.

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<sup>16</sup>A government’s bond rating affects its cost of borrowing money by affecting the interest rate it must pay to lenders.

<sup>17</sup>GASB established minimum requirements for what is considered a trust or similar arrangement. Among the requirements are that the assets in the trust must be dedicated to benefits for retirees and their beneficiaries, cannot be recovered by the government, and must be sheltered from claims of creditors of the government.

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**Table 1: Examples of Vehicles for Prefunding Retiree Health Liabilities**

<b>Funding vehicle</b>	<b>Section of the Internal Revenue Code</b>	<b>Vehicle description</b>
Health benefits subaccount	401(h)	A separate subaccount of a defined benefit pension trust that allows up to 25 percent of the total employer contribution to the pension fund to be allocated to retiree health benefits. Investment income on assets in the subaccount accumulates tax free, and retiree health benefit payments made from the subaccount are not taxable to retirees.
Governmental trust	115	A trust established by a governmental employer to fund an essential government function, which may include providing retiree health benefits. Contributions to the trust are not limited. The investment income on the trust is not taxed, and the benefits ought to be tax free to the retiree when received, with confirmation from the Internal Revenue Service.
Voluntary employees' beneficiary association (VEBA)	501(c)(9)	A tax-advantaged entity, usually a trust, for the benefit of a voluntary membership of active and retired employees, and from which tax-free distributions may be made for qualifying health care expenses of retirees.

Sources: Internal Revenue Code and Congressional Research Service, 2006.

Prefunding retiree health benefits has its advantages, but it does not change actual health care costs. Reducing health care costs by making benefit changes may be another way for governments to address their retiree health liabilities.<sup>18</sup> The extent to which benefit changes can reduce a government's liability depends on the nature of the changes and whom the changes affect. For example, reductions in the liability would be greater if the government were to make benefit reductions effective for all current and future retirees. In comparison, if changes were only effective for future retirees, it could be some time before the government would experience significant savings from the changes.

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<sup>18</sup>State and local government employee pension benefits are often defined in state statutes or constitutions and local ordinances or charters and, in that sense, are protected from change. Retiree health benefits for those employees, however, may not have the same degree of protection. To the extent retiree health benefits receive legal protection, it is generally because they are defined in labor contracts negotiated subject to collective bargaining.

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## Unfunded OPEB Liabilities for State and Local Governments Exceed \$530 Billion

We found that the total reported unfunded liabilities for OPEB (which are primarily retiree health benefits) for state and select local governments exceed \$530 billion.<sup>19</sup> The \$530 billion includes about \$405 billion for states and about \$129 billion for the 39 local governments we reviewed. We reported in 2008 that various studies available at that time estimated the total unfunded OPEB liability for the states and all local governments to be between \$600 billion and \$1.6 trillion, although the studies' estimates were based on limited government data.<sup>20</sup> It is not surprising that our total is on the low end of that range because we did not review data for all local governments, though we did review reported liability data for the largest local governments and all 50 states. Five-hundred and thirty billion dollars is still a large unfunded liability for governments. As variation between studies' totals shows, totaling unfunded OPEB liabilities across states and local governments can be challenging. This may be attributable, in part, to some OPEB data being reported in plans' separate financial reports that are not included as part of the government's CAFR. In addition, over time valuations of OPEB reflect more up-to-date assumptions, policy decisions, and data. For example, the variety of actuarial approaches used can result in variations among the OPEB data reported in the CAFRs, such that two valuations of the same underlying OPEB can differ.<sup>21</sup>

Reported state and local governments' unfunded OPEB liabilities varied widely in size. For example, unfunded state liabilities ranged from \$71 million for Arizona to \$62 billion for California, and unfunded local government OPEB liabilities ranged from \$15 million for a county in Arizona to over \$59 billion for New York City. (See app. III for individual state governments' and large local governments' aggregate OPEB liabilities, assets, unfunded OPEB liabilities.) However, the significance of

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<sup>19</sup>To determine this total, we reviewed the most recent governmentwide CAFRs as of June 30, 2009, for 50 states and the 39 largest local governments. Of the 89 CAFRs reviewed, 7 were for fiscal year 2007 and the rest were for fiscal year 2008.

<sup>20</sup>GAO, *State and Local Government Retiree Benefits: Current Funded Status of Pension and Health Benefits*, GAO-08-223 (Washington, D.C.: Jan. 29, 2008). A study issued more recently than those cited in that report puts the states' total unfunded OPEB liability at \$440 billion. Like our total, that study did not estimate the unfunded OPEB liabilities for the universe of local governments. Robert L. Clark, Melinda Sandler Morrill, *Health Plans for Retired State Employees: Is There a Funding Crisis?*, (July 2009).

<sup>21</sup>Various actuarial approaches are allowed under GASB and are commonly used among governments. OPEB valuations require long-term projections and are estimates based on assumptions that vary among state and local government entities. Actuarial estimates are sensitive to these assumptions. For example, changing the health care inflation rate assumption by a small amount can significantly change the resulting estimate of liability.

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each government's unfunded OPEB liability is relative to its ability to fund those benefits through currently available assets, future revenues, or a combination of the two. In addition, reported liabilities may vary based on various factors, including differing plan benefits, assumptions, and government contributions.

Most state and local governments for which we reviewed CAFRs have not set aside assets to fund OPEB liabilities (see fig. 1).<sup>22</sup> Approximately 35 percent of the governments for which we reviewed CAFRs—18 of 50 states and 13 of 39 local governments—reported having set aside at least some assets for OPEB liabilities for one or more entities in the government, as of their actuarial valuation.<sup>23</sup> Setting aside assets for OPEB indicates that a government may have prefunded at least a portion of its liability associated with retiree health benefits.<sup>24</sup> In total, the state and local government CAFRs we reviewed reported having set aside at least \$25 billion in assets to fund their OPEB liabilities, constituting less than 5 percent of the \$559 billion total OPEB liabilities reported.<sup>25</sup> Thus, most state and local governments included in our review are paying for their OPEB liabilities for active and retired workers in a given year from their current revenues.

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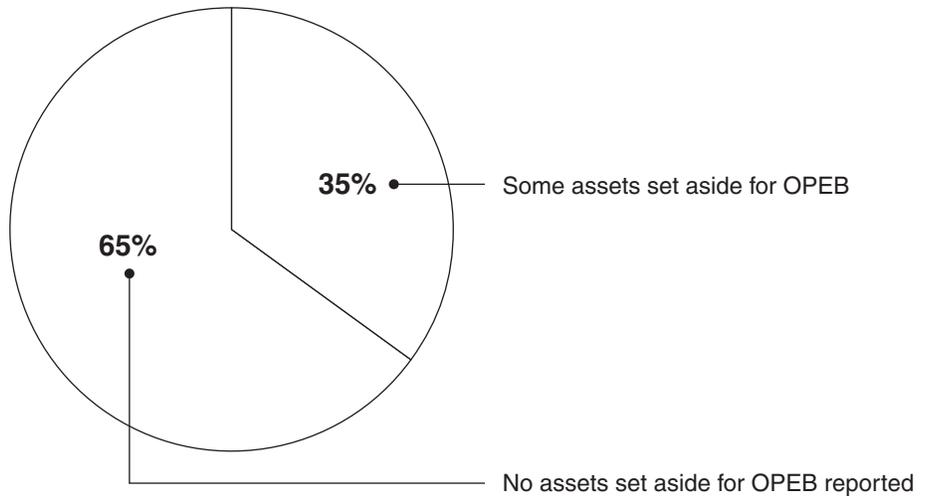
<sup>22</sup>In the absence of assets set aside for OPEB liabilities, most state and local governments are paying for benefits for retired workers in a given year as they do for those of their active workers—from their current revenues. State and local governments have generally managed retiree health benefits together with active employee benefits. [GAO-07-1156](#).

<sup>23</sup>Governments typically report OPEB data for separate plans (e.g., plans for university employees, public safety workers, and judges). CAFRs for three states—Nebraska, Nevada, and West Virginia—did not include data about OPEB liabilities and assets. Additionally, three local government CAFRs did not include data about OPEB. They were for San Bernardino County, California; San Diego County, California; and Cook County, Illinois. Therefore, we do not know if these six governments have set aside assets for OPEB. However, under GASB standards there is no reporting requirement when a government's OPEB liability is not material or nonexistent.

<sup>24</sup>The assets set aside may be for prefunding OPEB liabilities other than those associated with retiree health benefits.

<sup>25</sup>The percentage of the OPEB liability funded—called the funded ratio—varied across government entities. Among the minority of government entities with assets set aside, about 38 percent had a funded ratio of less than 10 percent, while 30 percent had a funded ratio of 50 percent or more. There was also variation in the funded ratio across the entities reported in individual governments' CAFRs. For example, among the six entities reported in Kentucky's CAFR, the funded ratios reported ranged from 4 percent to 106 percent.

**Figure 1: Percentage of State and Local Government CAFRs We Reviewed Reporting Some Assets Set Aside for OPEB Liabilities, as of Their Most Recent CAFRs**



Source: GAO review of the most recently issued CAFRs for the 50 states and the 39 local governments.

Notes: The CAFRs for three states and three local governments did not include any OPEB liabilities data. As a result, it cannot be determined from the CAFR review if these governments have liabilities or have set aside assets for OPEB; under GASB standards there is no reporting requirement when a government's OPEB liability is not material or nonexistent. The CAFRs reviewed were the most recent CAFRs as of June 30, 2009. One of these CAFRs was for fiscal year 2007, before the reporting standard for OPEB was required. CAFRs issued more recently for those governments may include OPEB data.

The total unfunded OPEB liability for state and local governments is larger than the roughly \$530 billion because we reviewed OPEB data in select governmentwide CAFRs. Although we reviewed CAFRs for all the states and focused our review on CAFRs for the 39 largest local governments, and included some of the largest unfunded liabilities, we did not review OPEB data for all governments.<sup>26</sup> Thus, a review of all local government CAFRs would show a higher total unfunded OPEB liability than what we found. In addition, we reviewed governmentwide CAFRs and not information for component entities or cost-sharing multiple-employer plans that is reported in separate financial statements and not in the

<sup>26</sup>The 39 local governments we selected were the largest based on Total Revenue, as reported by the most recent U.S. Census Bureau data. See U.S. Census Bureau, *2002 Census of Governments*, vol. 4, no. 3, *Finances of County Governments: 2002 GC02(4)-3*, U.S. Government Printing Office (Washington, D.C., 2002); and U.S. Census Bureau, *2002 Census of Governments*, vol. 4, no. 4, *Finances of Municipal and Township Governments: 2002 GC02(4)-4*, U.S. Government Printing Office (Washington, D.C., 2002).

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CAFRs.<sup>27</sup> For example, in fiscal year 2008, \$2 billion in unfunded OPEB liabilities for one state's public employees' retiree health and life insurance plans was reported in the plans' own financial statements and not in the state's CAFR. Consequently, the \$2 billion is not included in our total for states' unfunded OPEB liability.

In addition, the ultimate cost of OPEB may significantly differ from estimated OPEB liabilities because (1) the CAFRs we reviewed report data that predate the market downturn and (2) significant uncertainties affect the estimation of OPEB liabilities. We reviewed the most recently issued CAFRs, as of June 30, 2009, which reported OPEB assets valued and liabilities based on discount rate assumptions set before the market downturn. In most cases, the most recently issued CAFR was for fiscal year 2008.<sup>28</sup> The value of those assets has likely fallen, which means the total unfunded OPEB liabilities are likely higher in mid-2009 than the total we found, at least for the minority of entities with at least some assets. In addition, when market interest rates fall, to the extent that actuaries apply lower discount rates to OPEB valuations, the value of unfunded OPEB liabilities will increase—all other factors remaining equal. Uncertainties affecting the estimation of OPEB liabilities include potential differences between assumptions used and actual experience, as well as potential and

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<sup>27</sup>GASB Statement 45 indicates that employers (e.g., governments) that participate in cost-sharing multiple-employer plans that meet certain requirements are not required to report the unfunded OPEB liability for such plans in their financial statements. Employers are required to disclose whether such an OPEB plan issues a stand-alone financial report or is included in the report of a public employee retirement system or another entity, and, if so, how to obtain the report. If the cost-sharing plan in which an employer participates does not issue and make publicly available a stand-alone plan financial report prepared in accordance with the requirements of GASB Statement 43, and the plan is not included in the financial report of a public employee retirement system or another entity, the cost-sharing employer should present certain information as required supplementary information in its own financial report. In addition, discrete component entities may have unfunded OPEB liabilities, which are not included in our total if they are not reported in the CAFR. Discrete component entities are related to the government entity, but are not part of the government entity, and the governmentwide CAFRs report only limited detailed information on them.

<sup>28</sup>Of the 89 CAFRs reviewed, 7 were fiscal year 2007 CAFRs, and the rest were fiscal year 2008 CAFRs. OPEB valuations are estimates based on assumptions that vary among state and local government entities. Any adjustment to the assumptions used can have a large effect on the size of the unfunded OPEB liability, even holding the benefit plan and employee population constant. A discount rate (also called the investment return assumption) is the rate used to adjust a series of future payments to reflect the time value of money. The discount rate is applied whether there are assets or not.

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future changes to eligibility and government contributions.<sup>29</sup> Governments have some discretion in what assumptions they use. Two significant assumptions used in OPEB liability calculations are the discount rate and the health care inflation rate. When governments value their OPEB liabilities, a decrease in the discount rate or increase in the health care inflation rate used results in higher unfunded OPEB liabilities, holding other factors, like the benefit plan and employee population, constant. A July 2009 study prepared for SLGE reported that one state's unfunded OPEB liability increased by almost 20 percent based on a 1 percent increase in the health care inflation rate assumed. As the July 2009 SLGE study showed, actuarial valuations for state OPEB assumed discount rates ranging from 3 percent to 8.5 percent.<sup>30</sup> Our review of 10 states' most recently issued CAFRs found that 5 states used discount rates on the high end of that range.<sup>31</sup> Further, in accordance with GASB guidance, when governments value OPEB liabilities, governments apply a health care inflation rate based on expected long-term future trends. According to the July 2009 SLGE study, virtually all state governments assume their expected long-term future rate to be about 5 percent, although actual health care inflation rates from 2002 to 2005 ranged from 16 percent to 10.3 percent, respectively.<sup>32</sup>

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<sup>29</sup>These assumptions vary among state and local governments and even the different reporting entities within a government. A health care cost trend rate is the rate of change in per capita health claims costs over time as a result of factors such as medical inflation, utilization of health care services, plan design, and technological developments.

<sup>30</sup>Richard C. Kearney, Robert L. Clark, Jerrell D. Cogburn, Dennis M. Daley, and Christina Robinson, *At a Crossroads: the Financing and Future of Health Benefits for State and Local Government Retirees*, a report prepared for the Center for State and Local Government Excellence, July 2009. Discount rates for OPEB are based, in part, on the amount of assets set aside for OPEB, which may explain some of the variation in rates used.

<sup>31</sup>We did not review the reasonableness of the assumptions state and local governments used in calculating their liabilities.

<sup>32</sup>Kearney et al., *At a Crossroads*. The health care inflation rate for 2002 to 2005 was cited in this report as reported by The Kaiser Family Foundation/Hewitt Associates 2005 Retiree Health Benefits Survey. Some governments use a combination health care inflation rate, which drops from a higher rate in the first few years of the valuation to a lower long-term rate.

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## Some State and Local Governments Have Taken Actions to Address Retiree Health Liabilities through Prefunding and Making Benefit Changes

Some state and local governments have taken actions to address their liabilities associated with retiree health benefits by setting aside assets in order to prefund the liabilities and reducing these liabilities by changing the structure of retiree health benefits.

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## Some State and Local Governments Have Taken Steps to Prefund Their Retiree Health Liabilities and Have Done So to Varying Degrees

Prefunding at least a portion of OPEB costs is one action that some state and local governments have taken to address their retiree health liabilities. As noted earlier, approximately 35 percent of the 89 governments for which we reviewed CAFRs reported having set aside some assets for OPEB liabilities for one or more entities in the government as of the time of their actuarial valuations. Setting aside assets for OPEB indicates that a government may have prefunded at least a portion of its liability associated with retiree health benefits.<sup>33</sup> The CAFRs that we reviewed also showed that the percentage of the OPEB liability funded—the funded ratio—varied.

Among the 10 selected governments whose actions we reviewed in more detail, officials from the governments that were prefunding at least a portion of their retiree health liability reported using irrevocable trusts. As noted earlier, under GASB accounting standards, only assets held in a trust or equivalent arrangement count toward reducing a government's unfunded liability. Furthermore, officials from some of these governments reported using a section 115 governmental trust, which is a trust established by a governmental employer to fund essential government functions. Similarly, according to results from a survey of state officials published in December 2008, more states reported having adopted, or being likely to adopt, a section 115 governmental trust than a section 401(h) health benefits subaccount or a VEBA, two other funding vehicles available to state and local governments under the federal tax code.<sup>34</sup>

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<sup>33</sup>The assets set aside may be for prefunding OPEB liabilities other than those associated with retiree health benefits.

<sup>34</sup>See Daley and Cogburn, *Retiree Health Care in the American States*.

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Some of the officials we spoke with, as well as the literature, indicated that section 115 trusts are simpler and more flexible than the other options available to governments.<sup>35</sup> For example, officials from New York City told us that they chose a section 115 trust because it was simple to establish and operate, satisfied GASB Statement 45 standards for assets, and is exempt from taxation. According to officials from some of the selected governments, the governments' trusts were administered by the same board or individuals that administered the governments' pension fund. Government officials told us that the pension boards were chosen to manage the retiree health funds because they had the necessary experience, expertise, and resources to effectively manage the trusts. For example, the City of Thousand Oaks chose to invest its assets in a trust established and administered by the California Public Employees' Retirement System. The trust, called the California Employers' Retiree Benefit Trust, is available to all public employers in the state to prefund retiree health costs. A city official told us that the city chose to use this pooled trust because the pension system had a successful track record investing local governments' pension funds and because of the trust's low administrative costs.

The governments we selected varied with regard to the source of funds used to prefund their retiree health liabilities. Officials from some of the governments reported utilizing funds from multiple sources. Among the selected governments, some officials reported that sources of money for prefunding retiree health liabilities were contributions from government employers such as agencies—generally, obtained as a specified percentage of an employer's payroll—and general revenue. For example, officials from the City of Thousand Oaks reported that in fiscal year 2010, city agencies are contributing 4.15 percent of their payroll to prefund the government's retiree health liability. Officials from some governments reported prefunding at least a portion of their retiree health liabilities by borrowing money, for example, through the issuance of bonds.<sup>36</sup> However, results from a survey of state officials published in December 2008 indicated that at the time of the survey few states had reported issuing, or

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<sup>35</sup> According to an article by a manager at the Government Finance Officers Association, section 115 trusts do not have limits or restrictions on eligibility, funding, or benefits. In contrast, both 401(h) subaccounts and VEBAs have funding limits, and VEBAs have membership requirements. See John Ruggini, "In an OPEB Trust We Trust?" *Government Finance Review*, vol. 24, no. 1 (2008): 34-40.

<sup>36</sup> Among the governments we selected, only local governments reported borrowing money to fund their retiree health liability.

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reported being likely to issue, bonds to finance their OPEB liabilities, including retiree health benefits.<sup>37,38</sup>

The governments we selected also varied in how they determine the level or amount to commit to prefunding their retiree health liabilities each year. While officials from some of the selected governments indicated that they rely on formulas or plans to help them determine these prefunding levels, some officials from the selected governments noted that actual amounts depend on appropriations. For example, officials from New York City specified that any funding above the government's pay-as-you-go costs—that is, the costs for benefits provided at the given time—is provided if and when sufficient resources exist, as determined through the government's budgetary process. Although often dependent on appropriations, officials from some of the governments reported that their levels of prefunding were determined based on the ARC—an estimate of the amount that if paid in full each year would be expected to fund currently accruing costs as well as a portion of any unfunded liability. For example, officials from some of the governments we selected indicated that their governments have prefunded the full ARC, while officials from another government indicated that a specified portion of the ARC has been funded each year. Some of the selected governments do not base the level of prefunding on the ARC. For example, officials from South Carolina reported that the amount of prefunding is determined by a combination of factors, including a formula linked to the health insurance plan's cash reserves and any annual appropriation the legislature chooses to make for retiree health benefits.

Officials from the selected governments reported some challenges with prefunding their liability. Budgetary or fiscal constraints were the most commonly reported challenge. Officials from one government indicated that budgetary constraints led the government to stop prefunding its retiree health liability, while officials from another government reported

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<sup>37</sup>See Daley and Cogburn, *Retiree Health Care in the American States*. This report also indicates that few states reported being likely to finance their liability by borrowing funds from the state pension fund, raising revenue through higher taxes, or using funds generated through cuts to other state programs.

<sup>38</sup>The limited number of governments financing their liabilities through the issuance of bonds or similar arrangements may be due, at least in part, to the risks associated with such a funding stream. According to the literature, such arrangements are only effective if the funds collected can be invested and earn a higher rate of return than the interest payments required for paying back the loan.

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scaling back prefunding efforts.<sup>39</sup> Other government officials explained that declining revenue, resulting from both tax reforms and the poor economy, created challenges to prefunding. These same officials also commented that prefunding was challenging because of increasing health care costs and changes in the demographics of their workforces, namely changes to the ratio of retirees to active workers. Other challenges noted by officials from the governments we selected included the need to educate stakeholders about prefunding and the need to establish the legal authority to create irrevocable trusts.

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### Some State and Local Governments Have Worked to Address Retiree Health Liabilities through Three Types of Benefit Changes

Another action some state and local governments have taken to address their retiree health liabilities has been to change the structure of the health benefits they offer retirees. While governments also make relatively routine changes to the health benefits they offer retirees (such as changing co-payments, deductibles, or covered benefits) that could affect their liability, we identified three key types of changes our selected governments have made to the structure of retiree health benefits: changing the type of retiree health benefit plan, changing the level of the government's contribution toward retirees' health insurance premiums, and changing the eligibility requirements employees need to meet to qualify for retiree health benefits.

- **Type of health benefit plan:** Officials from some of the governments we selected indicated that since 2004 their governments changed the type of health benefit plan for retirees as a way of reducing the liability associated with these benefits. Specifically, officials reported a shift from a defined benefit retiree health plan to a defined contribution plan. As the term implies, a defined benefit plan specifies the amount of benefits to be provided during retirement. The benefits may be specified in dollars, such as a flat dollar amount, or as a type or level of coverage, such as a percentage of health insurance premiums paid. In contrast, defined contribution plans stipulate only the amounts to be contributed by a government to an employee's account each year of active employment. Defined contribution plans do not specify the amount of benefits employees will receive upon retirement; rather, the amount of benefits a retiree receives will depend on the value of that individual's account. Since a government's payment under a defined contribution plan is limited to the

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<sup>39</sup>The government had originally planned to phase in to fully funding its ARC over a 5-year period. However, because of the government's fiscal situation it shifted to an 8-year phase-in period.

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amount it contributes to an individual's retiree health account, the government's cost, and hence its liability, is no longer affected by increases in health care costs.

- **Level of government contribution:** Some of the governments we selected have changed the level of the contribution they provide toward retiree health insurance premiums by reducing the amount or proportion of health insurance premiums paid for by the government or by changing how the level of contribution is calculated. For example, according to government officials, some of the selected governments changed the calculation of the contribution so that it was no longer affected by changes in premium costs, thereby shifting the risk of rising health care premiums onto the retiree. Changes to the level of government contribution were the most common benefit change reported by the governments we selected. Additionally, results from a survey of state officials published in December 2008 indicate that many states increased retirees' premium contributions in the past 5 years—an indication that the states may have changed the level of government contribution for those retirees.<sup>40</sup>
- **Eligibility requirements:** Officials from some of the governments we selected reported changing the requirements that determine eligibility for retiree health benefits, such as increasing the number of years an employee must work for the government before being eligible for health benefits upon retirement. Results from a survey of state officials published in December 2008 indicate that more states have changed their eligibility requirements by increasing the years of service required for eligibility for retiree health benefits than by increasing the age at which employees become eligible to receive these benefits.<sup>41</sup>

Table 2 provides examples of some of the retiree health benefit changes made since 2004 by the governments we selected. As seen in table 2, in some cases the selected governments made more than one change to their retiree health benefit structures. The changes were most often applied to newly hired employees or currently active employees. As a consequence, the selected governments may not realize cost saving associated with these changes for many years. However, they may see some effect on the amounts of their projected liability within a shorter period of time.

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<sup>40</sup>See Daley and Cogburn, *Retiree Health Care in the American States*.

<sup>41</sup>See Daley and Cogburn, *Retiree Health Care in the American States*.

**Table 2: Examples of Retiree Health Benefits Changes Made by Selected Governments since 2004**

Government	Type of benefit change	Description of retiree health benefit change
Gainesville, Florida	<ul style="list-style-type: none"> <li>• Government contribution</li> </ul>	<p>In 2009, the city began determining the amount of government contribution as a fixed dollar amount based on the retiree’s years of service and age at the time of benefit commencement. Before the change, the contribution was a specified percentage of a retiree’s health insurance premium, which meant that the amount of contribution changed with changes in premium costs.</p>
Harris County, Texas	<ul style="list-style-type: none"> <li>• Government contribution</li> <li>• Eligibility</li> </ul>	<p>In 2007, the county increased the number of years of service needed for an individual to receive a government contribution for the cost of his or her retiree health benefits and reduced the amount of that contribution. As a result of the changes, the county now has the following three-tiered system:</p> <ul style="list-style-type: none"> <li>• Individuals employed by the county as of March 1, 2007, and eligible to retire by February 2011 are eligible to receive retiree health benefits if the sum of their age and years of service equals 75 and they have a minimum of 10 years of service. The county provides a 100 percent contribution for these individuals.</li> <li>• Individuals employed by the county as of March 1, 2007, and eligible to retire after February 2011 are eligible to receive retiree health benefits if the sum of their age and years of service equals 80 and they have a minimum of 10 years of service, or if they are at least age 65 (or Medicare eligible) and have a minimum of 10 years of service. Individuals who retire before age 65 will have to pay a portion of their premium until reaching age 65.</li> <li>• Individuals hired by the county after March 1, 2007, are eligible to receive retiree health benefits if the sum of their age and years of service equals 80 and they have a minimum of 20 years of service, or if they are at least age 65 (or Medicare eligible) and have a minimum of 15 years of service. However, according to a government official, the county may not provide any contribution for these individuals.</li> </ul>
New Jersey	<ul style="list-style-type: none"> <li>• Government contribution</li> </ul>	<p>In 2007, the state began requiring some retirees to contribute toward the cost of their health insurance premiums, thus reducing the amount of government contribution. Specifically, employees who reach 25 years of state government service, the length of service required to be eligible for retiree health benefits, on or after July 1, 2007, must contribute an amount equal to 1.5 percent of their pension benefit toward the cost of their health insurance premiums. The retiree’s contribution is waived for individuals who participate in a government-sponsored wellness program.</p>

<b>Government</b>	<b>Type of benefit change</b>	<b>Description of retiree health benefit change</b>
Oakland County, Michigan	<ul style="list-style-type: none"> <li>Benefit design</li> <li>Government contribution</li> </ul>	In 2005, in response to a large increase in the county's costs for retiree health benefits, the county adopted a new defined contribution retiree health benefit plan for eligible individuals hired on or after January 1, 2006. The defined contribution plan replaced the county's defined benefit plan, under which the county paid for from 60 to 100 percent of the premium for eligible individuals hired before 2006. Under the defined contribution plan, the county contributes \$1,300 per year to a retirement health savings plan for each eligible employee. Upon retirement, employees with 15 years of county service can access 60 percent of the funds the county contributed to their health savings plans for eligible medical expenses. With each additional year of service, the employee has access to another 4 percent of the contributed amount. As such, employees with 25 or more years of service have access to the full amount of funds in their health savings plans when they retire.
South Carolina	<ul style="list-style-type: none"> <li>Government contribution</li> </ul>	The state reduced the level of government contribution for employees hired after May 1, 2008, who become eligible for retiree health benefits. Employees hired before that date, who become eligible for retiree health benefits, qualified for the full amount of government contribution (which officials said was approximately 71 percent of the premium) if they retired with at least 10 years of service. Under the new requirements, in order to qualify for the full government contribution, such employees hired on or after May 1, 2008, must have 25 years of service. Individuals with from 15 to 25 years of service qualify for half of the government contribution, while no contribution is provided to employees with less than 15 years of service.

Source: Information obtained through communications with, and documents provided by, officials from selected governments.

Some of the governments we selected assessed the effect of their health benefit changes on the amount of their retiree health liability. Specifically, according to government officials, Gainesville's change to its government contribution reduced the city's liability by \$6 million, or 12 percent. According to state officials, South Carolina's retiree health benefit changes are projected to save the state \$3.5 billion over 50 years. Additionally, officials from Oakland County, Michigan, indicated that the county's actuary estimated that the change from a defined benefit to a defined contribution plan would result in decreases to the county's ARC beginning in 2017, as the number of retirees receiving benefits through the defined benefit health plan decreases.<sup>42</sup>

Officials from the governments we selected reported some challenges in determining and implementing changes to their retiree health benefits. The most commonly reported challenge was reaching agreement with the various parties involved in the decision-making process, most notably the

<sup>42</sup>Officials explained that the closing of its defined benefit plan actually increased the county's ARC in the short term, as it required some changes in actuarial assumptions.

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collective bargaining units representing affected personnel. For example, officials from one government indicated that the government was currently in arbitration with a collective bargaining unit over its health benefit changes, while officials from another government indicated that an unfair labor practice claim had been filed against the government as a result of its benefit changes. Officials from a third government noted that given the fiscal environment, it was difficult to make cuts to retiree health benefits since the government was already negotiating other compensation changes with collective bargaining units, such as eliminating pay raises for active employees. Finally, officials from one government noted that the state's constitution would prohibit the state from reducing the retiree health benefits for existing employees or retirees, thereby limiting the state's ability to change retiree health benefits for anyone except newly hired employees.

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## Health-Related Spending, Including OPEB Liabilities, Is Increasing State and Local Governments' Fiscal Pressures

Unfunded OPEB liabilities on their own are large enough to represent a fiscal pressure for state and local governments but are also likely to be considered part of the broader fiscal challenge of managing increasing health care costs. State and local governments faced increasing fiscal pressures in 2008, in part because of recession-induced revenue shortfalls. Since the start of the recession in the fourth quarter of 2007 to the same quarter in 2008, state and local government revenues declined by 3 percent, after adjusting for inflation. During the same period, spending in the state and local government sector increased by about 1 percent, also adjusted for inflation.<sup>43</sup>

Our model of state and local government revenues and spending projects that state and local governments' fiscal pressures will increase in the future and will largely be driven by increases in health care spending.<sup>44</sup> We

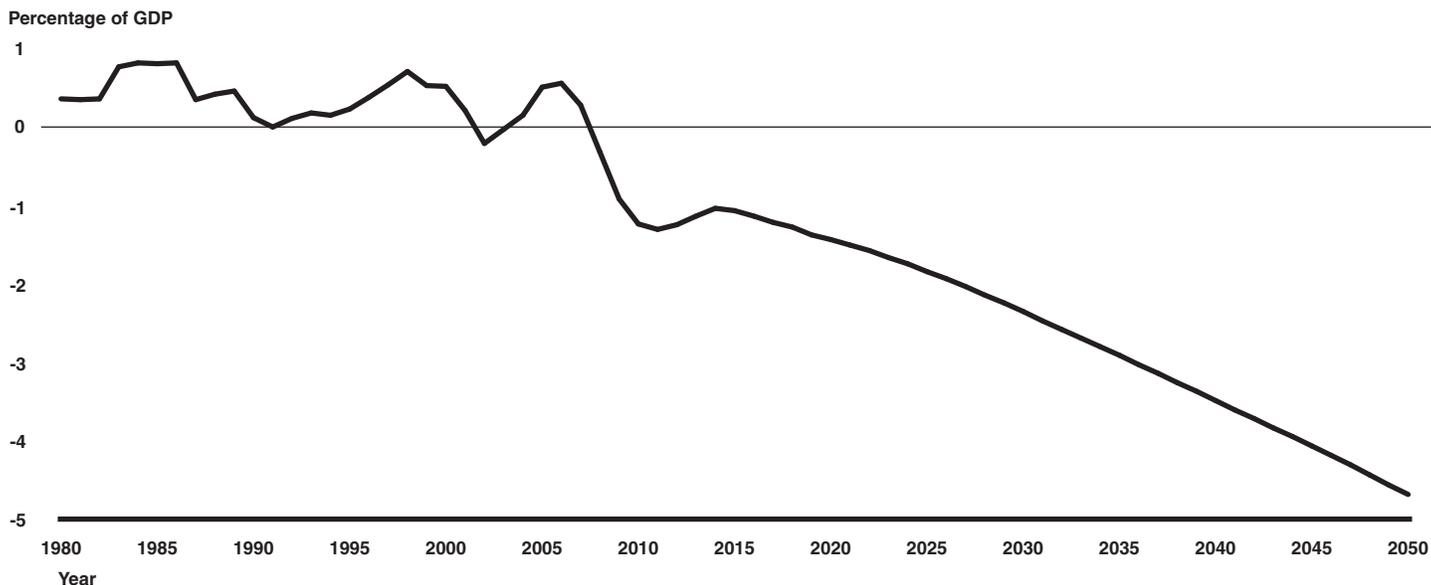
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<sup>43</sup>Our calculations are based on data from the National Income and Product Accounts (NIPA). The NIPA, published by the Department of Commerce's Bureau of Economic Analysis, is a set of economic accounts that provides the framework for presenting detailed measures of U.S. output and income. Inflation adjustments are based on the expenditure deflator for state and local government expenditures.

<sup>44</sup>Our model provides projections of the aggregate operating budget balance for all state and local governments combined. The operating budget balance is the excess of spending over revenues, where the spending is limited to paying for the routine functions of governments. It excludes capital expenditures for public investment, since such spending fluctuates from year to year and is often financed with borrowing and paid for in subsequent years. Also, a government can defer capital expenditures more easily than operating expenditures.

constructed a model of aggregate spending and revenues for all state and local governments in the United States in order to provide a general picture of fiscal pressures facing many state and local governments in the future.<sup>45</sup> Our model reflects the fiscal implications assuming current policies remain unchanged. The model's results are not a prediction of future decisions on government policies; in the face of growing fiscal pressure, changes in policies are likely. According to this model, over an extended period of time the difference between the growth of spending and revenues could compound to a large overall operating budget imbalance. As our simulation suggests (see fig. 2), under current policies the operating budget balance for these governments as a whole could deteriorate steadily, from surpluses in 2006 to a deficit of 4.7 percent of gross domestic product (GDP) by 2050.

**Figure 2: State and Local Government Operating Budget Balance, as a Percentage of GDP**



Source: Historical data from National Income and Product Accounts and GAO simulations updated January 2009.

<sup>45</sup>Our model projects growth in state and local revenues from the present level of \$1.8 trillion to \$11.3 trillion in 2050. Gross domestic product (GDP) in 2050 is projected at \$77.2 trillion. State and local revenues tend to grow in step with GDP, which is a proxy for the country's ability to finance spending. GDP is projected to grow at an annual rate of 4.1 percent from 2008 to 2050, while revenues grow at 4.5 percent annually. Spending is projected to grow more rapidly than revenues, at 5.1 percent annually.

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Health-related spending represents the fastest growing component common in government budgets at all levels in the United States.<sup>46</sup> For state and local governments, the largest spending item for this category is Medicaid. Although retiree health benefits require a much smaller share of total spending than Medicaid, health benefits for state and local government retirees also have projected rapid cost growth.<sup>47</sup> In 2007, at \$324 billion, Medicaid expenditures represented 17 percent of total state and local government spending. State and local government spending on health benefits for nearly 3 million retirees was \$15.8 billion in 2008. As shown in figure 3, our model indicates that future spending for purposes other than health care will fall as a percentage of GDP, but health-related spending will more than make up for the decline.<sup>48</sup>

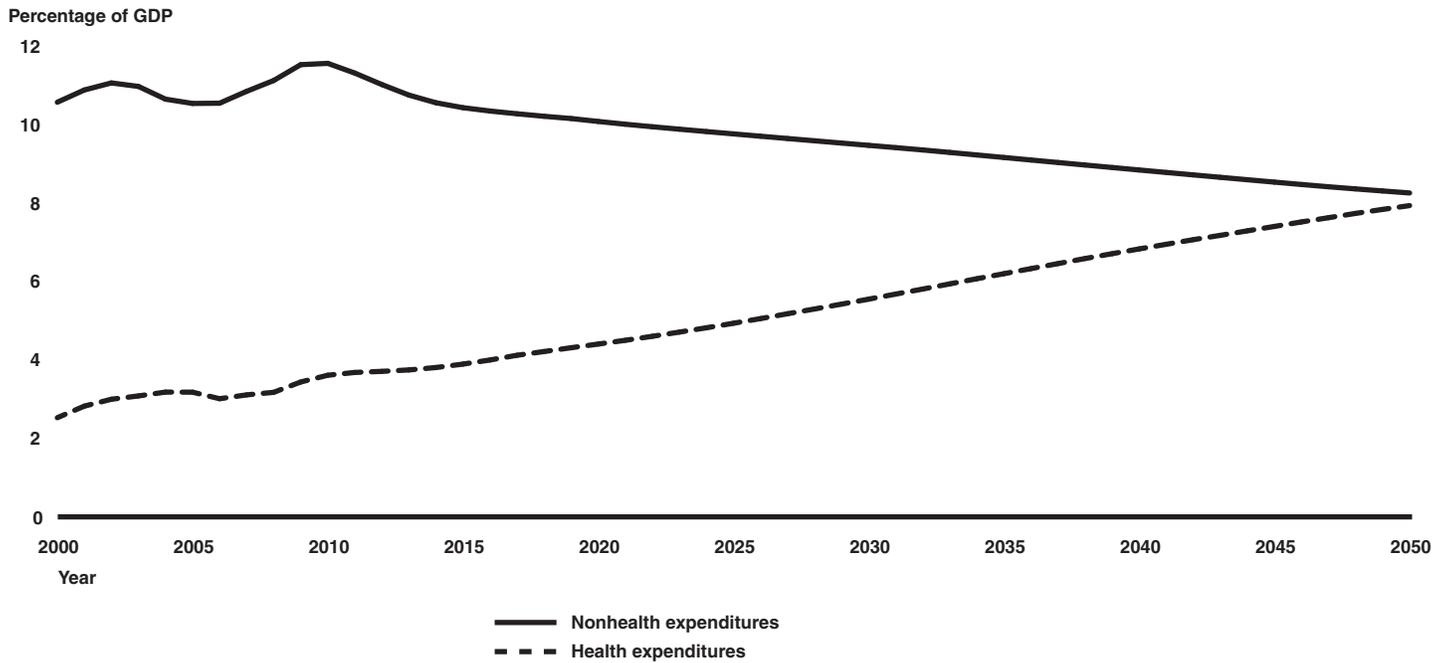
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<sup>46</sup>Even an annual growth rate in health-related spending of a few percentage points in excess of projected growth in revenues contributes to large operating budget imbalances in the long run.

<sup>47</sup>Medicaid is a joint federal-state program that finances health care for certain low-income individuals.

<sup>48</sup>The fiscal pressure indicated by our model's results could be even greater if our estimates for the growth of health-related spending prove to be understated.

**Figure 3: Health and Nonhealth Expenditures for the State and Local Government Sector, as a Percentage of GDP**



Source: Historical data from National Income and Product Accounts and GAO simulations updated January 2009.

The increased share of operating revenues consumed by state and local governments' spending on retiree health benefits projected under current policies indicates the fiscal pressure associated with those benefits. According to our model, by 2050 the number of state and local government retirees is likely to grow by about 70 percent from the current level of 3 million to 5.1 million retirees. This implies that the number of retirees grows at an average annual rate of about 1.3 percent. However, the cost of retiree health benefits is projected to grow more quickly, at an annual rate of 6.7 percent over that same period.<sup>49</sup> According to our model, this means that current spending of \$15.8 billion on retiree health benefits will grow to \$237.3 billion by 2050, in current dollars. As a share of total state and

<sup>49</sup>The calculations incorporate a long-run inflation rate of 1.9 percent as measured by the GDP price index. For more information on how the model projects the cost of retiree health benefits, see app. II.

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local government operating revenues, the projected spending for state and local government retirees' health benefits might not be viewed with great concern. However, spending on state and local government retirees' health benefits is projected to more than double as a share of total operating revenues by 2050, from 0.9 percent to 2.1 percent. State budget officials have told us that they face challenges financing future health benefits in general, including Medicaid benefits and health benefits for active government employees, not just for their retirees. The rapid increase projected for retiree health liabilities is just one effect of the escalating health care costs under ongoing debate by policymakers and others. Future possible changes in policies could cause actual budget outcomes to diverge from what our model projects. Such changes could include reductions in health care benefits, reductions in the number of retirees receiving benefits, increases in state and local taxes, or a combination of these.

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## External Comments

We provided a draft of this report to GASB and the National Association of State Auditors, Comptrollers and Treasurers, which provided technical comments that we incorporated as appropriate.

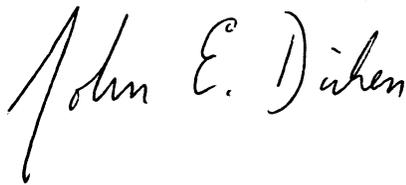
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Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in appendix V.

Sincerely yours,

A handwritten signature in black ink that reads "John E. Dicken". The signature is written in a cursive style with a large initial 'J'.

John E. Dicken  
Director, Health Care

A handwritten signature in black ink that reads "Barbara D. Bovbjerg". The signature is written in a cursive style with a large initial 'B'.

Barbara D. Bovbjerg  
Director, Education, Workforce, and Income Security

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# Appendix I: Supplemental Scope and Methodology for State and Local Government CAFR Review

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To describe what is reported about state and local governments' unfunded other postemployment benefits (OPEB) liabilities, we reviewed the most recent governmentwide comprehensive annual financial reports (CAFR), as of June 30, 2009, for the states and selected local governments.<sup>1</sup> We contacted representatives from individual state and local governments to discuss the reporting of OPEB data in the CAFRs, as necessary. Specifically, we reviewed the fiscal year 2008 CAFRs for 48 states and the fiscal year 2007 CAFRs for 2 states that had not released their fiscal year 2008 CAFRs by June 30, 2009.<sup>2</sup> We also reviewed the most recent CAFRs for the 39 largest local governments (i.e., cities and counties with total revenue of \$2 billion or more, according to U.S. Census Bureau data). Of those, we reviewed fiscal year 2008 CAFRs for 34 local governments and fiscal year 2007 CAFRs for the 5 that had not released their fiscal year 2008 CAFRs by June 30, 2009.<sup>3</sup> We based our selection of local governments on the most recent U.S. Census Bureau data from the 2002 Census of Governments, "Finances of County Governments" and "Finances of Municipal and Township Governments," which includes local governments with populations of at least 25,000.<sup>4</sup> The 39 local governments for which we reviewed CAFRs are listed in appendix III, table 4.

We determined that the state and local government CAFR data were sufficiently reliable for our purposes, which were to describe the total unfunded OPEB liability reported; the total OPEB liability, assets, and unfunded liability for each of the individual governments for which we reviewed CAFRs; as well as the ranges of unfunded OPEB liabilities, assets, and funded ratios reported.<sup>5</sup> Although we reviewed the most recent CAFRs, typically fiscal year 2008 CAFRs, the body of OPEB data on which

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<sup>1</sup>CAFRs are typically audited.

<sup>2</sup>We reviewed fiscal year 2007 CAFRs for Illinois and Ohio.

<sup>3</sup>We reviewed fiscal year 2007 CAFRs for Indianapolis, Indiana; Westchester County, New York; Chicago, Illinois; Cook County, Illinois; and Detroit, Michigan.

<sup>4</sup>U.S. Census Bureau, *2002 Census of Governments*, vol. 4, no. 3, and U.S. Census Bureau, *2002 Census of Governments*, vol. 4, no. 4.

<sup>5</sup>As stated earlier, governmentwide CAFRs typically report OPEB data for separate plans. However, we report only aggregate state data, except for the funded ratio data for individual plans reported by two state CAFRs and two local government CAFRs, which we include in order to provide illustrative examples. Otherwise, we do not report OPEB data for individual plans.

we report reflects many different actuarial valuation dates.<sup>6</sup> Because the universe of local governments is estimated at about 88,000 governments, we limited our review of local government CAFRs to those for the 39 largest local governments, as described above, thus leaving out of our review the majority of local government CAFRs. We did not analyze the CAFR data governments reported or review the reasonableness of the actuarial assumptions used to estimate the OPEB and related unfunded liabilities. To complement our CAFR review, we contacted experts on state and local government retiree health benefits, such as national organizations, including the National Governors Association, the Association of Local Government Auditors, the National Conference of State Legislators, the National Association of Counties, and the Government Finance Officers Association. Other organizations we contacted include the State and Local Government Benefits Association, the National Conference of Public Employees Retirement Systems, and Standard and Poor's. We also reviewed actuarial literature and different studies and data sets related to the unfunded OPEB liabilities across states and local governments. Those sources include Workplace Economics, *State Government Retiree Health Benefits: Current Status and Potential Impact of New Accounting Standards*, 2004; Cato Institute, *Unfunded State and Local Health Costs: \$1.4 Trillion*, 2006; Standard and Poor's, *U.S. State and Quantifying OPEB Liabilities and Developing Funding Strategies as the GASB Deadline Nears*, 2007; National Association of State Comptrollers, *Annual OPEB Survey*, 2006, 2007, and 2008; PEW Center on the States, *Promises with a Price: Public Sector Retirement Benefits*, 2007; Credit Suisse, *You Dropped a Bomb on Me*, GASB, 2007; the Center for State and Local Government Excellence, *At a Crossroads: The Financing and Future of Health Benefits for State and Local Government Retirees*, 2009; and Robert Clark and Melinda Sandler Morrill, *Health Plans for Retired State Employees: Is There a Funding Crisis?* 2009.

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<sup>6</sup>For an actuarial valuation, an actuary estimates the amount (in current dollars) as of the valuation date that will be needed to pay for future benefits.

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# Appendix II: Supplemental Scope and Methodology for Description of State and Local Governments' Fiscal Pressures

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To describe the fiscal pressures facing state and local governments, we used our model that simulates fiscal outcomes of the state and local sector in the aggregate for several decades into the future. The model is not designed to project the fiscal position of individual states; rather, it simulates the potential level of aggregate receipts and expenditures of the state and local sector in future years based on current and historical spending and revenue patterns. A January 2008 report provided a detailed description of how we constructed the model, and sections of that methodology directly relevant to data in this report are provided below.<sup>1</sup>

As an organizing framework and basic data source, our state and local government model relies on the National Income and Product Accounts (NIPA), prepared by the Department of Commerce's Bureau of Economic Analysis. We project the growth in each category of receipts and expenditures using the Congressional Budget Office's economic assumptions whenever possible. In several cases, we were not able to obtain existing projections and needed to develop our own assumptions about the likely future growth path of certain receipts or expenditures. We also developed detailed models to project items such as necessary pension fund contributions, the costs of health insurance for employees and retirees, and several tax receipt categories. Our base-case model assumes current policies remain in place. Below, we describe how that basic assumption is realized. Once all receipts and expenditures of the sector are simulated forward through 2050, we develop summary indicators of the state and local government sector's fiscal status. Because the model covers the state and local government sector in the aggregate, the fiscal outcome of individual states and localities cannot be captured. Also, the model does not identify whether it is the states or the local governments that face greater fiscal challenges. The following describes (1) the receipts and expenditures for the state and local government sector; (2) the measure of fiscal imbalance; (3) how we developed factors for employment, retirement, and benefits; and (4) how we projected the costs of health care.

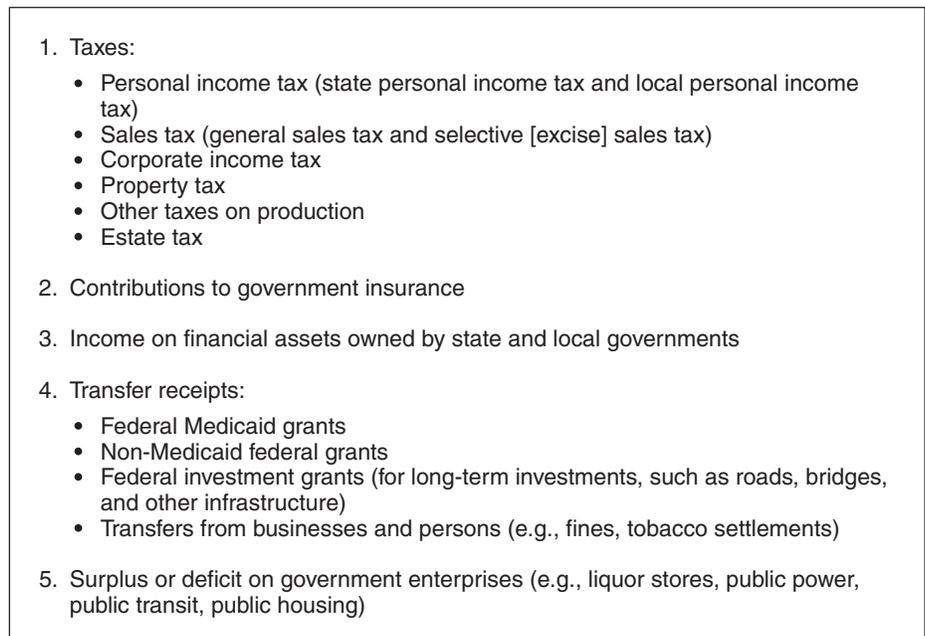
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<sup>1</sup>[GAO-08-317](#).

## Projection of Receipts and Expenditures of the State and Local Government Sector

The model provides projections for each type of receipt of state and local governments. The Bureau of Economic Analysis assembles the NIPA based on data from the quinquennial Census of Governments, annual surveys of government finances, and other sources. In the NIPA, receipts are divided into five major categories: tax receipts, contributions for government social insurance, income receipts on assets, transfer receipts, and the current surplus of government enterprises. Figure 4 shows these categories as well as the breakdown of receipts within each of these classifications.

**Figure 4: Receipt Classifications of State and Local Governments**



Source: GAO organization of NIPA classifications.

Note: Unlike the NIPA, we do not distinguish between current and noncurrent receipts.

In the NIPA, expenditures are divided into five categories, some much larger than others. Figure 5 shows the five categories. Consumption expenditures, the largest category, include such items as the compensation of state and local government employees. Transfer payments include Medicaid payments. Smaller classifications are interest paid on the outstanding debt of these governments, subsidies, and expenditures for investments in fixed capital and nonproduced assets.

Figure 5: Expenditure Classifications of State and Local Governments

1. Consumption expenditures
  - Compensation of employees
    - Wages and salaries
    - Pension fund contributions
    - Health care payments
    - Other employee benefits (e.g., life insurance)
  - Consumption of fixed capital (i.e., depreciation)
  - Miscellaneous consumption expenditures
    - Purchases of intermediate goods
    - Offsets related to tuition, hospitals, and certain other services not considered enterprises
    - Own account investments—offsets related to expenditures classified as consumption expenditures in the given year but really related to longer-term investments
2. Transfer payments to citizens
  - Medicaid and other health payments
  - Non-Medicaid transfers
3. Interest paid on outstanding state and local debt
4. Subsidies
5. Purchases of fixed assets and purchases of nonproduced assets (mostly land)

Source: GAO organization of NIPA classifications.

## Measures of Fiscal Balance

In this report, we use the operating budget balance (operating balance) as a measure of fiscal balance. Operating balance is a GAO-developed measure that we call the *operating balance excluding funds for capital expenditures*. This measure is designed to be roughly akin to the operating budgets of subnational governments—budgets that these governments are generally required to balance or nearly balance. We develop a measure of receipts not available to finance current spending as the difference between investment spending and the change in medium- and long-term debt. Subtracting this amount from total receipts leaves the estimated receipts that are available to finance current expenditures. The expenditure component of the balance measure excludes both investment spending and depreciation. Our operating balance measure includes two further adjustments to NIPA-based totals. First, we exclude the current surplus/deficit of government enterprises from receipts because state and local government operating budgets exclude government enterprises. This adjustment has no effect on our base-case simulations because we assume

the balance is equal to zero, but its incorporation accommodates potential alternative assumptions about the current balance of government enterprises. We also exclude a category of funds that we call the net balance of social insurance funds. As noted earlier, state and local employees as well as employers make contributions to social insurance funds to pay for such items as temporary disability and workers' compensation insurance. Payments from these funds are embedded in transfer payments that governments pay to workers when they are disabled or otherwise entitled to payments from these insurance funds. In our simulations, the balance is assumed to grow with total wage and salary disbursements. While governments hold balances in these funds, the funds are not available for operating expenses.

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## Development of Factors for Employment and Beneficiary Levels

Key underlying information for the health care expenditure simulations relate to future levels of employment, retirees, and wages. In particular, to estimate the expenditure for the postretirement promises the sector has and will continue to make as well as expenditures for health care for active employees, we need to project the number of employees and retirees in each future year. The cost of health care is discussed later in this appendix. We project the number of state and local government employees and the number of beneficiaries for each year during the simulation time frame. To project the level of employment in each future year, we assume that state and local employment grows at the same rate as total population under the intermediate assumptions of the Board of Trustees of the Old-Age and Survivors Insurance and Disability Insurance Trust Funds<sup>2</sup>—that is, we assume that the ratio of state and local employment to total population remains constant.<sup>3</sup> The Trustees assume that population growth gradually declines from 0.8 percent during the next decade to a steady rate of 0.3 percent per year beginning in 2044. Accordingly, state and local government employment growth displays the same pattern in our projections. To project the number of beneficiaries, we assumed that future growth in the number of state and local government retirees—many of whom will be entitled to pension and

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<sup>2</sup>See *The 2007 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds* (Washington, D.C., May 1, 2007), table A2.

<sup>3</sup>This assumption implies that if there were no growth in the productivity of state and local workers, the output of services per person served would remain the same. As such, any increased growth in services provided per citizen depends on the degree to which productivity in public sector services advances.

health care benefits—is largely driven by the size of the workforce in earlier years. While actuaries use detailed information and assumptions regarding the age, earnings, service records, and mortality rate applicable to the entities they evaluate, information in such detail is not available for the state and local government sector as a whole. This lack of detailed data necessitated the development of a method of projecting aggregate state and local beneficiary growth that is much simpler than the methods that actuaries employ.

The method we developed reflects the logic that each year's growth in the number of beneficiaries is linked to past growth in the number of employees. Total state and local government employment from 1929 through 2005 was obtained from NIPA tables 6.4a, b, c, and d. The U.S. Census Bureau provided data on the number of state and local pension beneficiaries from 1992 through 2005, during which continuous observations were available. Cyclical swings in the employment series were removed using a Hodrick-Prescott filter.<sup>4</sup> Then both the employment and beneficiary series were logged and first-differenced, transforming the data from levels to proportionate changes. We developed a routine that searched across 45 years of lagged employment growth to select a set of weights for the years in which past employment growth best explained a given year's growth in beneficiaries.<sup>5</sup> The routine included the restrictions that the weights must be nonnegative and sum to one.

The method produced a relationship that reflected the contribution of a particular past year's employment change in explaining a given year's change in retirees. In particular, the estimated relationship suggests that beneficiary growth in a given year is largely determined by employment growth 21, 22, 23, and 34 years before the given period. This pattern appears consistent with the categories of workers that the sector employs. Many fire and police positions, for example, offer faster pension accrual or early retirement due to the physical demands and risks of the work, while many other state and local workers have longer careers.

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<sup>4</sup>The Hodrick-Prescott filter is an algorithm for choosing smoothed values for a time series.

<sup>5</sup>The Excel Solver function was used to find the weights that minimized the sum of the squared residuals between actual and fitted beneficiaries.

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## Projections of Health Care Costs for State and Local Employees and Retirees

Most state and local governments pay for employee and retiree health insurance on a pay-as-you-go basis—that is, these benefits are generally not prefunded. We made projections of the pay-as-you-go expenditures for health care for the sector, as a percentage of wages, in each year until 2050.<sup>6</sup> To estimate expenditures for employee and retiree health insurance in future years, we used the methods described above to develop projections of employment in the sector and the number of retirees. An additional assumption for the health care analysis is that in future years, the same percentage of employees and retirees of state and local governments will be enrolled in health insurance through their previous employers as we observe were enrolled in 2004—the most recent year for which data were available. For retirees, we developed this measure from two data sources. The U.S. Census Bureau's State and Local Government Employee-Retirement System survey provided data on the total number of state and local retirees, and the Department of Health and Human Services' Medical Expenditure Panel Survey provided data on state and local government retirees who are covered by employer-provided health insurance. Through these data sources we found that the share of retirees with health insurance is 44 percent, and we hold this constant through the simulations. From the latter data source we also obtained the most recent year state and local government spending data on health care for retirees. For active employees we also used the Medical Expenditure Panel Survey data on employees covered by health insurance and compared them to the Bureau of Economic Analysis data on the total employment in the sector. This provided us with a finding that 71 percent of active employees are receiving health benefits. Again, we hold this value constant during the simulation time frame.

One of the most central assumptions we must make to estimate the pay-as-you-go health care expenditures for employees and retirees in future years is the cost growth of health care itself. The cost of health care has been increasing faster than gross domestic product (GDP) for many years. As such, we developed assumptions about how much faster health care costs would grow, relative to the economy, in future years. We developed these assumptions based on our own research and discussions with experts. In particular, we assume that the excess cost factor averages 1.4 percentage points per year through 2035, and then begins to decline, reaching 0.6 percentage points by 2050.

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<sup>6</sup>Implicitly, we assume that the medical coverage continues to pay about the same percentage of medical costs for employees and retirees that it currently does.

Using these assumptions, we developed projections for the expenditures on health care for employees and retirees each year through 2050. We found that the projected expenditures for retiree health insurance, while not a large component of state budgets, will more than double as a percentage of wages over the next several decades. In 2006, these expenditures amounted to approximately 2.1 percent of wages, and by 2050 we project that they will grow to nearly 5.1 percent of wages—a 150 percent increase. Our estimates of these expenditures are highly sensitive to certain of our assumptions. In particular, the assumptions regarding health care cost growth are critical. For example, if health costs were to only rise at the rate of GDP per capita, expenditures for retiree health care would only grow, as a percentage of wages, from 2.1 percent today to 3.0 percent by 2050. Conversely, if health costs were to grow by twice the rate we assume in the base case, these costs would constitute 8.7 percent of wages by 2050.<sup>7</sup>

The percentage of an active employee's wage expended on health care amounted to 12.8 percent of wages in 2006 and by the end of the simulations in 2050 is expected to be 22.2 percent of wages. In the case of the optimistic scenario—with lower escalation in the cost of health care—we found that expenditures on employee health care will only rise slightly to 13 percent of wages by 2050. However, under the pessimistic scenario characterized by more rapidly growing health costs, expenditures on health care for active employees rise to 37.7 percent of wages in 2050.

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<sup>7</sup>Because our state and local government retiree health care cost estimates are based on data that did not incorporate possible savings attributable to the Medicare Part D drug subsidy that began in 2006, the estimates may overstate retiree health care costs slightly.

# Appendix III: Aggregate Other Postemployment Benefits Liability Data for States and Local Governments We Reviewed

The data for OPEB (which are primarily retiree health benefits) presented in tables 3 and 4 are those reported in the most recently issued governmentwide CAFRs, as of June 30, 2009, for the 50 states and the 39 largest local governments. As described more fully in appendix I, in most cases the most recently issued CAFR was for fiscal year 2008.<sup>1</sup> We reviewed only the governmentwide CAFRs and did not review separate financial reports for component entities or cost-sharing multiple-employer plans that do not report their OPEB data in the CAFR. Also, data below reflect the data reported by the governments in their CAFRs and not GAO analysis of financial reports.<sup>2</sup>

**Table 3: Aggregate OPEB Liability Data for 50 States, Based on the Most Recent Governmentwide CAFRs**

Dollars in thousands

State	Liability	Value of assets	Unfunded liability
Alabama <sup>a</sup>	\$2,984,796	\$0	\$2,984,796
Alaska <sup>a</sup>	3,758,699	1,651,729	2,106,970
Arizona <sup>a</sup>	71,180	0	71,180
Arkansas	1,748,182	0	1,748,182
California	62,000,000	0	62,000,000
Colorado <sup>b</sup>	276,332	0	1,326,332
Connecticut <sup>c</sup>	2,318,800	0	2,318,800
Delaware <sup>d</sup>	5,565,100	79,400	5,486,100
Florida	2,404,323	0	2,404,323
Georgia <sup>e</sup>	19,100,171	778,048	18,457,641
Hawaii	8,788,892	0	8,788,892
Idaho	493,746	4,325	489,421
Illinois <sup>a</sup>	24,200,000	0	24,200,000

<sup>1</sup>Of the 89 CAFRs reviewed, 7 were fiscal year 2007 CAFRs, and the rest were fiscal year 2008 CAFRs.

<sup>2</sup>There was one exception. In the few cases where a CAFR reported an entity with a funded ratio of more than 100 percent, we did not include the “overfunded” unfunded liability in the government’s aggregate unfunded liability because to do so could understate the aggregate unfunded liability of the remaining entities. We did not adjust the aggregate liabilities or assets in those cases. In those cases, the unfunded liability is more than the liability minus assets, as noted in each case. Also, for some governments, the aggregate unfunded OPEB liability does not equal the aggregate of the liabilities minus assets, because of the data that were reported in the CAFR.

**Appendix III: Aggregate Other  
Postemployment Benefits Liability Data for  
States and Local Governments We Reviewed**

Dollars in thousands

<b>State</b>	<b>Liability</b>	<b>Value of assets</b>	<b>Unfunded liability</b>
Indiana	442,268	0	442,268
Iowa	404,362	0	404,362
Kansas	316,640	0	316,640
Kentucky <sup>f</sup>	13,008,572	1,348,326	11,661,694
Louisiana	12,542,953	0	12,542,953
Maine	2,422,806	139,000	2,283,806
Maryland	14,852,304	118,884	14,733,420
Massachusetts	11,649,000	329,000	11,320,000
Michigan <sup>a</sup>	14,929,200	14,300	14,914,900
Minnesota	1,011,444	0	1,011,444
Mississippi	570,248	0	570,248
Missouri	2,867,472	15,646	2,851,826
Montana <sup>a</sup>	631,918	0	631,918
Nebraska	The CAFR reports that the implementation of Governmental Accounting Standards Board (GASB) Statement 45 had no material effect on the financial statements. According to the CAFR, after a retired employee reaches age 65, the state has no further obligation for OPEB, except for a very small number of employees.		
Nevada <sup>a</sup>	The CAFR reports that the state's OPEB data are accounted for by a multiple employer cost-sharing defined postemployment benefit plan and the related OPEB data are reported in a separate stand-alone financial report and not in the governmentwide CAFR.		
New Hampshire <sup>a</sup>	2,559,500	0	2,559,500
New Jersey <sup>a</sup>	50,649,500	0	50,649,500
New Mexico <sup>g</sup>	3,116,916	170,626	2,946,289
New York	50,819,000	0	50,819,000
North Carolina	29,364,734	623,174	28,741,560
North Dakota	124,046	42,500	81,546
Ohio <sup>a</sup>	31,594,079	11,204,857	20,389,222
Oklahoma <sup>a</sup>	359,800	0	359,800,000
Oregon	868,393	258,600	609,793
Pennsylvania <sup>h</sup>	11,794,150	108,240	11,685,919
Rhode Island <sup>a</sup>	788,189	0	788,189
South Carolina	8,609,121	0	8,609,121
South Dakota	76,406	0	76,406
Tennessee	2,398,673	0	2,398,673
Texas <sup>a</sup>	7,007,453	0	7,007,453

**Appendix III: Aggregate Other  
Postemployment Benefits Liability Data for  
States and Local Governments We Reviewed**

Dollars in thousands

State	Liability	Value of assets	Unfunded liability
Utah	669,617	0	669,617
Vermont <sup>l</sup>	1,618,245	3,664	1,614,582
Virginia <sup>a</sup>	4,984,000	1,345,000	3,639,000
Washington	3,799,530	0	3,799,530
West Virginia <sup>a</sup>	The CAFR reports that the state provides OPEB, which are provided under a multiemployer cost-sharing plan. According to the CAFR, complete financial statements and additional disclosures for the plan are available from the plan's administrative offices.		
Wisconsin <sup>a</sup>	1,472,774	0	1,472,774
Wyoming	174,161	0	174,161
<b>Total<sup>l</sup></b>	<b>\$422,207,695</b>	<b>\$18,235,319</b>	<b>\$405,159,751</b>

Source: GAO calculations based on data reported in states' CAFRs.

<sup>a</sup>Our review of the government's CAFR indicated that there is or may be OPEB information for at least one plan reported outside the CAFR.

<sup>b</sup>For one entity, Colorado's CAFR reports the unfunded liability but not the liability or assets, which is why the state's unfunded liability shown above is about \$1.05 billion more than liability minus assets.

<sup>c</sup>Connecticut's fiscal year 2008 CAFR also reports an additional "estimated accrued liability" of \$23.7 billion as of June 30, 2008, according to an interim actuarial valuation. The CAFR states that because the valuation was "limited in scope," the associated funded status and funding progress data are not disclosed. The liability and unfunded liability are shown here as they were reported in the CAFR.

<sup>d</sup>Delaware's CAFR reports an unfunded liability for one entity that is \$400,000 higher than the liability minus assets. The unfunded liability is shown here as it was reported in the CAFR.

<sup>e</sup>Georgia's CAFR reported one entity with a funded ratio of 121 percent. The unfunded liability shown above does not include the "overfunded" unfunded liability because doing so could understate the unfunded liability of the remaining two entities, which is why the total unfunded liability is \$135 million more than liability minus assets.

<sup>f</sup>Kentucky's CAFR reported one entity with a funded ratio of 106 percent. The unfunded liability shown above does not include the "overfunded" unfunded liability because doing so could understate the unfunded liability of the remaining entities, which is why the total unfunded liability is \$1.4 million more than liability minus assets.

<sup>g</sup>New Mexico's CAFR reports an unfunded liability for one entity that is slightly less than the liability minus assets disclosed for that entity. The unfunded liability is shown here as it was reported in the CAFR.

<sup>h</sup>Pennsylvania's CAFR reports unfunded liabilities for two entities that are slightly more than the liability minus assets for each of those entities, and an unfunded liability for one entity that is slightly less than the liability minus assets, resulting in an aggregate unfunded liability that is slightly higher than the total liabilities minus total assets. The unfunded liability is shown here as it was reported in the CAFR.

<sup>i</sup>Vermont's CAFR reports an unfunded liability for one entity that is slightly less than the liability minus assets disclosed for that entity. The unfunded liability is shown here as it was reported in the CAFR.

<sup>j</sup>The total unfunded liability reported here does not equal the total liability minus total assets, for the reasons discussed in the previous table notes and also because of rounding.

**Appendix III: Aggregate Other  
Postemployment Benefits Liability Data for  
States and Local Governments We Reviewed**

**Table 4: Aggregate OPEB Liability Data for the 39 Largest Local Governments,  
Based on the Most Recent Governmentwide CAFRs**

Dollars in thousands

<b>Local governments</b>	<b>Liability</b>	<b>Value of assets</b>	<b>Unfunded liability</b>
Alameda County, Calif.	\$639,800	\$614,800	\$25,000
Baltimore, Md.	2,149,800	76,000	2,073,800
Baltimore County, Md.	1,765,553	0	1,765,553
Boston, Mass.	5,490,836	0	5,490,836
Chicago, Ill.	1,786,833	0	1,786,833
Clark County, Nev.	799,864	4,639	795,225
Cook County, Ill.	The most recent CAFR available for our review was the county's fiscal year 2007 CAFR, which did not reflect implementation of GASB Statement 45 and therefore did not report OPEB liability data. The CAFR indicates that the fiscal year 2008 CAFR will reflect implementation of GASB Statement 45.		
Denver, Colo.	128,607	96,457	32,150
Detroit, Mich. <sup>a</sup>	6,000,000	0	6,000,000
Harris County, Tex.	852,351	0	852,351
Houston, Tex.	326,500	54,500	272,000
Indianapolis, Ind.	137,738	0	137,738
Jacksonville, Fla.	175,117	0	175,117
Fairfax County, Va.	679,524	0	679,524
Los Angeles, Calif.	5,160,558	2,830,204	2,330,354
Los Angeles County, Calif.	21,231,100	0	21,231,100
Maricopa County, Ariz. <sup>b,c</sup>	15,915	0	15,915
Memphis, Tenn.	1,600,546	0	1,600,546
Miami-Dade County, Fla.	284,024	0	284,024
Montgomery County, Md.	1,176,000	0	1,176,000
Nashville-Davidson County, Tenn.	2,649,279	0	2,640,248
Nassau County, N.Y.	3,316,121	0	3,316,121
New York City, N.Y.	62,135,453	2,594,452	59,541,001
Orange County, Calif.	423,025	79,717	343,308
Philadelphia, Pa. <sup>b</sup>	1,158,100	0	1,158,100
Phoenix, Ariz. <sup>d</sup>	405,923	74,072	345,579
Prince George's County, Md. <sup>b</sup>	762,335	0	762,335
Riverside County, Calif.	47,828	10,411	37,417
Sacramento County, Calif.	245,592	0	245,592

**Appendix III: Aggregate Other  
Postemployment Benefits Liability Data for  
States and Local Governments We Reviewed**

Dollars in thousands			
Local governments	Liability	Value of assets	Unfunded liability
San Antonio, Tex. <sup>e</sup>	1,118,131	464,476	670,245
San Bernardino County, Calif.	The CAFR does not report any OPEB information. An official from the county's Office of the Auditor/Controller-Recorder said that the county does not offer OPEB to retirees and thus has no OPEB liabilities to disclose.		
San Diego, Calif.	1,235,707	29,637	1,206,070
San Diego County, Calif. <sup>b</sup>	The CAFR reports that the county provides retiree health benefits and participates in a cost-sharing multiple-employer defined benefit health plan. According to the CAFR, a separate entity issues financial reports that include financial statements for the retiree health plan.		
San Francisco, Calif. <sup>f</sup> (city and county)	4,000,000	0	4,014,000
Santa Clara County, Calif.	1,432,241	0	1,432,241
Suffolk County, N.Y.	4,292,950	0	4,292,950
Washington, D.C.	745,200	219,700	525,500
Wayne County, Mich.	885,057	0	885,057
Westchester County, N.Y.	1,334,800	0	1,334,800
<b>Total<sup>g</sup></b>	<b>\$136,588,409</b>	<b>\$7,149,065</b>	<b>\$129,474,631</b>

Source: GAO calculations based on data reported in local governments' CAFRs.

<sup>a</sup>Detroit's fiscal year 2007 CAFR indicates that the city will implement GASB Statement 45 in its fiscal year 2008 CAFR, which was not yet available as of June 30, 2009.

<sup>b</sup>Our review of the government's CAFR indicated that there is or may be OPEB information for at least one plan reported outside the CAFR.

<sup>c</sup>Maricopa County's CAFR indicates that the OPEB data reported for one plan represent data for the entire plan group and includes all participating jurisdictions because only one actuarial report is completed for the plan group. The liability, assets, and unfunded liability data are shown here as they were reported in the CAFR.

<sup>d</sup>Phoenix's CAFR reported one entity with a funded ratio of 123 percent. The unfunded liability shown above does not include the "overfunded" unfunded liability for that entity because doing so could understate the unfunded liability of the remaining entities, which is why the total unfunded liability is about \$13.7 million more than liability minus assets.

<sup>e</sup>San Antonio's CAFR reported one entity with a funded ratio of 153 percent. The unfunded liability shown above does not include the "overfunded" unfunded liability for that entity because doing so could understate the unfunded liability of the remaining entities, which is why the total unfunded liability is about \$16.6 million more than liability minus assets.

<sup>f</sup>San Francisco's CAFR reports unfunded liability for three entities but liability and assets for one, so the unfunded liability shown above is about \$14 million more than the liability minus assets.

<sup>g</sup>The total unfunded liability reported here does not equal the liability minus assets, for the reasons discussed in the previous table notes and also because of rounding.

# Appendix IV: State and Local Governments' CAFR Internet Addresses

In conducting our review of the most recent CAFRs for the states and 39 local governments, we obtained the reports from the government's public Web sites, as shown, with hyperlinks in table 5. As of August 2009 the Internet addresses were current. However, as Internet sites change the Internet addresses may also change.

**Table 5: State and Local Governments' CAFR Internet Addresses and Hyperlinks**

<b>State governments</b>	
Alabama	<a href="http://comptroller.alabama.gov/pages/cafr.aspx">http://comptroller.alabama.gov/pages/cafr.aspx</a>
Alaska	<a href="http://fin.admin.state.ak.us/dof/financial_reports/cafr_toc.jsp">http://fin.admin.state.ak.us/dof/financial_reports/cafr_toc.jsp</a>
Arizona	<a href="http://www.gao.az.gov/financials/default.asp">http://www.gao.az.gov/financials/default.asp</a>
Arkansas	<a href="http://www.arkansas.gov/dfa/accounting/documents/cafr2008.pdf">http://www.arkansas.gov/dfa/accounting/documents/cafr2008.pdf</a>
California	<a href="http://www.sco.ca.gov/ard_state_cafr.html">http://www.sco.ca.gov/ard_state_cafr.html</a>
Colorado	<a href="http://www.colorado.gov/dpa/dfp/sco/cafr/cafr.htm">http://www.colorado.gov/dpa/dfp/sco/cafr/cafr.htm</a>
Connecticut	<a href="http://www.osc.state.ct.us/reports/">http://www.osc.state.ct.us/reports/</a>
Delaware	<a href="http://accounting.delaware.gov/cafrdefault.shtml">http://accounting.delaware.gov/cafrdefault.shtml</a>
Florida	<a href="http://www.myfloridacfo.com/aadir/statewide_financial_reporting/cafr.htm">http://www.myfloridacfo.com/aadir/statewide_financial_reporting/cafr.htm</a>
Georgia	<a href="https://www.audits.state.ga.us/sgd/cafr_main.html">https://www.audits.state.ga.us/sgd/cafr_main.html</a>
Hawaii	<a href="http://hawaii.gov/dags/accounting-division/Annual%20Financial%20Report">http://hawaii.gov/dags/accounting-division/Annual%20Financial%20Report</a>
Idaho	<a href="http://www.sco.idaho.gov/web/DSADoc.nsf/financial_reports">http://www.sco.idaho.gov/web/DSADoc.nsf/financial_reports</a>
Illinois	<a href="http://www.ioc.state.il.us/library/cr.cfm">http://www.ioc.state.il.us/library/cr.cfm</a>
Indiana	<a href="http://www.in.gov/auditor/2370.htm">http://www.in.gov/auditor/2370.htm</a>
Iowa	<a href="http://das.sae.iowa.gov/financial_reports/index.html">http://das.sae.iowa.gov/financial_reports/index.html</a>
Kansas	<a href="http://www.da.ks.gov/ar/finrept/">http://www.da.ks.gov/ar/finrept/</a>
Kentucky	<a href="http://finance.ky.gov/ourcabinet/caboff/ooc/ofm/debt/cafr.htm">http://finance.ky.gov/ourcabinet/caboff/ooc/ofm/debt/cafr.htm</a>
Louisiana	<a href="http://doa.louisiana.gov/OSRAP/CAFR-2.htm">http://doa.louisiana.gov/OSRAP/CAFR-2.htm</a>
Maine	<a href="http://www.maine.gov/osc/finanrept/cafr.htm">http://www.maine.gov/osc/finanrept/cafr.htm</a>
Maryland	<a href="http://www.marylandtaxes.com/finances/revenue/cafr.asp">http://www.marylandtaxes.com/finances/revenue/cafr.asp</a>
Massachusetts	<a href="http://www.mass.gov/?pageID=oscterminal&amp;L=3&amp;L0=Home&amp;L1=Publications+and+Reports&amp;L2=Financial+Reports&amp;sid=Aosc&amp;b=terminalcontent&amp;f=reports_audits_rpt_cafr&amp;csid=Aosc">http://www.mass.gov/?pageID=oscterminal&amp;L=3&amp;L0=Home&amp;L1=Publications+and+Reports&amp;L2=Financial+Reports&amp;sid=Aosc&amp;b=terminalcontent&amp;f=reports_audits_rpt_cafr&amp;csid=Aosc</a>
Michigan	<a href="http://www.michigan.gov/budget/0,1607,7-157-13406_13419---,00.html">http://www.michigan.gov/budget/0,1607,7-157-13406_13419---,00.html</a>
Minnesota	<a href="http://www.finance.state.mn.us/fin/acct">http://www.finance.state.mn.us/fin/acct</a>
Mississippi	<a href="http://www.dfa.state.ms.us/offices/ofm/bfr.htm">http://www.dfa.state.ms.us/offices/ofm/bfr.htm</a>
Missouri	<a href="http://oa.mo.gov/acct/cafr.htm">http://oa.mo.gov/acct/cafr.htm</a>
Montana	<a href="http://accounting.mt.gov/cafr/default.mcp">http://accounting.mt.gov/cafr/default.mcp</a>
Nebraska	<a href="http://www.das.state.ne.us/accounting/cafr/cafrcon.htm">http://www.das.state.ne.us/accounting/cafr/cafrcon.htm</a>
Nevada	<a href="http://controller.nv.gov/CAFR_Download_Page.htm">http://controller.nv.gov/CAFR_Download_Page.htm</a>
New Hampshire	<a href="http://admin.state.nh.us/accounting/reports.asp#PAFR">http://admin.state.nh.us/accounting/reports.asp#PAFR</a>

**Appendix IV: State and Local Governments'  
CAFR Internet Addresses**

<b>State governments</b>	
New Jersey	<a href="http://www.state.nj.us/treasury/omb/publications/08budget/index.shtml#cafr">http://www.state.nj.us/treasury/omb/publications/08budget/index.shtml#cafr</a>
New Mexico	<a href="http://www.dfafcd.state.nm.us/html/indexcafr.html">http://www.dfafcd.state.nm.us/html/indexcafr.html</a>
New York	<a href="http://www.osc.state.ny.us/finance/">http://www.osc.state.ny.us/finance/</a>
North Carolina	<a href="http://www.osc.nc.gov/financial/">http://www.osc.nc.gov/financial/</a>
North Dakota	<a href="http://www.nd.gov/fiscal/cafr/">http://www.nd.gov/fiscal/cafr/</a>
Ohio	<a href="http://obm.ohio.gov/SectionPages/FinancialReporting/">http://obm.ohio.gov/SectionPages/FinancialReporting/</a>
Oklahoma	<a href="http://www.ok.gov/OSF/Comptroller/Financial_Reporting.html">http://www.ok.gov/OSF/Comptroller/Financial_Reporting.html</a>
Oregon	<a href="http://www.oregon.gov/DAS/SCD/SARS/publications.shtml">http://www.oregon.gov/DAS/SCD/SARS/publications.shtml</a>
Pennsylvania	<a href="http://www.budget.state.pa.us/portal/server.pt/community/financial_reports/4574">http://www.budget.state.pa.us/portal/server.pt/community/financial_reports/4574</a>
Rhode Island	<a href="http://controller.admin.ri.gov/Financial%20Reports/index.php">http://controller.admin.ri.gov/Financial%20Reports/index.php</a>
South Carolina	<a href="http://cg.sc.gov/publications/currentcafr.htm">http://cg.sc.gov/publications/currentcafr.htm</a>
South Dakota	<a href="http://www.state.sd.us/BFM/cafr.htm">http://www.state.sd.us/BFM/cafr.htm</a>
Tennessee	<a href="http://tennessee.gov/finance/act/cafr.html">http://tennessee.gov/finance/act/cafr.html</a>
Texas	<a href="https://fmx.cpa.state.tx.us/fm/pubs/cafr/index.php">https://fmx.cpa.state.tx.us/fm/pubs/cafr/index.php</a>
Utah	<a href="http://finance.utah.gov/reporting/cafr.html">http://finance.utah.gov/reporting/cafr.html</a>
Vermont	<a href="http://finance.vermont.gov/reports_and_publications/cafr">http://finance.vermont.gov/reports_and_publications/cafr</a>
Virginia	<a href="http://www.doa.virginia.gov/Financial_Reporting/CAFR/CAFR_Main.cfm">http://www.doa.virginia.gov/Financial_Reporting/CAFR/CAFR_Main.cfm</a>
Washington	<a href="http://www.ofm.wa.gov/cafr/">http://www.ofm.wa.gov/cafr/</a>
West Virginia	<a href="http://www.wvfinance.state.wv.us/cafrgap.htm">http://www.wvfinance.state.wv.us/cafrgap.htm</a>
Wisconsin	<a href="http://www.doa.state.wi.us/subcategory.asp?linksubcatid=374&amp;linkcatid=225&amp;linkid=69&amp;locid=3">http://www.doa.state.wi.us/subcategory.asp?linksubcatid=374&amp;linkcatid=225&amp;linkid=69&amp;locid=3</a>
Wyoming	<a href="http://sao.state.wy.us/saopubs.htm">http://sao.state.wy.us/saopubs.htm</a>
<b>Local governments</b>	
Alameda County, Calif.	<a href="http://www.acgov.org/auditor/cafr.htm">http://www.acgov.org/auditor/cafr.htm</a>
Baltimore, Md. (City)	<a href="http://www.baltimorecity.gov/government/finance/docs.php">http://www.baltimorecity.gov/government/finance/docs.php</a>
Baltimore County, Md.	<a href="http://www.baltimorecountymd.gov/Agencies/budfin/finance/accounting/index.html">http://www.baltimorecountymd.gov/Agencies/budfin/finance/accounting/index.html</a>
Boston, Mass.	<a href="http://www.cityofboston.gov/auditing/cafr.asp">http://www.cityofboston.gov/auditing/cafr.asp</a>
Chicago, Ill.	<a href="http://egov.cityofchicago.org/webportal/COCWebPortal/COC_EDITORIAL/CAFR2007.pdf">http://egov.cityofchicago.org/webportal/COCWebPortal/COC_EDITORIAL/CAFR2007.pdf</a>
Clark County, Nev.	<a href="http://www.accessclarkcounty.com/depts/comptroller/pages/cafr.aspx">http://www.accessclarkcounty.com/depts/comptroller/pages/cafr.aspx</a>
Cook County, Ill.	<a href="http://www.cookcountygov.com/ccgovinternet/Portlets/ExistingWebApp/Frameset_Page.html?http://www.cookcountygov.com/bof4">http://www.cookcountygov.com/ccgovinternet/Portlets/ExistingWebApp/Frameset_Page.html?http://www.cookcountygov.com/bof4</a>
Denver, Colo.	<a href="http://www.denvergov.org/controller/comprehensiveannualfinancialreportcard/tabid/430463/default.aspx">http://www.denvergov.org/controller/comprehensiveannualfinancialreportcard/tabid/430463/default.aspx</a>
Detroit, Mich.	<a href="http://www.ci.detroit.mi.us/departments/finance/tabid/86/default.aspx">http://www.ci.detroit.mi.us/departments/finance/tabid/86/default.aspx</a>
Harris County, Tex.	<a href="http://www.co.harris.tx.us/auditor/statements_reports.aspx">http://www.co.harris.tx.us/auditor/statements_reports.aspx</a>
Houston, Tex.	<a href="http://www.houstontx.gov/controller/cafr.html">http://www.houstontx.gov/controller/cafr.html</a>
Indianapolis, Ind.	<a href="http://www.indy.gov/egov/city/controller/pages/home.aspx">http://www.indy.gov/egov/city/controller/pages/home.aspx</a>
Jacksonville, Fla.	<a href="http://www.coj.net/departments/finance/accounting/cafr.htm">http://www.coj.net/departments/finance/accounting/cafr.htm</a>
Fairfax County, Va.	<a href="http://www.fairfaxcounty.gov/finance/cafr.htm">http://www.fairfaxcounty.gov/finance/cafr.htm</a>

**Appendix IV: State and Local Governments'  
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<b>Local governments</b>	
Los Angeles, Calif.	<a href="http://www.lacity.org/ctr/financial_reports.htm">http://www.lacity.org/ctr/financial_reports.htm</a>
Los Angeles County, Calif.	<a href="http://file.lacounty.gov/lac/cms1_115472.pdf">http://file.lacounty.gov/lac/cms1_115472.pdf</a>
Maricopa County, Ariz.	<a href="http://www.maricopa.gov/finance/cafr.aspx">http://www.maricopa.gov/finance/cafr.aspx</a>
Memphis, Tenn.	<a href="http://www.cityofmemphis.org/framework.aspx?page=20">http://www.cityofmemphis.org/framework.aspx?page=20</a>
Miami-Dade County, Fla.	<a href="http://www.miamidade.gov/finance/annual_reports.asp">http://www.miamidade.gov/finance/annual_reports.asp</a>
Montgomery County, Md.	<a href="http://www.montgomerycountymd.gov/mcgtmpl.asp?url=/content/finance/financial.asp#2008">http://www.montgomerycountymd.gov/mcgtmpl.asp?url=/content/finance/financial.asp#2008</a>
Nashville-Davidson County, Tenn.	<a href="http://www.nashville.gov/finance/operations/cafr2008.asp">http://www.nashville.gov/finance/operations/cafr2008.asp</a>
Nassau County, N.Y.	<a href="http://www.nassaucountyny.gov/agencies/comptroller/specialreports.html">http://www.nassaucountyny.gov/agencies/comptroller/specialreports.html</a>
New York City, N.Y.	<a href="http://www.comptroller.nyc.gov/bureaus/acc/cafr2007_ins.shtm">http://www.comptroller.nyc.gov/bureaus/acc/cafr2007_ins.shtm</a>
Orange County, Calif.	<a href="http://www.ocgov.com/finrpt.asp">http://www.ocgov.com/finrpt.asp</a>
Philadelphia, Pa.	<a href="http://www.phila.gov/finance/cafr.html">http://www.phila.gov/finance/cafr.html</a>
Phoenix, Ariz.	<a href="http://phoenix.gov/menu/cityfinfinance.html">http://phoenix.gov/menu/cityfinfinance.html</a>
Prince George's County, Md.	<a href="http://www.princegeorgescountymd.gov/Government/AgencyIndex/Finance/accounting.asp">http://www.princegeorgescountymd.gov/Government/AgencyIndex/Finance/accounting.asp</a>
Riverside County, Calif.	<a href="http://www.auditorcontroller.org/opencms/topics_interest/CAFR.html">http://www.auditorcontroller.org/opencms/topics_interest/CAFR.html</a>
Sacramento County, Calif.	<a href="http://www.budget.saccounty.net/cafr/default.htm">http://www.budget.saccounty.net/cafr/default.htm</a>
San Antonio, Tex.	<a href="http://www.sanantonio.gov/ir/cafr%20stmts.htm">http://www.sanantonio.gov/ir/cafr%20stmts.htm</a>
San Bernardino County, Calif.	<a href="http://www.sbcounty.gov/acr/pdf_download.htm#CAFR">http://www.sbcounty.gov/acr/pdf_download.htm#CAFR</a>
San Diego, Calif.	<a href="http://www.sandiego.gov/comptroller/reports/index.shtml">http://www.sandiego.gov/comptroller/reports/index.shtml</a>
San Diego County, Calif.	<a href="http://www.sdcounty.ca.gov/auditor/cafr.html">http://www.sdcounty.ca.gov/auditor/cafr.html</a>
San Francisco, Calif. (city and county)	<a href="http://www.sfgov.org/site/controller_page.asp?id=1824">http://www.sfgov.org/site/controller_page.asp?id=1824</a>
Santa Clara County, Calif.	<a href="http://www.scctax.org/portal/site/fin/agencychp?path=%2Fv7%2FFinance%20Agency%20%28AGY%29%2FController-Treasurer%20Department%2FCAFR%20Report">http://www.scctax.org/portal/site/fin/agencychp?path=%2Fv7%2FFinance%20Agency%20%28AGY%29%2FController-Treasurer%20Department%2FCAFR%20Report</a>
Suffolk County, N.Y.	<a href="http://www.co.suffolk.ny.us/home/departments/comptroller/financial%20reports.aspx">http://www.co.suffolk.ny.us/home/departments/comptroller/financial%20reports.aspx</a>
Washington, D.C.	<a href="http://cfo.dc.gov/cfo/cwp/view,a,1322,q,590082,cfoNav,%7C33210%7C.asp">http://cfo.dc.gov/cfo/cwp/view,a,1322,q,590082,cfoNav,%7C33210%7C.asp</a>
Wayne County, Mich.	<a href="http://www.waynecounty.com/mygovt/mb/financial_statements.aspx">http://www.waynecounty.com/mygovt/mb/financial_statements.aspx</a>
Westchester County, N.Y.	<a href="http://westchestergov.com/finance/">http://westchestergov.com/finance/</a>

Source: GAO review of public Web sites.

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# Appendix V: GAO Contacts and Staff Acknowledgments

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## GAO Contacts

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