August 26, 2014

Director of Research and Technical Activities
Governmental Accounting Standards Board
401 Merritt 7, PO Box 5116
Norwalk, CT 06856-5116

Re: Project No. 34-1E Exposure Draft on Accounting and Financial Reporting for Postemployment Benefits Other than Pensions

Dear Director:

On behalf of the International Association of Fire Fighters (IAFF), I am writing in response to GASB’s request for comments on the Exposure Draft Accounting and Financial Reporting for Postemployment Benefits Other than Pensions.

The International Association of Fire Fighters, headquartered in Washington, DC, is the leading advocate in North America for the wages, benefits, safety and training of fire fighters and paramedics. The IAFF represents more than 295,000 full-time professional fire fighters and paramedics who protect communities in every state in the United States and throughout Canada. More information is available at www.iaff.org.

The IAFF respectfully submits the following comments in regard to Accounting and Financial Reporting for Postemployment Benefits Other than Pensions.

GASB’s Proposed Changes to OPEB Accounting

In adopting GASB 43 and 45, GASB decided that other post employment benefit (OPEB) liabilities should be accounted for similarly to pension benefits. GASB 43/45 potentially benefited public employees by encouraging governmental employers to pre-fund their OPEB benefits.

GASB 67 and 68 changed the pension accounting focus from focusing on the annual required contribution (ARC) – a budgeting concept designed to result in consistent cash expenditures for pension benefits provided by the government– to a focus on the balance sheet. Following GASB 25 a government that contributed the ARC each and every year had an annual budgeted cost contribution, but did not reflect any unfunded liability on balance sheet. The unfunded liability was only disclosed in footnotes to the financial statement. GASB 68 puts the unfunded liability directly on the balance sheet, and the cash expenditures to the pension plan are only disclosed. Pension accounting was turned upside down.

Now the GASB is proposing a similar change to OPEB accounting.

GASB purports to improve the accounting for post-retirement benefits plans, by requiring additional disclosure and, more significantly, by recognizing the entire unfunded liability on the government’s financial statement. However, post-retirement medical, dental, pharmacy and death benefits (OPEBs) are very different, than pension plan benefits. While pension plan benefits can easily be calculated when an employee terminates or
retires. OPEB benefits are a promise to provide health care under substantially the same terms as they are provided at retirement. However, the benefits will change as the health care industry changes. The nature of the benefit and the cost can only be estimated. Thus, we believe that the proposed standards are attempting to require employers to book a liability that is subject to change, and we believe that GASB’s efforts will simply lead to significant financial game playing in the future\(^1\).

For example, as the proposal stands, a recently elected governor could modify the existing OPEB plan by eliminating post age 65 coverage, except for those provided by a portion of assets currently set aside to provide for benefits. This would produce a substantial decrease in liabilities, and since the liabilities are for retirees this gain would be recognized immediately. This would allow the recently elected governor to immediately reduce or eliminate any budget deficit, while not actually increasing revenue or reducing current expenditures.

**Differences between pension and OPEB plans**

Unlike pension plan benefits, OPEBs:

- Do not vest prior to retirement
- There is generally not a benefit formula relating the cost of benefits to years of service
- OPEBs do not receive the same legal protections as pensions, and are frequently subject to modification or even termination
- Plan provisions are changed, nearly on an annual basis to change retiree premiums, change deductibles and co-payments, change drug formularies, change medical procedures covered, change authorized medical providers, switch from primary to secondary payer, change eligibility for benefits requirements and/or implement life time maximum benefits, and/or in response to changes in the Medicare program or health care reform.
- Liabilities depend on trend assumptions (medical cost inflation), which have been very hard to predict.

Because of these issues, insurance is not available to transfer the risk of providing these benefits.

**Consequences of the Differences between Pension and OPEB plans**

The largest and most significant difference is in the firmness of the liability. Pension liabilities, while requiring significant assumptions about future events, are much more firm, quantifiable liabilities. The pension benefit in a future year can be expressed as a formula whereas the OPEB benefit in a future year will depend on the health of the participant, changing technology the evolution of the health care market and changing State and Federal law. OPEB liabilities are subject to huge changes due to benefit and eligibility changes, as well as simply differences between trend assumptions and actual experience. Because of this lack of firmness of the OPEB liability, the Contract Accounting Standards Board (CASB) concluded that the Federal Government could not pay contractors for unfunded accrued liabilities in OPEBs, as discussed below.

The constant benefit changes, along with some moderation of medical trends, have resulted in large gains for many OPEB plans in recent years. Under GASB’s proposed rules, these would be largely recognized over a short time period, resulting in annual income for the government.

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\(^1\) See Ellen Shultze’s book, Retirement Heist, for examples of the possible unintended effects of these changes, as happened with the implication of SFAS 106 (now ASC 715).
OPEB plans may be subject to modification by employers, potentially without negotiations with employee groups, and often do revise them. While employees may have a right to their pension, when they leave a government employer, this right does not necessarily extend to OPEBs. Thus, Governments potentially may make changes to their workforce or the OPEB, resulting in significant gains. Decreases in liabilities due to plan changes are recognized immediately and are income to the government from the changes.

In order to eliminate the liability an employer would be required to create an irrevocable trust with assets equal to the liabilities. Since the liabilities are based on a hard to predict medical trend assumption, the resulting trust contributions could turn out to be greater than were needed for 100 percent funding taking away funds needed for other municipal needs. While this also a risk for pension funding, the risk is greater for OPEB plans because in addition to investment risk there is also medical trend risk. In addition, many OPEB plans already have less generous benefits for more recent hires, so the potential surplus cannot readily be used to finance benefits for future accruals.

We believe that the result of this proposed standard will be to reduce transparency, reduce comparability between the financial statements of governments providing similar OPEBs to retirees, confusing the public and other users of the financial statements and provide the opportunity to mask the underlying cause of any deficits. We believe that this is not the intent of GASB.

**CASB and Settlement of OPEB Liabilities**

We believe that GASB should consider what the Cost Accounting Standards Board did when reviewing the possibility of the Federal Government settling unfunded liabilities for post retirement benefits, even though the situation for governmental employers is different from that of government contractors.

The Board agrees that the liability for a plan that meets the criteria for accrual accounting set forth in this proposed Standard can be reasonably estimated. However, the Board does not believe that a liability is a firm liability simply because it can be estimated. The financial effect of many contingencies can be estimated, but the estimated value associated with these contingencies may not rise to the level of a firm liability for contract costing purposes without meeting other criteria. …

The Board noted that, unlike pension benefits, employees’ rights to promised post-retirement benefits often do not vest until the employees approaches retirement eligibility, e.g., age 50 and 20 years of employment. Because of this substantial delay in vesting, a contractor can have a formal, ironclad contractual promise that is communicated to its employees, but still be able to discontinue the plan leaving only those employees who are currently eligible or close to eligibility with rights to post-retirement benefits. This Board, like its predecessor, is concerned that the contractor could reap a substantial gain attributable to the liability released by nonvested participants. …

After considerable consideration, the CASB decided to withdraw its efforts to establish a policy for paying contractors for their unfunded accrued liability for OPEBs:

Because contractors need the flexibility to modify, reduce, or even eliminate post-retirement benefits in the future in response to the pressures of medical inflation, an aging population and global competition, the Board finds that the liability for post-retirement benefits cannot be made sufficiently firm to be

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recognized for government cost accounting purposes without undue financial risk to both the contractor and the government.\(^3\)

**Alternatives**

For the reasons stated above, we believe that the GASB should not revise the current accounting standards for OPEBs as provided for in Statements 43 and 45. We note that other future liabilities which, like OPEBs, may readily be delayed or modified at the direction of the governmental employer are not recognized in current financial statements. Examples of these include future salaries and benefits as provided for in union contracts, future maintenance of existing infrastructure and creation of infrastructure needed in the future.

However, we believe that GASB could reduce the potential harm of the currently proposed approach by:

- Requiring that the firmness of the liability be clearly disclosed in the financial statements. The governmental employer should describe what benefit and eligibility parameters of the OPEB are subject to change, and what restrictions, if any apply to changes.
- Requiring the governmental employer to book a liability equal to the value of OPEBs without any trend assumption, and disclosing the amount of this liability separately for retired members, employees currently eligible to retire and all other employees. Under this alternative, the liability would be based on the current cost of benefits, there would be less variation between employers reporting of comparable benefits, and the chance that the liability would be over-estimated would be greatly reduced.

We appreciate the opportunity to comment on the Exposure Drafts and welcome any questions you may have.

Sincerely,

Harold A. Schaitberger

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