REPORT TO THE

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A Review
of the
Public Education Retirement Benefits

July 2005

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Digest of
A Review of Public Education Retirement Benefits

Utah's public education system currently offers post-retirement salary stipends and additional health insurance benefits that are above and beyond the typical state pension and retiree insurance package. Just as with the state's post-retirement benefits, public education has amassed a large, unfunded liability that must be addressed to prevent future educational funding problems. This audit addresses a legislative request for an estimate of both accrued and future liabilities for public education and, if needed, recommendations for an appropriate course of action to resolve concerns with public education's benefit liabilities.

Chapter II: Public Education's Post-retirement Benefits Must Be Modified.

Public Education Post-retirement Benefit Programs Have a Potential Liability of $1.4 Billion. About $954 million of this liability is committed to current employees with prior years of service and is, for the most part, unfunded. An unfunded liability increases the risk of an inability to pay future benefit obligations. The remaining $500 million represents the additional costs that will result if the programs are allowed to continue unchecked.

Public education must modify or eliminate offered benefits and develop a plan to fund the remaining liability without compromising educational services or requiring additional taxpayer assistance. While the state had less costly benefits than most within public education, the 2005 Legislature's passage of House Bill 213 established a clear policy position to modify the cost of post-retirement benefits and improve the fiscal integrity and soundness of its benefits package. It is important that public education do likewise.

Chapter III: Legislature Can Play Vital Role

Although Large Potential Liabilities Exist, There Is Hope for Reducing and Better Managing These Costs. Primary control of public education's post-retirement benefits rests within each district. However, there may be a tendency to address short-term funding needs rather than these post-retirement potential liabilities that could be years or decades away. The Legislature can play a vital role helping school districts to promptly address the growing liability problem created by these benefits.

Again, it is critical that each school district and the Utah State Board of Education (which includes the State Office of Education, the State Office of Rehabilitation, and the School for the Deaf and Blind) reduce their liability by modifying or eliminating their benefits. Once modified, each district must develop a viable funding plan for its remaining liability. Modification or elimination of these costly post-retirement benefits is a challenge but can be done. The Legislature can also assist school districts by requiring actuarial studies and specifying reporting requirements for district cost control and funding plans.

Chapter III Recommendations

1. We recommend the Legislature require districts and the USBE to assess their full liability by having actuarial studies completed by June 2006 on all post-retirement benefits including stipends, insurance to age 65, and insurance after age 65.

2. We recommend the Legislature require districts and the USBE to standardize key actuarial assumptions such as the medical inflation rate and the discount rate and report these assumptions during the 2006 General Session.

3. We recommend the Legislature require the USBE to provide for the compiling and reporting of all actuarial study results to the Legislature during the 2007 General Session.

4. We recommend the Legislature require districts and the USBE to modify or eliminate post-retirement benefits to a level that is affordable, sustainable, and more comparable with the state's costs.

5. We recommend the Legislature require districts and the USBE to develop plans to fund post-retirement obligations by modifying or eliminating benefits instead of requesting additional funding from the Uniform School Fund or local taxpayers and without negatively impacting educational services. These plans should be reported to the Legislature during the 2007 General Session.

6. We recommend that the Legislature consider fiscal sanctions or other appropriate measures if the progress reported by public education during the 2007 General Session is not satisfactory.

Chapter I
Introduction

Public education's post-retirement benefits, offered in addition to employee pensions, have not been fully acknowledged or controlled. As a result, we estimate Utah's school districts and the Utah State Board of Education (USBE) (which includes the State Office of Education, the State Office of Rehabilitation and the School for the Deaf and Blind) have a potential benefit liability in excess of $1.4 billion. About $954 million of this liability is committed to current employees with prior years of service and is, for the most part, unfunded. The remainder represents the additional costs that will result if the programs are allowed to continue unchecked. These mounting post-retirement costs, however, can be minimized. Addressing the spiraling cost of health insurance benefits, the 2005 Legislature's passage of House Bill 213, as prompted by the Governmental Accounting Standards Board (GASB) reporting standard 45, established a clear policy position to modify the cost of post-retirement benefits. It is important that those within public education also modify or eliminate their benefits to ensure their liabilities can be met without compromising educational services or placing an unreasonable burden upon taxpayers to fund the obligation.

Public education must eliminate or change some benefits to avoid compromising educational services in the future.

Public education's liability is greater than the state's because it offers post-retirement salary stipends and health insurance benefits not available for state employees. The total cost of public education's benefits are shown, along with the state's pre-House Bill 213 costs, in Figure 1.

Figure 1. Present Value of Estimated Post-retirement Liabilities. Unless current benefits are changed, school districts will pay over $1.4 billion (expressed in today's dollars) for stipends, insurance and supplemental insurance for current employees alone over the next 35 years. As education grows, new employees will accrue additional liability.

	School Districts	USBE*	State of Utah**
Health Insurance	$975,048,000	$19,616,000	$875,153,000
Stipends/ Termination Payments	333,358,000	2,882,000	No Benefit
Medicare Supplement for Life	162,623,000	No Benefit***	No Benefit***
Future Benefit Costs	$1,471,029,000	$22,498,000	$875,153,000

** USBE's health insurance is part of the State of Utah's total health insurance. We have broken out their liabilities for comparative purposes.*
*** With the passage of HB 213, we estimate the State of Utah (including USBE) will avoid about $374 million of potential liability.*
**** Medicare Supplemental insurance is not offered as a standard benefit. However, if an employee had available sick-leave hours, Medicare Supplemental insurance could be purchased.*

Prompt action must be taken to modify and fund public education's liabilities.

If steps are not taken to modify and fund public education's liability, the problem will continue to grow disproportionally and may exceed their ability to pay for these benefits. The Legislature can play a vital role by ensuring public education promptly address post-retirement benefit programs by requiring that school districts and the USBE:

- modify or eliminate their benefits so that they are affordable and costs are comparable to the state's, and
- assess their full liability for all post-retirement benefits using the methodology described in GASB 45 and then fund all these benefits in such a way as to ensure their future sustainability.

The post-retirement benefits discussed in this report are long-standing benefit programs offered by public education. These benefits include all early retirement, voluntary termination, post-employment, and post-retirement benefits offered by the state's school districts. While the program names differ from district to district, their functions are similar and comparable. This report will refer to all district programs as post-retirement benefits.

State Reduced Future Early Retirement Benefits

The state has taken steps to control its early retirement benefit costs. The Utah Legislature's passage of House Bill 213 in the 2005 General Session reduced future benefits for current state employees while honoring those benefits already earned by them. By taking this action, the State should avoid about $374 million in future benefit costs.

The State of Utah started its early retirement incentive program in 1983. The program offered to those retiring before age 65 up to five years of health insurance. If the employee was retiring before they qualified for Medicare (i.e., prior to age 65), this insurance benefit was seen as a bridge to Medicare coverage. The incentive program was later modified to allow employee sick hours remaining after an optional 25 percent cash-out and the deduction of 480 hours to be used to purchase either additional insurance to age 65 or insurance supplemental to Medicare after age 65. Specifically, eight sick-leave hours purchased one month of health insurance.

By passing HB 213, our analysis estimates the state should avoid about $374 million in future benefit costs.

However, with the rising costs of health premiums, this benefit became more and more costly. As a result, during the 2005 general session, the Legislature made the decision that this benefit was too costly for the state to continue and it was reduced for current state employees. While this benefit was reduced for the future, the current obligation that employees have earned was honored.

Most School Districts Have Not Modified Benefits

Essentially, public education's school districts are facing what the state faced when the Legislature passed House Bill 213. As of yet, however, most school districts have not modified their benefit plans. Of concern is the fact that their liability is potentially much greater because there are more employees with more generous benefits. Currently, school districts offer three types of post-retirement benefits: stipend payments to age 65, health insurance premium payments to age 65, and supplemental health insurance premium payments beginning after age 65 for the life of the

retiree. While the qualification requirements vary among districts, in general, an employee must:

- be eligible for retirement under Utah Retirement System guidelines (e.g., retire at any age with 30 years service, retire at age 62 with 20 years service), and
- meet specific district employment requirements (e.g., employed 10 years with Ogden School District, employed 20 years with Uintah School District).

Stipends Offered in Most Districts

Public education offers retirement benefits beyond the typical state retirement package.

Stipends are generally described as a bridge from salary to full social security and are widespread within school districts (only five districts do not offer stipends). These payments are in addition to any retirement pension being received and, in most cases, will continue even if the retiree becomes re-employed. Stipend payments are paid for a set number of years (most often five years) or until the retiree reaches age 65.

Health Insurance Offered in Most Districts

Districts offer two types of post-retirement insurance: health insurance to age 65 and health insurance after age 65.

Health Insurance Payments to Age 65. Like stipends, health insurance premiums are paid for a set number of years or until the retiree reaches age 65. However, there are a few districts that will pay health insurance to age 65 regardless of the age at retirement. For example, if a Weber district employee qualifies for and retires at age 55, the employee can receive insurance coverage for 10 years. These health insurance payments are conceived as a financial support that bridges the gap from retirement until the employee qualifies for Medicare. This benefit is widespread within school districts and only three districts do not offer health insurance to age 65.

Health Insurance after Age 65. This benefit provides medical insurance that is supplemental to Medicare. Under this benefit, supplemental health insurance premiums are paid for retirees beginning at age 65 and continuing for the life of the retiree and, in some cases, for the life of the retiree's spouse as well. This benefit is not widespread. Only four districts (Alpine, Murray, Provo, and Tooele) offered this benefit type

and all four are in various stages of expense containment. It is also anticipated that the implementation of Medicare Part D will significantly reduce district expenses for this benefit.

Liability Assessment for Post-retirement Benefits Needed

Public education needs to assess and recognize their post-retirement liabilities. The General Accounting Standards Board (GASB) has provided, through GASB 45, a standard to which we believe most post-retirement benefit commitments should be applied. The philosophy behind GASB 45 is to make those who commit to future benefits aware of the cost and need for funding such commitments. Employers (both in private industry and in government) generally have not calculated the future expense of today's commitments. If employers are unable to meet these unfunded commitments, employees can be left without a benefit they relied upon. In addition, the obligation may jeopardize educational programs by drawing funds away.

An actuarial study can help districts understand and manage their post-retirement liabilities.

To insure that employers understand their liabilities, GASB 45 requires an actuarial study with periodic actuarial re-assessments in years that follow. An actuarial study performed to comply with GASB 45 generally identifies the following:

- the organization's liability already committed to employees because of prior years of service. This liability is called the actuarial accrued liability (AAL) and can be thought of as the amount that should be funded as of the actuarial valuation date.

- the portion of the AAL that is not funded is called the unfunded actuarial accrued liability (UAAL), and it is the UAAL that carries with it the risk of failure if future funds are limited.

- the portion of the UAAL that must be paid annually. GASB 45 allows the UAAL to be amortized over 30 years. In other words, an organization is allowed 30 years to eliminate the existing UAAL.

- the current year benefits costs called the normal cost. If not fully funded, then it adds to the UAAL. By modifying or

terminating future benefits, the normal cost can be reduced considerably.

- the projected future liability for current employees. This projection assumes benefits will remain unchanged. If the AAL and the projected future liability are added together, the result is the present value of total projected benefits. The present value of total projected benefits is the single sum necessary to fully fund all anticipated future benefits for all members, active and retired.

Regardless of GASB requirements, we believe public education's post-retirement benefits are real liabilities and a solution is necessary.

The former chairman of the Government Accounting Standards Board believes GASB 45 is lenient with employers because it allows 30 years to fund the accrued liability. GASB is also developing a policy entitled *Accounting for Termination Benefits* that the former chairman believes will be tougher on employers than GASB 45. Under this policy, when the benefit is granted, the employer must calculate the total cost of the benefits and recognize that full amount as an expense on the income statement.

Given public education's longstanding post-retirement programs (generally 20 years or more) and the philosophy behind GASB 45 to insure that these programs can be sustained, this report adopts a GASB 45 viewpoint. Regardless of GASB requirements, we believe these are actual liabilities and a solution is necessary. If steps are not taken to begin funding these liabilities, then the problem of unfunded liabilities and the associated risk of being unable to pay future benefits will simply be pushed to future administrators. The Legislature provided a difficult but logical solution by modifying state employees' benefits.

Audit Scope and Objectives

Legislative awareness of unfunded post-retirement benefit liabilities was significantly heightened by House Bill 213. Through this process, concern for the state's exposure to liabilities was extended to public education where it was known that post-retirement benefits included stipends and insurance. The Legislature requested an estimate of both accrued and future liabilities for the state's 40 school districts and USBE. This report contains:

1. An estimation of actuarial accrued liabilities for public education.

2. An estimation of future liability for public education.

3. Information on the need for legislative involvement in modifying public education's post-retirement benefits.

This audit analysis is not intended to be a substitute for district actuarial studies.

To accomplish these objectives, liability estimations were made for each district and the USBE. For a detailed description of our methodology, see Appendix A. Our analysis is not an actuarial study nor is it a substitute for one. Instead, these are estimates of what an actuarial study might identify.

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Chapter II
Public Education's Post-retirement Benefits Must Be Modified

Public education post-retirement benefit programs have a potential liability of $1.4 billion. Much of this liability is from post-retirement health insurance similar to the state's program. In addition, public education offers additional benefits beyond those offered by the state. Specifically, most school districts offer cash stipends, and some have offered lifetime health insurance coverage. Because of the expense, we believe public education should follow the state's lead and modify or eliminate these programs. It is important that public education ensure its liabilities can be met without compromising education services or placing an unreasonable burden upon taxpayers to fund the obligation.

To reduce this $1.4 billion potential liability, public education should follow the state's lead and modify or eliminate benefits.

Most post-retirement benefit liability is unfunded and, thus, has an increased risk of inability to pay benefit obligations. Consequently, it is critical that each school district and the USBE reduce their unfunded liability by eliminating or modifying their benefits. Once modified, each district must develop a viable funding plan for its remaining liability. Modification or elimination of these costly post-retirement benefits is a challenge but can be done. The state, which had less costly benefits than those of most school districts, took action in 2005 to improve the fiscal integrity and soundness of its benefits package. Public education needs to do likewise.

Public Education Must Address Existing Liability

Unfunded liability is not fiscally sound if progress not made to reduce or eliminate it over time.

Our estimate indicates that public education's current accrued liability is about $954 million. This amount represents the cost, to date, of accumulated benefits. Most of this liability is unfunded since districts generally used a pay-as-you-go methodology. These costs need to be modified and funded or eliminated altogether to follow sound fiscal principles. An unfunded liability is not fiscally sound and should be modified or eliminated to fit the funding ability of the organization.

This $954 million liability is comprised of estimates for three benefits offered within public education. Those three benefits and their contribution to the overall estimate are:

- Stipend payments– $231 million,
- Insurance premium payments up to age 65—$560 million, and
- Insurance premium payments after age 65 (Medicare supplemental insurance)—$163 million.

Most of public education offers both stipend payments and insurance premium payments up to age 65 and four districts offered an additional benefit of lifetime insurance after age 65. Public education, offering more benefits than the state at a higher cost, needs to follow the state's lead in modifying its benefits to improve the fiscal integrity and soundness of its benefit packages.

The estimated accrued liability for each district and the USBE is shown in Figure 2. Again, for those districts without an actuarial study, estimates were made using Jordan School District's actuarial study as a foundation. See Appendix A for the details of the estimation methodology and Appendix B for a letter from our consultant, a senior actuarial consultant with Gabriel, Roeder, Smith and Company, who reviewed and commented on our methodology.

Figure 2. Post-retirement Accrued Liability. Public education's estimated accrued liability for stipends, insurance and supplemental insurance is $954 million.

District	Cost of Stipends	Cost of Insurance	Cost of Medicare Supplement	Total
Alpine	$31,825,000	**$54,721,364**	**$107,195,942**	$193,742,306
Beaver	0	1,546,000		1,546,000
Box Elder	0	10,940,000		10,940,000
Cache	11,166,000	11,775,000		22,941,000
Carbon	1,248,000	4,497,000		5,745,000
Daggett	452,000	423,000		875,000
Davis	21,675,000	55,026,000		76,701,000
Duchesne	2,296,000	0		2,296,000
Emery	1,495,000	3,307,000		4,802,000
Garfield	1,018,000	1,951,000		2,969,000
Grand	0	3,556,000		3,556,000
Granite	26,574,000	77,143,000		103,717,000
Iron	3,706,000	9,582,000		13,288,000
Jordan	**46,087,751**	**92,031,143**		138,118,894
Juab	1,571,000	0		1,571,000
Kane	1,050,000	1,771,000		2,821,000
Logan	4,719,000	4,364,000		9,083,000
Millard	1,356,000	4,867,000		6,223,000
Morgan	419,000	717,000		1,136,000
Murray	1,286,000	2,992,000	**5,733,845**	10,011,845
Nebo	12,629,000	17,052,000		29,681,000
No. Sanpete	924,000	1,939,000		2,863,000
No. Summit	523,000	795,000		1,318,000
Ogden	0	45,820,000		45,820,000
Park City	1,282,000	3,002,000		4,284,000
Piute				
Provo	14,977,000	**26,025,661**	**32,042,009**	73,044,670
Rich	637,000	833,000		1,470,000
Salt Lake	0	**19,019,349**		19,019,349
San Juan	5,179,000	0		5,179,000
Sevier	912,000	1,819,000		2,731,000
So. Sanpete	39,000	900,000		939,000
So. Summit	410,000	2,359,000		2,769,000
Tintic				
Tooele	1,199,000	**9,602,064**	**17,650,750**	28,451,814
Uintah	4,826,000	5,317,000		10,143,000
Wasatch	2,624,000	3,131,000		5,755,000
Washington	9,617,000	23,930,000		33,547,000
Wayne	2,000	126,000		128,000
Weber	15,559,000	46,780,000		62,339,000
USBE	1,931,000	10,952,000		12,883,000
Rounded Total	**$231,214,000**	**$560,612,000**	**$162,623,000**	**$954,448,000**

** Bolded numbers for Alpine, Jordan, Murray, Provo, Salt Lake and Tooele came from their actuarial studies. Salt Lake includes our added estimate for retirees.*

As noted in the footnote accompanying Figure 2, some of the reported cost of insurance numbers came from district actuarial studies. In three of these studies (Alpine, Salt Lake, and Tooele), the assumptions for medical inflation rate trends are significantly different than the assumption made by Jordan's study. While Jordan's actuarial study assumes a medical inflation rate rising over time to 8 percent, Alpine, Salt Lake and Tooele assume an inflation rate falling to around 5.5 percent by 2008. As a result, the cost of insurance reported for these three districts is lower than it would have been had an estimate been made using Jordan's medical inflation assumption.

Public education must modify or eliminate offered benefits and develop a plan to fund the estimated $954 million liability without compromising educational services or requiring additional taxpayer assistance. While these estimates are the liabilities for past years' service, additional liability will continue to be incurred if public education allows benefit plans to remain unchanged.

Without Benefit Changes Public Education's Liabilities Will Increase

An additional $.5 billion liability increase is likely for current employees if benefits are not modified.

Modification or elimination of these benefits for future employees is necessary but does not fully address the growing liability. Public education must also modify the future post-retirement benefits of current employees, or an additional $.5 billion liability increase is likely. This $.5 billion in potential liability is just for current employees and is stated in present value terms. This $.5 billion of future liability for current employees is comprised of estimates for two of the three benefits offered by public education. Those two benefits and their contribution to the overall estimate are:

- Stipend payments—$105 million, and
- Insurance premium payments up to age 65—$ 434 million

No potential future liability was identified for insurance premium payments past age 65 (Medicare Supplemental) in this study because these plans have already been modified. To see the potential additional liability estimated for each district and the USBE, see Figure 3.

Figure 3. Additional Future Liability if Benefits Are Unchanged. Public education will incur at least $.5 billion more liability if benefits are unchanged.

District	Cost of Stipends	Cost of Insurance	Total
Alpine	$14,681,000	$58,448,636	$73,129,636
Beaver	0	1,254,000	1,254,000
Box Elder	0	8,585,000	8,585,000
Cache	5,195,000	8,916,000	14,111,000
Carbon	517,000	3,095,000	3,612,000
Daggett	214,000	323,000	537,000
Davis	10,487,000	42,936,000	53,423,000
Duchesne	1,085,000	0	1,085,000
Emery	596,000	2,201,000	2,797,000
Garfield	459,000	1,436,000	1,895,000
Grand	0	2,768,000	2,768,000
Granite	11,866,000	57,178,000	69,044,000
Iron	1,678,000	7,036,000	8,714,000
Jordan	**21,483,599**	**65,015,440**	86,499,039
Juab	710,000	0	710,000
Kane	428,000	1,227,000	1,655,000
Logan	2,129,000	3,232,000	5,361,000
Millard	511,000	3,188,000	3,699,000
Morgan	225,000	576,000	801,000
Murray	634,000	2,147,000	2,781,000
Nebo	5,519,000	12,357,000	17,876,000
No. Sanpete	382,000	1,356,000	1,738,000
No. Summit	265,000	637,000	902,000
Ogden	0	33,975,000	33,975,000
Park City	698,000	2,504,000	3,202,000
Piute			
Provo	6,420,000	**22,080,213**	28,500,213
Rich	263,000	600,000	863,000
Salt Lake	0	**8,397,446**	8,397,446
San Juan	2,364,000	0	2,364,000
Sevier	451,000	1,396,000	1,847,000
So. Sanpete	23,000	769,000	792,000
So. Summit	183,000	1,725,000	1,908,000
Tintic			
Tooele	510,000	**13,904,936**	14,414,936
Uintah	2,170,000	3,847,000	6,017,000
Wasatch	1,251,000	2,450,000	3,701,000
Washington	4,681,000	18,720,000	23,401,000
Wayne	1,000	73,000	74,000
Weber	5,996,000	31,035,000	37,031,000
USBE	951,000	0	951,000
Rounded Total	**$105,027,000**	**$434,389,000**	**$539,079,000**

** Numbers in bold for Alpine, Jordan, Murray, Provo, Salt Lake and Tooele came from their actuarial studies.*

As shown in Figure 3, insurance to age 65 contributes the majority of the potential liability. This contribution level is because, for the last decade, medical premium inflation rates have been high and Jordan's actuarial study, upon which our estimate is based, assumed medical inflation rates would continue to be high. It was these increasing medical insurance rates that drove the state to take its own cost cutting measures.

Public Education Must Modify or Eliminate Existing Benefits

The Legislature demonstrated fiscal responsibility to the taxpayer by substantially modifying the state's benefit program.

Addressing public education's post-retirement liability is challenging. Districts must first determine what benefits they can afford within their existing budgets. Most likely, the funding level identified in this report for post-retirement benefits cannot be met without compromising current and future educational services and/or without increased property tax/uniform school fund support. The Legislature demonstrated fiscal responsibility to the taxpayer by substantially modifying the state's benefit program. Public education will also need to modify and eliminate programs. Second, not all of the liability can be eliminated, so districts and the USBE must develop plans to fund the remaining liability.

Some Districts Have Started the Modification Process

To illustrate these funding challenges, the annual costs of funding post-retirement benefits are shown in Figure 4 for four districts that have had actuarial studies performed. It should be noted that only Jordan's actuarial analysis considers both stipends and insurance benefits—thus, only Jordan captures their full liability. The other three studies considered insurance benefits only.

Figure 4. Actuarial Annual Costs of Four Districts. The annual contributions necessary to fund benefits are as low as $2.1 million and as high as $17.8 million for these districts.

District	Normal Cost	Amortization of UAAL	Annual Required Contribution
Alpine*	$ 8,789,824	$ 9,005,412	$ 17,795,236
Jordan**	9,169,363	7,480,162	16,649,525
Provo***	1,602,238	2,876,281	4,478,519
Tooele****	604,984	1,515,729	2,120,713

** Alpine's study was performed in October 2003 using a 4% interest rate. Analysis did not include stipend payments.*
*** Jordan's study was performed in September 2004 using a 3% interest rate. Analysis includes stipend payments.*
**** Provo's study was performed in March 2005 using a 3% interest rate. Analysis did not include stipend payments.*
***** Tooele's study was performed in September 2003 using a 4% interest rate. Analysis did not include stipend payments.*

Annual contributions necessary to fund post-retirement benefit programs can be high.

The amortization payment of the UAAL represents 1/30th of the district's total UAAL. Under GASB 45, since this payment is funding the actuary's estimate of what has accumulated for current employees because of past years' service, this amount must either be placed in a trust fund or reported as a liability. Although potentially difficult, it is possible to reduce the actuarial UAAL estimate by modifying the benefit plan to reduce actual costs. Modifying the benefit plan can change the actuarial assumptions used to estimate the UAAL.

The normal cost, shown in Figure 4, identifies the benefit costs accrued for the current year that, if not paid in full, will increase the UAAL. While the amortization payment of the UAAL will continue for no more than 30 years, the normal cost will continue as long as benefits are offered. However, the normal cost can be reduced or eliminated if future benefit policies are changed for current employees.

These annual costs may be difficult for districts to meet. For example, although Tooele has the lowest annual cost of the four, Tooele's administration is unsure if they can dedicate this amount of money every year to benefits. According to Tooele's business administrator, local taxes are already high, so it is not anticipated that the local taxpayers would support a tax increase to pay these post-retirement benefits. So, unless the benefits can be modified, Tooele's salary structure will remain relatively

low since Tooele district cannot afford higher salaries as well as current post-retirement benefits. In summary, the business administrator stated, "Insurance obligations is our number one dilemma in this district." Nonetheless, Tooele, like every other district, must develop a plan to fund its liability.

Modification Options Are Available

Several modification options exist for districts to consider regarding their benefit packages.

Post-retirement benefits can be modified for the future and/or for the past. The former affects the potential accrued liability and was the approach used by the state. The latter approach affects the actuarial accrued liability and was the approach successfully implemented by Murray school district. Depending on a district's funding situation and legal obligations, several options can be considered when examining ways to terminate or modify benefits either in the past or for the future. Some possible options are:

- Change the benefit plan structure (e.g., change from a defined benefit to a defined contribution plan);
- Reduce or eliminate specific benefits levels (e.g., offer single or couple coverage only as a post-retirement benefit. Eliminate family coverage);
- Maintain current benefits but require employees to either pay a larger share of the benefit or take a salary cut to fund the benefits;
- Terminate the post-retirement benefits altogether and provide something else of value (e.g., payments into employees' 401K accounts).

The State Has Modified Its Future Benefits. Although the state's early retirement benefits were less than those within many of the districts, the Legislature, during the 2005 General Session, took action and modified future benefits for state employees. The state modified these benefits because their continuation was fiscally irresponsible. It should be noted, however, that while future benefits were modified, accrued benefits (those benefits already earned by employees) were honored.

We estimated that the state's accrued liability for these early retirement benefits is around $521 million. Further, we estimated the total cost of

the benefits for current employees (before modification by House Bill 213) was around $895 million. Because the Legislature took action and modified the benefit as of January 2006, we believe that the state avoided future benefits costs of around $374 million. The districts should assess if this type of benefit modification would reduce some of their potential liability.

Murray District Has Modified Its Past Benefits. Murray district successfully reduced its Medicare Supplemental actuarial accrued liabilities from approximately $26 million to $6 million. A representative committee was formed to study the issue and make a recommendation to the negotiating teams because the Medicare Supplemental insurance benefit affected administrators, teachers and classified employees. The committee determined that to fund the liability, a salary cut of approximately 12 to 15 percent was necessary. This solution was considered unacceptable by the committee.

Murray district demonstrated how accrued liability can be reduced if it is too expensive to fund.

Instead, the recommended solution was to terminate the benefit and provide something else of value. Murray district accomplished this by requiring that current employees who had been offered Medicare Supplemental insurance upon retirement make one of two choices prior to the benefit termination date:

- retire by benefit termination date and receive the benefit under the old plan. To take this option, an employee had to meet the age requirements present under the old program, or

- if retirement by the benefit termination date was not possible or desired, then an employee could receive a one-time payment to their 401Ks for future retirement use in exchange for releasing the district from its supplemental insurance benefit obligation.

This type of benefit modification may not work for all districts. However, it provides an example of how the actuarial accrued liability can be reduced if it cannot be funded by the district. Ultimately, however, each of public education's forty school districts as well as the USBE must determine how their accrued and future benefit liabilities are going to be controlled and funded.

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Chapter III
Legislature Can Play Vital Role

Primary control of public education's post-retirement benefits rests within each district. If, however, school districts cannot adequately address their post-retirement cost problems, the state does have an interest, and the Legislature can intervene. We believe the Legislature can play a vital role with legislation that requires school districts to promptly address the growing liability problem. The districts may not have strong incentives to identify and fund their post-retirement liabilities. Consequently, the Legislature can move the districts forward by specifying an accounting methodology and reporting requirement for district cost control and funding plans.

Funding Incentives Are Weak

Districts probably see other immediate funding needs as more deserving of action today.

From a district perspective, the effort necessary to identify and fund post-retirement liabilities is high for an outcome that is not on the near horizon. Most likely, districts see other short-term funding needs as more deserving of action today. In fact, this particular issue was recently outlined in a 2005 Education Analysis conducted by the California Legislative Analyst's Office. This analysis provides two reasons why districts might not want to identify and fund their liabilities:

- Setting aside funds on an annual basis to meet future obligations will complicate district budgeting since it will reduce funds available for other priorities, and

- Any financial crisis that would result from these liabilities may be years or decades away.

Given these reasons, it is not hard to understand why some district administrators might not want to follow GASB 45 and have an actuarial study done. In fact, a few districts have told us they are worried by what the actuary might report, and so they are putting off any study for as long as possible. Some districts are taking the approach that an actuarial study is unnecessary for them because their post-retirement benefits have

generated no accrued liabilities. These districts take the approach that employees have no right to expect any post-retirement benefit until retirement is declared by the employee and accepted by the district. Basically, liabilities do not accrue because these districts do not believe they have committed to any program.

This approach appears risky to us. The post-retirement programs within these districts operate similarly to those of other districts, and these districts, like most districts, have offered their post-retirement benefits for 20 years or more. The longer post-retirement benefits are offered, the more likely employees are to expect them upon retirement. If this is the case, it would seem less risky to set aside funds over time to meet the coming obligation rather than wait until the obligation is due.

In light of these weak incentives for districts to identify and fund post-retirement benefits, the Legislature might need to require district action.

Legislature Can Help Move Districts Forward

The Legislature should require districts to identify their liabilities and develop plans to meet these obligations over time.

Legislative action supporting school districts in their need to address post-retirement benefit liabilities may be a desirable option. Toward this end, we believe the Legislature should require districts take action in identifying liabilities and developing funding plans. Specifically, the Legislature should require public education to:

- actuarially assess its full liability for all post-retirement benefits including stipends, insurance to age 65 and insurance after age 65 for all current employees and retirees,
- modify or eliminate benefits so that they are affordable and costs are comparable to the state's, and
- fund all remaining benefits in such a way as to ensure that the benefits can be sustained into the future.

The Legislature should keep in mind that, as actuarial studies are performed, public education may have an incentive to understate these liabilities. One way this understatement might be done is through the assumptions made in the actuarial analysis. GASB 45 allows organizations to make a number of underlying assumptions—for example, the interest rate used, the medical inflation rate used—and these assumptions can affect the actuarial results. Consequently, public education's assumptions should

be focused on insuring a reasonable estimate and adequate funding of obligations. In our opinion, public education should standardize some of the actuarial assumptions that are used among districts (i.e., medical inflation rate, general inflation rate) to increase the comparability among district actuarial studies. Also, the Legislature may want to review the school district and USBE assumptions at some point in the future to make sure the assumptions are reasonable.

In summary, the post-retirement benefits offered by public education must be brought under control. Our estimate of the total post-retirement liability for public education is approximately $1.4 billion. Because the post-retirement stipends and health insurance benefits offered are so costly, school districts and the USBE should modify their benefits so they are affordable and their costs are more comparable with the state's. In addition, since much of this liability is unfunded, it is important that each school district as well as the USBE develop a funding plan to insure their obligation will be met.

Recommendations

1. We recommend the Legislature require districts and the USBE to assess their full liability by having actuarial studies completed by June 2006 on all post-retirement benefits including stipends, insurance to age 65 and insurance after age 65.

2. We recommend the Legislature require districts and the USBE to standardize key actuarial assumptions such as the medical inflation rate and the discount rate and report these assumptions during the 2006 General Session.

3. We recommend the Legislature require the USBE to provide for the compilation and reporting of all actuarial study results to the Legislature during the 2007 General Session.

4. We recommend the Legislature require districts and the USBE to modify or eliminate post-retirement benefits to a level that is affordable, sustainable, and more comparable with the state's costs.

5. We recommend the Legislature require districts and the USBE to develop plans to fund post-retirement obligations by modifying or

eliminating benefits instead of requesting additional funding from the Uniform School Fund or local taxpayers and without negatively impacting educational services. These plans should be reported to the Legislature during the 2007 General Session.

6. We recommend that the Legislature consider fiscal sanctions or other appropriate measures if the progress reported by public education during the 2007 General Session is not satisfactory.

Appendix A
Liability Estimation Methodology

In order to develop an overall estimate of public education's post-retirement liability, it was necessary to make district estimations in those cases in which an actuarial study had not been performed. To accomplish this estimate, we used a September 2004 actuarial analysis performed on Jordan school district as the foundation from which all district estimations would be made. Jordan had the most recent actuarial study and is the only district that estimated the liability associated with stipend payments.

One change was made to Jordan's study. While Jordan's original study used a three percent interest rate, the study was re-analyzed, at our request, using a four percent interest rate. This re-analysis was done to maintain reporting consistency among the districts for which an actuarial study had already been completed. In all cases but one (Provo), the existing actuarial studies had used a four percent interest rate. Of course, this higher interest rate reduces the reported estimated liability amounts from what would have been reported using a three percent interest rate.

Our estimates focused only on stipends and insurance to age 65. The four districts that offer insurance past age 65 (Alpine, Murray, Provo, and Tooele) have had actuarial studies performed. When any actuarial projections were available (e.g., insurance to age 65, insurance after age 65), we used that information rather than our estimates. In making district estimates, we made the following assumptions:

- a large factor that should influence a district's actuarial estimates relative to Jordan's would be the district's size relative to Jordan. So, adjustments were made to Jordan's actuarial estimates based on the comparative district's relative size.

- another factor that should influence a district's actuarial estimate relative to Jordan would be the relative richness or leanness of the benefits offered compared to Jordan's. In other words, under the same conditions, would the comparative district pay more or less in benefits than Jordan? So, as with size, adjustments were made to Jordan's actuarial estimates based on comparative benefit richness.

To enable adjustments based on relative size, each district provided a valuation census. This census was comprised of the number of active employees—segregated into administrative, classified, and certified categories—who could potentially receive a benefit as well as the number of retirees currently receiving an early retirement benefit.

Based on relative size, adjustments were made to Jordan's actuarial study. For example, Carbon has only 11 percent of the administrative employees that Jordan has. So, only 11 percent of Jordan's administrative actuarial estimate was used for Carbon.

To enable adjustments based on relative benefit richness, each district responded to five scenarios (two administrative, two certified, and one classified) for which salaries, insurance premiums, inflation rates, etc. were all standardized. By doing this standardization, a reasonable measure of actual differences in the benefit plans were obtained. This methodology was first used in 2004 by higher education for benefit comparison among higher education's institutions, and we used higher education's scenarios with only slight modifications. Each district's stipend and insurance benefit payout—calculated separately for administrative, classified, and certified employees—was expressed relative to Jordan's.

Based on relative richness or leanness of benefits, adjustments were made to Jordan's actuarial estimates. For example, Carbon's stipend benefit for administrative employees is only 33 percent that of Jordan's. Consequently, 33 percent of the remaining 11 percent (after the relative size adjustment is made) would become our estimate for Carbon's administrative stipend liability.

Provided in Appendix C is an example of how our estimate was made. Carbon is used for this example, and all district estimates were made using this methodology.

To test the reasonableness of our methodology, we compared our model's estimates with two available actuarial studies—Provo and Tooele.

- Provo– The assumptions within Provo's actuarial study and Jordan's actuarial study are very similar, and so it was hoped that our estimate and the actuarial estimate would be close. In fact, they were. Our estimate of Provo's actuarial accrued liability and present value of total benefits for medical insurance is $27 million and $46.6 million, respectively. Provo's actuarial estimate of accrued liability and present value of total benefit cost was $26 million and $48.1 million, respectively.

- Tooele– The assumptions within Tooele's actuarial study and Jordan's actuarial study are not similar in at least one important aspect— the assumptions for medical premium inflation trends. Tooele's trend assumption declines over time to a 5.5 percent inflation rate while Jordan's trend rises over time to an 8 percent inflation rate. Thus, it is reasonable for our estimate to be higher then Tooele's actuarial estimate. Our estimate of Tooele's actuarial accrued liability for medical insurance is $15.4 million while the actuarial estimate is $9.6 million. Our estimate is 60 percent higher. We discussed this difference with an actuary who indicated that the difference in Jordan's medical inflation rate assumption

would produce an estimate 35 to 40 percent higher than Tooele's actuarial study. Taking this assumption difference into account, our estimate was 20 to 25 percent above Tooele's actuarial estimate.

Since one comparison (Provo) validated our methodology while the other (Tooele) did not, we had our methodology and calculations reviewed by an actuary specializing in post-retirement benefits. We contracted with Gabriel, Roeder, Smith, and Company to review our methodology and comment on its ability to provide a reasonable estimate of actuarial liabilities. Our consultant concluded that while there are limitations to our methodology "..., we believe the analysis is sound, [and] ... will produce a "ballpark" estimate of the true liabilities calculated under GASB 45 and GASB 27." To see our consultant's complete response, see Appendix B.

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APPENDIX B
Gabriel, Roeder, Smith & Company

GABRIEL, ROWER, SMITH & COMPANY

Consul'ants & Actuaries

4600 South Ulster Street • Suite 700 • Denver, Colorado
80237-2603·303-846-3031 • fax 303-740-6789

June 30, 2005

John Schaff
Auditor General
Office of the Legislative Auditor General
W315 Utah State Capitol Complex
PO Box 145315
Salt Lake City, UT 84114-5315

Dear John:

As requested, we have reviewed your calculations of retiree liabilities of the Utah school districts relating to health care benefits and stipends. We are enclosing a spreadsheet which estimates the liabilities using methodology similar to yours, but with a few changes which we believe make the estimates more accurate. We also have many comments on the calculations.

Process

Your office estimated the liabilities using the following process:

- Each school district was asked to estimate post retirement benefits for five hypothetical employees.
- The values of those benefits was compared to similar values for Jordan School District
- Each school district provided census information
- Liabilities for the Jordan School District were calculated in an actuarial report prepared by Milliman USA. These were broken down by:
  - Type of benefit
    - Early Retirement Incentive Pay (Stipend)
    - Retiree Health Care
  - Type of covered member
    - Administrative
    - Classified
    - Certified Teacher
- Liabilities for other districts were estimated by adjusting each of Jordan's liabilities by the ratios of:
  - Benefit value of the particular school district to the Jordan benefit value, and
  - Group size of the particular school district to the Jordan group size

We duplicated your liability calculation process, but did not duplicate each district's determination of their benefit values. We checked a few district's determinations where they looked particularly high, and made several corrections to your initial determinations.

We automated much of the process so that corrections can more easily be updated. In particular, it appeared that some Jordan benefit determinations were quite inconsistent from the determinations performed by other districts. Because Jordan is used as the baseline, it is critical that benefit values be calculated consistently.

We reviewed the updated information which you received from Jordan and concur with your adjustments. Those benefit values are included in the attached spreadsheet.

Limitations of Process

We wish to stress that this process is not an actuarial valuation as required under Governmental Accounting Standards No. 27 and 45. It is merely an attempt to adjust another actuarial valuation of one school district to another district. To the extent the Jordan School District is not identical to other school districts, the liabilities will be different. Key characteristics which may vary among districts include:

- Pay levels
- Breakdown of retirees between classified, certified, and administrative, which differ from active employees
- Ages
- Male/Female ratios
- Utilization of health care
- Retirement patterns

Despite these limitations, we believe the approach chosen is reasonable and will produce a "ballpark" estimate of the true liabilities calculated under GASB 45 and GASB 27.

Some of these assumptions will result in numbers which are different from these estimated. In particular, if a district's pay is higher or lower than Jordan's, then the liability related to the stipend will be higher or lower than those estimated.

Issues

Applicable Accounting Standard

The Jordan actuarial report presented the actuarial liabilities for both the stipend and the health care benefits in total as a liability to be reported under GASB 45. We believe that the stipend is not subject to GASB 45, but should either be reported under GASB 27, or as a special termination benefit under less conservative accounting rules. We have broken out our liabilities between the two benefit types. We believe that the "Stipends" column is applicable under GASB 27, while the "Health" column is applicable under GASB 45.

Investment Return Rate
Statement No. 45 indicates that liabilities should be discounted based on the expected return of assets used to fund the liabilities. Because the plan is currently not pre-funded, this suggests that the rate of return on short term investments is appropriate. Both 3% and 4% discount rates were used in the Jordan reports, while a 4% rate is being used in the Office of the Legislative Auditor General's office. We believe that 4% is a reasonable rate to be used for this purpose. Although 4% is somewhat higher than current yields on short term bonds, it is reasonable to assume that bond rates will increase to be at the 4% level in the not too distant future. We have heard informal information from GASB that rates in the 6% to 7% range are not reasonable. They have not commented on lower rates.

Supplemental Insurance
Three districts: Alpine, Murray, Provo, and Toole, reported liabilities of supplemental insurance which you included in your analysis. We did not analyze those liabilities.

Comparison with Actuarial Valuations
We wish to reiterate that our analysis was not an actuarial valuation as required under GASB Statements 27 and 45. It was a confirmation of your approximation attempt to map one actuarial valuation done on one district onto all districts. Subject to these limitations, we believe the analysis is sound.

Actuarial Definitions
This report refers to the "actuarial accrued liability" and "present value of total projected benefits". The present value of projected benefits is the single sum necessary to fully fund all anticipated future benefits for all members, active and retired. The "actuarial accrued liability" is an allocation of the present value to years in the past. It can be thought of as the amount that should be funded as of the actuarial valuation date.

Conclusions

As shown on the attached summary and spreadsheet, the following table presents the total present value of projected benefits and the actuarial accrued liabilities for the district's stipend and health programs. Liabilities by district are included in the attached spreadsheet:

	Actuarial Accrued Liability	Present Value of Total Projected Benefits
Stipends (GASB 27)	$217 million	$316 million
Health (GASB 45)	$573 million	$994 million
Total	$790 million	$1.310 billion

Estimate of Post Retirement Liabilities as of September 1, 2004
Based on 4% Discount Rate

	Actuarial Accrued Liability			PV Total Projected Benefits		
Districts	Stipends	Health	Total	Stipends	Insurance	Total
Alpine	$31,824,648	$64,115,814	$95,940,462	$46,506,383	$113,170,40	$159,676,792
Beaver	$0	$2,273,048	$2,273,048	$0	$4,133,444	$4,133,444
Elox Elder	$0	$10,940,125	$10,940,125	$0	$19,525,118	$19,525,118
Cache	$11,166,160	$11,774,910	$22,941,070	$16,361,437	$20,691,286	$237,052,724
Carbon	$1,247,828	$4,497,357	$5,745,185	$1,764,675	$7,591,782	39,356,457
Daggett	$452,394	$423;062	$875,456	$666,175	$746,327	$1,412,602
Davis	$21,674,719	$55,026,391	$76,731,110	$32,161,733	$97,961,706	$120,123,$39
Eluchesne	$2,295,970	$0	$2,295,970	$3,380,551	$0	$3,380,551
Emery	$1,494,686	$3,306655	$4,831,342	$2,091,488	$5,507,830	$7,599,218
Garfield	$1,045,647	$2,745,074	$3,790,722	$1,513,110	$4,703,492	$6,216,602
Grand	$0	$3,555,749	$3,555,749	$0	$6,323,900	$6,323,900
Granite	$26,574,305	$77,142535	$103,716,840	$38,429,843	$134,320,99	$172,760,635
Iron	$3,705,678	$10,292.565	$13,998,243	$5,384,369	$17,840,442	$23,224,611
Jordan	$46,087,751	$92,031,143	$138,118,894	$67,571,350	$157,046,58	$224,617,933
Juab	$1,570,577	$0	$1,570,577	$2,261,183	$0	$2,281,183
Kane	$1,050,202	$1,770,505	$2,820,707	$1,478,099	$2,998,283	$4,476,382
Logan	$4,938,052	$4,472',396	$9,410,448	$7,125,205	$7,752,834	$14,888,039
Millard	$1,355,565	$4,866,618	$6,222,183	$1,866,953	$8,05$,496	$9,922,4149
Morgan	$418,666	$716,622	$1,135,289	$644,373	$1,292,807	$1,937,180
Murray	$1,285,740	$2,992,145	$4,277,885	$1,920,006	$5,138,780	$7,058,786
Nebo	$0	$0	$0	$0	$0	$0
No. Sanpete	$923,559	$1,938,605	$2,832,164	$1,306,416	$3,294,927	$4,601,243
No. Summit	$522,910	$795,425	$1,318,335	$768,496	$1,432,168	$2,220,64
Ogden	$0	$45,820,267	$45,820,267	$0	$79,794,789	$79,794,789
Park City	$1,281,883	$3,001,676	$4,293,559	$1,979,988	$5,505,791	$7,485,779
Piute	$0	$0	$0	$0	$0	$0
Provo	$14,976,854	$26,987,683	$41,954,536	$21,397,376	$46,644,651	$68,042,028
Rich	$636,506	$833,369	$1,459,874	$899,752	$1,433,151	$2,332,903
Salt Lake	$0	$40,500,848	$40,530,848	$0	$69,612,110	$69,612,110
San Juan	$5,179,209	$0	$5,179,209	$7,543,330	$0	$7,543,230
Sevier	$911,870	$1,819125	$2,730,995	$1,362,835	$3,214,755	$4,577,590
So. San pete	$53,652	$1,073,994	$1,127,646	$61,261	$1,928,431	$2,009,691
So. Summit	$409,999	$2,345,695	$2,755,694	$592,597	$4,061,043	$4,653,640
Tintic	$0	$0	$0	$0	$0	$0
Tooele	$1,199,005	$15,443,457	$16,642,462	$1,708,655	$26,510,962	$28,219,617
Ilintah	$5,088,142	$5,701,020	$10,789,162	$7,384,384	$9,846,069	$17,230,463
Wasatch	$2,623,509	$3,131,203	$5,754,712	$3,874,505	$5,581,076	$9,455,582
Washington	$9,617,093	$23,929,598	$33,546,691	$14,298,491	$42,650,054	$56,948,545
Wayne	$0	$0	$0	$0	$0	$0
Weber	$15,559,474	$46,779,,535	$62,339,009	$21,555,029	$77,815,306	$59,370,235
Total	**$217,172,255**	**$573,044,216**	**$790,216,471**	**$315,940,051**	**$994,128,79**	**$1,310,066,843**

GABRIEL, ROEDER, SMITH & CO.

Please do not hesitate to contact us if you would like to discuss these matters further.

Sincerely,

William B. Fornia, FSA, EA, MAAA
Senior Consultant
gm

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Appendix C
Calculation of Carbon's Stipend Accrued Liability

		4 Percent Discount Rate Used		
	Jordan Actuarial Estimate	Carbon's Relative Size	Carbon's Relative Benefits	Carbon's Estimated Stipend (Rounded)
Administrative	**$ 5,379,643**	**.10798**	**.32337**	**$ 188,000**
Classified		**.06846**		
Certified	**33,591,187**	**.06264**	**.36623**	**771,000**
Retirees	**7,116,921**	**.10959**	**.37108**	**289,000**
Stipend Estimate				**$ 1,248,000**

* *Retirees relative benefit is a weighted average of administrative and certified relative benefits.*

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Agency Responses

UTAH STATE OFFICE OF EDUCATION

Leadership. . . Service. . . Accountability
Patti Harrington, Ed.D. State Superintendent of Public Instruction
Voice: (801) 538-7500 Fax: (801) 538-7521 TDD: (801) 538-7876
250 East Cesar E. Chavez Blvd. (500 South) P.O. Box 144200 Salt Lake City, Utah 84114-4200

July 8, 2005

John M. Schaff
Auditor General
Office of the Legislative Auditor General
W315 Utah State Capitol Complex
PO Box 145315
Salt Lake City, UT 84114-5315

Dear Mr. Schaff:

Thank you for allowing for a review of the Exposure Draft of A Review of the Public Education Retirement Benefits (Report No. 2005-07). The Utah State Office of Education (USOE) has reviewed the draft carefully and has visited with Tim Osterstock, Audit Manager. We appreciate the time and deliberation of this audit report by Tim and other staff.

School district superintendents and business officials are well aware of the issues raised by the findings of this audit. They have been meeting this year on GASB 45 as well as studying the legal obligations of post-retirement benefits. We believe the districts, for the most part, are moving toward a recognition and resolution of their unfunded post-retirement liabilities.

We concur that actuarial studies with standard assumptions are needed to assess the full liability of the various benefits. We are willing to coordinate those studies and report on progress and findings in a timely manner. We would hope to be able to present those findings to the Legislature during the 2007 General Session. However, without more research and without going through the RFP process, we are unsure how long such studies will take.

We also concur that, where necessary, post-retirement benefits should be modified so they are affordable, sustainable, and maintained in such a way as to be in the best financial interests of taxpayers.

Funding post-retirement obligations without spending additional Uniform School Funds or local property tax dollars may not be possible. In resolving its post-retirement liabilities, the Legislature appropriated additional funding for the implementation of House Bill 213, Unused Sick Leave At Retirement Amendments (2005 General Session).

We note, as did the audit, that the Legislature has granted primary control of public education's post-retirement benefits to local districts and to the Utah State Board of Education for the agencies under its direct control. We hope that any resolution of the findings of this audit by the Legislature does not ultimately limit or curtail that local responsibility and control.

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We also note that past efforts to resolve post-retirement unfunded liabilities have resulted in litigation. We again hope that any steps the Legislature takes in dealing with these issues does not limit the flexibility districts and USOE need to resolve the problems without becoming involved in litigation. Also, it may be more fiscally sound to await the outcome of pending litigation so that any legislation may be crafted with recent case law precedent in mind.

Finally, we note that there may be differing, but legitimate, interpretations of GASB 45 and GASB 47. We would hope that the Legislature would remain open to those interpretations and to the implementation of those interpretations to the extent that the best interests of the taxpayers of the state are always met.

Thank you for the early review of the report. With my apologies for a board meeting that conflicts with the public review of this audit, our office will be represented by Jean Hill.

Sincerely,

Patti Harrington, Ed.D.
State Superintendent of Public Instruction

July 1, 2005

John M. Schaff, CIA
Auditor General
State of Utah
Office of the Legislative Auditor General

Yesterday we received an estimate of a liability for post-employment benefits for Granite School District from your office. We understand that the estimate is based on an actuarial study prepared for Jordan School District.

Our District has actively studied this issue the past few years, working with our benefit providers, accounting department, and external auditors. We are in the process of contracting with an actuary to obtain a valid measurement of identified post-employment benefit obligations in preparation of implementing Government Accounting Standards Board Statements 45 and 47. (GASB Statement 45 is effective for our District for the fiscal year ending June 30, 2008).

The early retirement and related insurance benefits provided by Jordan School District differ from the benefits provided by Granite School District. We understand the benefits at Jordan are as follows:

> Administrators or certified employees with a minimum of 10 years in the District who voluntarily retire under the provisions of the Utah Retirement Systems receive a specified amount for a maximum of four years or until the eligible retiree reaches the age of unreduced social security benefits, whichever comes first.
>
> Jordan also provides health and life insurance coverage up to 7 years for eligible administrators, certified or classified employees who retire from the district under the provisions of the Utah State Retirement Act; the term of coverage is based on the eligible retiree's service in the District. The health insurance covers current premiums for retirees or supplemental coverage for retirees eligible for Medicare coverage.

Jordan's study has classified these benefits as other post-employment benefits (OPEB) as defined by GASB Statement 45.

At Granite, we provide early retirement and related insurance benefits to eligible retirees as follows:

> Contract employees with a minimum of 10 years in the District who reach age 60 or teachers under age 60 who qualify for state retirement receive benefits up to 5 years or until eligible for full social security benefits, whichever comes first. Benefits include health insurance and compensation.

These benefits meet the definition of termination benefits under GASB Statement 47. An obligation is recognized by the District in its government-wide financial statements when the early retirement incentive offer is accepted. The intent of the benefit is to bridge the period between voluntary retirement and when Social Security benefits become available.

Although similarities exist between the two districts' programs, the primary difference is Jordan's program provides health insurance to all eligible retirees before and after age 65 (qualifies as OPEB) whereas Granite's program provides health insurance only to full social security (qualifies as Termination Benefits).

Granite does provide other benefit programs that qualify for OPEB, such as health and life insurance benefits (adjusted by available Medicare benefits) to certain employees who qualify for disability, and a stipend equal to 20 days worth of an employee's last salary paid to a beneficiary upon an employee's death. These benefits meet the definition of OPEB and the obligation will be actuarially determined as required by GASB Statement 45. We are also considering options of restructuring these programs to provide similar benefits without the cost and uncertainty inherent with OPEB.

We believe it improper to apply data from any school district into a study prepared specifically for another district to estimate a liability. We are concerned that the estimates that have been sent by your office showing Granite's liability could be inaccurate. Benefit programs, discount rates, alternative actuarial methods, demographics of employees, eligibility, cost sharing between employers and employees, benefit providers, probability of retirement, funding, limitations, and other factors vary significantly among districts. Good decisions and policy are based on good information. It would be premature for us to try to estimate our obligation until additional information is available from an actuarial study prepared specifically for our district and promised implementation guidance is available from GASB. We are concerned that your estimates could be relied on, and perhaps misunderstood, by both the legislature and the public. We understand that it is the legislature asking for these numbers; however, due to the preliminary nature and methodology used to estimate differing benefit programs, it would be unfortunate if the information is used to make policy or take legislative action until it is better understood.

Sincerely,
David F. Garrett
Business Administrator/Treasurer
Granite School District

Cc: Stephen F. Ronnenkamp
Superintendent
Granite School District