

SOLUTIONS

The Power of We: Using Shared Actuarial Services to Implement GASB 45

By Robert B. (Bob) Scott and Monte Mercer

When it comes to Governmental Accounting Standards Board (GASB) Statement No. 45, *Accounting and Financial Reporting by Employers for Post Employment Benefits Other Than Pensions*, Texas is best known nationally for H.B. 2365, a controversial state law that exempts normally GAAP-abiding Texas governments from having to meet the requirements of GASB Statement No. 45. Perhaps not as well known is the fact that the vast majority of Texas governments appear to be quietly working toward implementing the standard in spite of the out provided by state law.

A prime example of these efforts is the Actuarial Shared Services Project, initiated in 2006 by the North Central Texas Council of Governments (NCTCOG), a voluntary association of local governments established by the state. The NCTCOG is charged with regional planning and with improving cooperation among governments. The purpose of this project is to provide all local governments within the state with access to high-quality, low-cost actuarial valuations, without each government having to write its own request for proposals (RFP) and go through its own selection process.

LEARNING TO SPELL “ACTUARY”

Most governments in Texas participate in statewide pension plan arrangements and have historically had little reason to use actuarial services individually. Further complicating the issue, the actuarial profession does not require any separate certification for health-care valuations, and many actuaries with only private-sector pension or risk and insurance experience are viewing GASB Statement No. 45 as a new growth area. This lack of experience – combined with the greater uncertainties that are inherent in a health care valuation, as compared with pension valuations – has produced wildly different results, both between entities and in valuations of the same entity done by different actuaries. It became obvious that a better-researched and more demanding RFP could be written, and actuarial costs could be reduced, if multiple governments were involved. As a result, the authors discussed the shared services concept with a number of finance officers in the state and determined that 40 to 50 governments might be interested.

Three actuarial firms in the Dallas area were interviewed regarding the concept and the best way to approach the RFP, including pricing drivers such as covered lives and health-plan options. In these interviews, it became evident that the winning actuary needed to have extensive experience with both GASB Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*. That’s because techniques for those valuations mirror those for GASB Statement No. 45, and an actuary performing these types of valuations would already have software that could be adapted quickly to a GASB Statement No. 45 valuation. The actuary would also be familiar with the unique aspects of government procurement and contracts such as

open records requirements and additional insurance or indemnifications requirements. Health-care experience was also deemed critical because of the volatility of health-care costs and the extreme complexities of health-care plans.

LEVELING THE PLAYING FIELD

The size of the state, which has thousands of local governments, made the shared services approach particularly beneficial to small or rural governments. Normally, these governments would not be able to get most actuaries to reply to their RFPs, or they would have to pay significant fee premiums to get actuaries – predominantly located in urban areas – to travel to their locations. The RFP indicated that multiple jurisdictions in the same geographic area of the state would coordinate meeting times to ease travel burdens. The RFP also structured pricing so that small governments would be likely to get reasonable pricing, given their size. Finally, given the possibility of attracting a large number of geographically concentrated urban and suburban governments through one RFP, it seemed likely that the actuarial community would be willing to price the more remote cities on an equivalent basis.

IMPROVING CONSISTENCY AND COMPARABILITY

Early valuations in Texas had produced dramatically different results, and a goal of the RFP was to promote both consistency between subsequent valuations of the same entity and comparability between Texas entities. It was felt that differences between valuations should be a direct result of substantive differences in the health plans offered or the demographics of the individual governments, rather than differences in the valuation approach or the assumptions used. The RFP was for a six-year period, which would allow for three biennial valuations by the same actuary.

A project of this type requires coordination among the participating entity's chief financial officer and human resources director, the pension administrator, the healthcare administrator, the auditor, and the actuary performing the service. The process was streamlined by considering the impact of all the key players before the RFP was drafted. The idea was to standardize wherever it was practical to do so and reduce the overall risk to the project and participants, as well as to the actuaries that responded to the RFP.

In designing the RFP, the project team looked for opportunities to standardize the census and claims data that would be used in the actuarial studies. Standardizing the data would increase the productivity of the actuaries, in part by reducing the risk that they would have to clean the data themselves, allowing them to reduce their fees. One of the RFP requirements was that the participating jurisdictions would use a standardized data file layout for submitting their data. In addition, the Texas Municipal Retirement System (TMRS) agreed to provide the shared services actuary for each member city with the TMRS assumptions for turnover rate, mortality rates, expected retirement dates and ages, etc. The participants also agreed to use closed amortization for 25 to 30 years, using level dollar amounts.

One potential problem identified in the exploratory phase was the potential for a deterioration in quality or availability of plan data, since it would only be requested every

other year. To ensure that data would be reviewed in a timely manner, the RFP also required participants to continue accumulating census data annually and to send it to the actuary. The actuary was charged with reviewing the off-year census data and reporting back if there has been a material change in the data so that the entity can deal with it.

The project team also recognized that while an overall base level of services was needed, some entities would also need optional services. The RFP anticipated that, based on the first valuation, many participants would want to consider changes in the types and levels of non-pension benefits for retired employees – collectively known as other postemployment benefits (OPEB) – they offered, and that some of the entities with biennial evaluations would want valuations for each of the first two years. The first-year valuation would be prior to the required implementation date and would be used primarily for evaluating options. The actuary would need to identify practical options and be prepared to run multiple scenarios and present them to the governing board, management, and employee groups. The RFP included costing for running scenarios based on different assumptions, funding policies, or benefit provisions to assist governments in modifying their OPEB plans to best meet their funding capabilities. Based on their expertise in the public sector, the actuaries could provide suggestions regarding plan benefit design, plan eligibility conditions, employee cost sharing, benefit capitation, pre-funding, etc. The second-year valuation, prepared after changes had been made to the OPEB types and levels, would be used in preparing the financial statements, notes, and schedules.

The NCTCOG then handled the procurement process and authorized the master agreement with the shared services actuary to perform the services. Participating entities were then able to access the contract by an interlocal agreement with the NCTCOG. The services agreement is between each participating entity and the actuary NCTCOG contracted with. This structure gives all clients a standard engagement letter with the terms and conditions already negotiated, saving administrative time for both the entities and the shared services actuary.

MORE THAN JUST COMPLIANCE

While the primary purpose of the actuarial services is complying with the requirements of GASB Statement No. 43 and No. 45, the RFP recognized from the start that GASB Statement No. 45 represents a significant opportunity for governments to improve their retiree health practices. A section of the RFP, titled “Group-Wide Services,” included educational classes for participants and annual benchmarking services using the data gleaned from all participants. In addition, the actuaries will routinely provide observations to shared-services participants regarding what other governments have done in the retiree health area that has proven effective and could be easily replicated. One example of a direct benefit to a shared-services client was apparent when a participant’s finance department discovered that employees who had left the city years before were allowed into the city’s OPEB plan upon retirement. The costs associated with this informal policy were significant, and the practice was ended.

PEERING INTO THE ACTUARIAL CRYSTAL BALL

Before the shared services contract was awarded, conversations with other governments revealed that some actuaries were hesitant to provide their clients any projections of future cash claims payments, annually required contribution amounts, or net OPEB obligation balances under the existing plan or with proposed plan changes. Any government that is evaluating a potential plan change or considering only partially funding its OPEB liability should insist on seeing plan projections for five and ten years out. This information is vital because options that produce savings today may be far more costly over a period of several years. This information is readily available in the calculations that support the valuation results, and actuaries should be willing to share this information with their clients. The hesitation, of course, is because the projections will always vary from the actual results, as no one can predict the future with 100 percent accuracy. The shared-services actuary deals with this issue by clearly disclosing the underlying assumptions used in the projections and using confidence levels, standard deviation, and other statistical techniques to disclose the probability that actual results will vary from projected numbers.

SELECTION AND AWARD

The project was completed based on a core group of 27 cities, along with the Texas Municipal League Inter-Employer Benefit Pool, that worked with NCTCOG staff to gauge jurisdictions’ interest in the project and the expectations they had of a service provider. A five-member committee evaluated the eight responses the NCTCOG received to its Shared Request for OPEB Actuarial Evaluation. The criteria for evaluating the responses was pricing, expertise of the management team, references, quality of the written proposal, quality of the oral presentation, and technical expertise.

The evaluation committee reviewed the responses and selected three firms to be interviewed. An actuary was chosen based on best overall combination of experience with health insurance and retiree health insurance benefits, firm capacity and ability to meet participants’ time schedules, references, overall reputation, and price. Exhibit 1 excerpts sample pricing from the proposals of the three finalists. This pricing was often half or less that quoted to governments that searched for an actuary on their own.

Exhibit 1: Excerpts of Proposed Fees from Actuarial Finalists for Biennial Study

Plan Structure	Finalist A	Finalist B	Finalist C
Fewer than 100 participants, insured, 1 health plan	\$3,750	\$5,000	\$8,500
Between 500 and 749 participants, self-insured, 2 health plans	\$6,950	\$8,000	\$15,750
Between 1,000 and 1,500 participants, insured, 3 health plans	\$8,500	\$8,000	\$18,000
Between 2,500 and 5,000 participants, self-insured, 3 health	\$13,500	\$11,000	\$25,000

The actuary that was chosen also provided a Web portal that allowed participants to model selected assumption sets, contribution patterns, and benefit designs to show projected future benefit patterns, liabilities, and contribution requirements. This additional feature gave participants a great deal of latitude in estimating the financial impact of changes without needing to ask for optional services from the shared-services actuary. After the participant provided the actuary with the model scenario that best met its needs, the actuary would study the impact in more detail and give an actuarial opinion and certification.

CONCLUSIONS

With Phase I governments just beginning to report GASB 45 information in their financial statements, the success of the shared-services approach is becoming clear. To date, 57 governments are under contract, and an additional 31 jurisdictions are obtaining governing board approval for the interlocal agreements and contracts. Representatives of numerous governments that had their initial valuation done by other actuaries, at far higher costs, have indicated that they will probably switch to the shared-services arrangement when it comes time for the next valuation. In addition, feedback from governments that have participated has been positive. With the Phase II deadline approaching, requests for information have increased significantly. A recent Government Finance Officers Association of Texas survey of its membership showed that 91 percent of survey respondent have implemented or will be implementing GASB 45. Thus, the ultimate participation rates in this shared-services project could easily exceed 100 governments – far more than originally estimated. There are no easy solutions for addressing soaring health-care costs, in general, and retiree health costs, in particular, but Texas governments are finding that banding together to reduce costs, improve quality, and share information is a step in the right direction.

ROBERT B. (BOB) SCOTT, CPA, is assistant city manager/chief financial officer for the City of Carrollton, Texas. **MONTE MERCER**, CPA, is deputy executive director, North Central Texas Council of Governments. He is available at mmercerc@nctcog.org or 817-695-9121. The council's Web site page for actuarial shared services can be found at NCTCOG.org.

SIDEBAR 1

Advantages of a Shared-Services RFP for Government

- Lower prices
- High-quality actuary
- No need to go through a selection process
- Uniform contract
- Specifications with pre-decided key assumptions and actuarial options

- Benchmarking information
- Ready-made network for exchanging ideas and information
- Valuation portal and electronic modeling of most common options

SIDEBAR 2

Advantages of a Shared-Services RFP for the Actuary

- Multiple clients with just one proposal
- Standard engagement letter and price list, eliminating the need for individual contract negotiations
- Economies of scale base on using standard assumptions and reducing the number of actuarial alternatives
- Increased market penetration and ability to sell other services
- Standard report formats
- Educational meetings initial contact meeting to be conducted with multiple clients