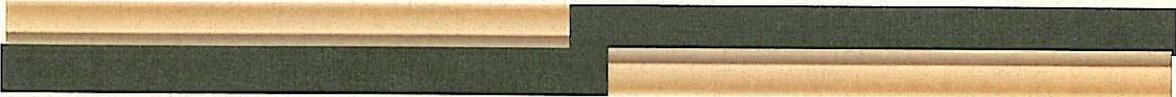


THE REPORT OF THE ACTUARIAL VALUATION  
AS OF DECEMBER 31, 2004  
OF THE  
CITY OF TROY  
RETIREE HEALTH CARE PLAN

GABRIEL, ROEDER, SMITH & COMPANY  
ACTUARIES • CONSULTANTS



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September 7, 2005

The Board of Trustees  
City of Troy Employees Retirement System  
Troy, Michigan

Submitted in this report are the results of the annual actuarial health valuation of the assets, actuarial values and contribution requirements associated with health benefits provided by the City of Troy Retiree Health Care Plan.

The date of the valuation was December 31, 2004.

Valuation results, comments and conclusions are contained in Section B.

The valuation was based upon information, furnished by your Assistant City Manager-Finance Director, concerning benefits, financial transactions, and individual members, terminated members, retirants and beneficiaries. Data was checked for year to year consistency but was not otherwise audited by us. This information is summarized in Section C.

Descriptions of the actuarial cost method and actuarial assumptions are contained in Section D, along with a glossary of technical terms.

This report has been prepared by Members of the American Academy of Actuaries who have substantial experience valuing Public Employee Retiree Health Care Plans.

To the best of our knowledge this report is complete and accurate and was made in accordance with actuarial methods recognized by the Actuarial Standards Board of the American Academy of Actuaries. The actuarial assumptions used for the valuation produce results which, individually and in the aggregate, are reasonable.

Respectfully submitted,

Brad Lee Armstrong,  
A.S.A., E.A., M.A.A.A.

Randall J. Dziubek  
A.S.A., E.A., M.A.A.A.

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## SECTION A

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PURPOSE OF THE ACTUARIAL VALUATION,  
COMPARISON OF FUNDING METHODS  
AND  
ACCOUNTING FOR HEALTH CARE BENEFITS

## PURPOSE OF THE ACTUARIAL VALUATION

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The payment of health care benefits to retired members is similar to the payment of pensions to retirees in that the amount of present disbursements is not indicative of the level of future disbursements. As employees retire year by year in the future, health payments will grow. The overall cost of health care has been rising sharply in the past 10-12 years. Prescription drugs have been a key factor in a 15% trend rate for the majority of employer sponsored health care plans, (as much as 20% in some years).

An actuarial valuation is the mathematical process used to project future payments made on account of specified benefit provisions. In this study, the benefits are the health payments provided for retired employees by the Retiree Health Care Plan. The future payments are the premiums or direct benefits anticipated to be made on behalf of future retirees. The payouts are projected and then converted to equivalent present value amounts and a corresponding level percent-of-payroll contribution is determined.

Actuarial valuations can be used to:

- *Understand the costs* of the present retiree health care benefits.
- *Provide liability information* for financial reports.
- *Maintain a funding program* so that costs will remain reasonably level from year-to-year and generation-to-generation, as opposed to the prospect of increasing costs that inevitably result from unfunded pay-as-you-go programs.

In making an actuarial valuation, assumptions must be used concerning future occurrences such as: increases in per capita health costs, rates of withdrawal from employment, ages at which people retire, rates of death and disability, patterns of pay increases, and the rates of future investment return. Only subsequent actual experience can indicate the overall adequacy of the assumptions. **Annual valuations which take into account all past activities and re-evaluate future expectancies will permit the City to manage the cost of these benefits on a systematic basis.**

## ACCOUNTING FOR HEALTH CARE BENEFITS

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The Government Accounting Standards Board (GASB) has finalized two new accounting standards applicable to “other post-employment benefits,” or OPEB plans. OPEBs are non-pension benefits provided after employment, and would include the benefits valued in this report. One of the accounting standards relates to sponsors of OPEB plans while the other is applicable to the OPEB plan itself.

The GASB standards (Employer Statement) require that the long-term cost of retiree health care and other OPEB benefits be determined and accrued on an actuarial basis similar to pension plans. The results of these valuations, including an annual OPEB expense, would have to be disclosed on the City’s financial statements.

The GASB standards (Employer Statement) allow for several actuarial cost methods to be used when calculating the Plan’s annual expense. We have chosen the entry age method, with 15-year amortization of unfunded accrued liabilities. The entry age actuarial cost method is described on page D-2.

It is important to note that the GASB standard does not mandate the *pre-funding* of OPEB liabilities. However, any pre-funding of OPEB benefits either prior to or after the effective date of this new standard, will help minimize or eliminate the OPEB obligation that will be required to be disclosed in the City’s financial statements. This net OPEB obligation could have a detrimental impact on the employer’s perceived financial health.

## DEFINITION OF ACTUARIAL TERMS

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*Normal Cost* means the level series of payments over each employee's working lifetime necessary to fund the health benefits likely to be paid on the member's behalf after retirement.

*Actuarial Accrued Liability* is the difference between the value of future health benefit payments to the present employees and retirees and the value of the future normal cost payments. The excess of this liability over accumulated assets, if any, is the *Unfunded Actuarial Accrued Liability*.

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The Association's *annual cost* to finance payments for health benefits on a *level percent-of-payroll basis* is the sum of two parts:

- 1) Normal Cost - as defined above, plus
- 2) Amortization Payment - the amount necessary to amortize over a period of years the Unfunded Actuarial Accrued Liability.

**Failure to meet this level annual cost will result in increasing costs in future years.**

## PRE-FUNDING HEALTH CARE BENEFITS

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Until a retirement program reaches a mature state, the number of members receiving benefits will continue to increase, with proportionate increases in the amount of benefit disbursements. When the retirement benefits being paid are health benefits, health costs can be expected to increase as the result of medical care inflation, changes in utilization and Medicare cost shifting. When both of these reasons for increased disbursements apply, it is reasonable to expect that the amount of the Plan's annual health disbursements will increase for years to come.

Many employers fund retiree health care benefits using the pay-as-you-go (or cash disbursement) method. The employer's annual cost for these benefits is considered to be the actual disbursements during the year for health care benefits for retired employees. This method of funding will result in increasing contributions over time. First, per capita cash disbursements will tend to increase from year-to-year as the cost of health care services, or the utilization of these services, increases. Second, the number of retired members is likely to increase for years to come. The more retirees, the greater the disbursements as a percentage of employee payroll.

The entry-age actuarial cost method has been used for this valuation because it tends to produce a more level series of contribution rates than other methods. Using the plan rules, the present health premiums and a set of actuarial assumptions, the anticipated future payments are projected. The entry-age method then provides for a systematic funding for these anticipated payments. Yearly contributions are computed to cover the cost of benefits being earned by covered members as well as to amortize a portion of the unfunded accrued benefit value. If experience is in accordance with the assumptions used, the cost will remain basically level on a year-to-year basis. **In other words, the benefits currently provided will not depend upon higher costs to be borne by future generations of taxpayers.**

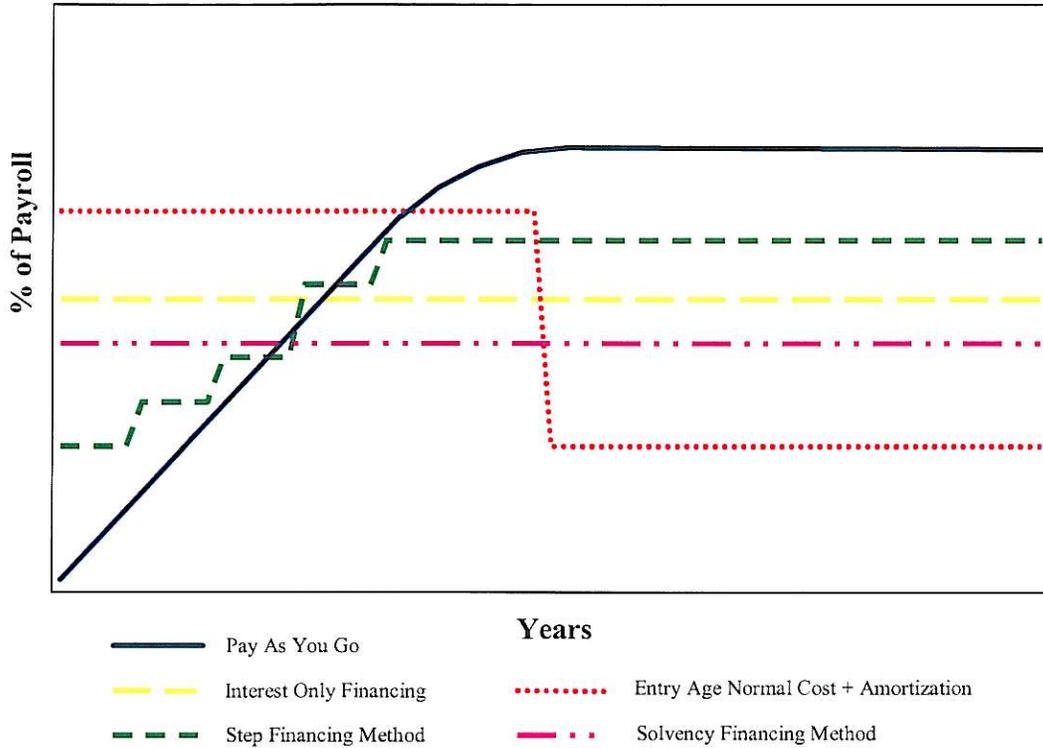
The ultimate determination as to the level of pre-funding will be the result of decisions made in an attempt to reconcile the often conflicting needs of benefit adequacy for members and fiscal responsibility for the City of Troy. The GASB accounting standards noted on page A-2 will factor into decisions concerning the level of pre-funding, however, they should not be the sole driver of these decisions.

## **PRE-FUNDING HEALTH CARE BENEFITS (CONCLUDED)**

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Understanding that there may be both short and long-term limitations on the amount of revenue available to pre-fund the current set of health care benefits we have graphically illustrated several different funding methods on the next page. Note that the “pay-as-you-go” method, in which annual contributions are equal to the benefits paid out during the year, is the minimum required amount to keep the health care plan solvent. Any contributions in excess of the “pay-as-you-go” amount would be used to pre-fund future benefits.

## ALTERNATE FINANCING ARRANGEMENTS FOR RETIREE HEALTH PLAN



- Pay-as-You-Go. Contributions during the year equals benefit payout during the year.
- - - Entry Age Normal Cost (EANC) + Interest Only Financing of the Unfunded Actuarial Accrued Liability (UAAL). Normal cost contributions are made for service rendered during the year. Unfunded actuarial accrued liability is kept constant in real dollars. This method is not allowed for calculating expense under the GASB standard.
- ..... EANC + X Year Amortization of the Unfunded Actuarial Accrued Liability. Normal cost contributions are made for service rendered during the year. Unfunded actuarial accrued liability is amortized over an x year period. (GASB standard requires 30 years or less.)
- - - Step Financing. Initial contributions to the system are increased in steps in future years. Ultimately, normal cost contributions are made for service rendered during the year. Any remaining unfunded actuarial accrued liability is kept constant in real dollars. This method is not allowed for calculating expense under the GASB standard.
- . - . Solvency Method Financing. Level contributions are made to the system to enable the Fund to remain solvent for x years or to a specific year. Under this financing arrangement, periodic review and changes to the benefit structure are required. The level of contributions under this method is heavily dependent upon the period under when solvency is desired. This method is not allowed for calculating expense under the GASB standard.

The graph above is for illustration purposes only. Actual contribution levels are dependent upon specific Plan liabilities.

**CONTRIBUTIONS COMPUTED TO MEET THE FINANCIAL  
OBJECTIVE OF THE RETIREE HEALTH CARE PLAN  
FOR THE FISCAL YEAR BEGINNING JULY 1, 2005**

Contributions for	Level Contribution as % of Active Payroll	
	General	Public Safety
Normal Cost	5.12 %	4.45 %
Amortization Payment (15-year amortization)	<u>2.15</u>	<u>(0.88)</u>
Computed City Rate	7.27	3.57

The unfunded actuarial accrued liabilities were amortized as a level percent of active member payroll over a period of 15 years. A 30-year amortization period for unfunded actuarial accrued liabilities is the maximum period allowed by GASB.

The assumptions underlying the above include a health care trend rate of 4.0%.

## COMMENTS

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**COMMENT A:** The results presented in this report were determined based on actuarial assumptions and methods adopted by the City for the purpose of prefunding retiree health benefits. In some cases, these assumptions or methods will not satisfy the requirements for determining the annual expense under the new GASB Standards. The annual expense under GASB is likely to be significantly higher than the results presented here.

**COMMENT B:** An annual actuarial valuation will re-compute the required contribution rate each year. This will permit fluctuations and trends in experience to be reflected in the contribution rate on a regular basis.

**COMMENT C:** The costs shown in this report have been calculated to remain level **as a percentage of payroll**. As payroll tends to increase, the dollar amount of the recommended contributions will also increase.

**COMMENT D:** New opportunities for investment and health care coverage for actives and retirees exist through MERS. It is too early to assess the value of these opportunities.

## RECOMMENDATIONS

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### RECOMMENDATIONS:

- Compliance with the new GASB Standards is only a year away. Consideration should be given to reviewing in greater detail how compliance will affect the City's comprehensive audited financial report. Discussions should involve both the actuary and the auditor.
- Monitor funding progress by means of regular valuations. Considering the volatility of health care costs, **annual** updates are suggested. History suggests that there is a close correlation between regular reviews and financial stability in all kinds of post retirement benefit programs.
- If plan costs rise at a rapid rate or if the computed contribution rates are higher than the City is prepared to support, undertake a benefit review to find ways to control cost increases.

## SECTION C

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### SUMMARY OF BENEFIT PROVISIONS AND VALUATION DATA

**BENEFIT PROVISIONS EVALUATED AND/OR CONSIDERED**  
**(DECEMBER 31, 2004)**

**REGULAR RETIREMENT:**

*Eligibility* - T.P.O.A., T.F.S.O.A. and T.C.O.A. members: 25 years of service; or age 60 with 10 years of service. General AFSCME, General Clerical Members, Classified or Exempt: Age 50 with 27 years of service; or age 55 with 25 years of service; or age 60 with 10 years of service.

*Mandatory Retirement Age* - None.

**EARLY RETIREMENT:**

*Eligibility* - Age 55 with 10 years of service.

**DUTY DISABILITY RETIREMENT:**

*Eligibility* - No age or service requirement. Worker's compensation must be payable.

**NON-DUTY DISABILITY RETIREMENT:**

*Eligibility* - 5 years of service (10 years for Exempt and Classified, AFSCME employees hired after 2/96).

**DUTY DEATH BEFORE RETIREMENT:**

*Eligibility* - No age or service requirement.

**NON-DUTY DEATH BEFORE RETIREMENT:**

*Eligibility* - 10 years service.

**HEALTH INSURANCE PREMIUM SUBSIDY:** Post-retirement health insurance premiums are subsidized by the City as follows:

T.C.O.A. - Fully paid after 7/1/94.

T.P.O.A - 4% per complete year, retired after 2/20/1996.

T.F.S.O.A- 4% per complete year, retired after 1/1/99.

AFSCME - 4% per complete year, retired after 1/1/01

Classified Exempt, Clerical - \$400/month or 4% per complete year, whichever is greater.

Retirees from prior provisions - \$400/month or 3% per complete year, whichever is greater.

**CITY OF TROY RETIREE HEALTH CARE PLAN**  
**ACTIVE MEMBERS AS OF**  
**DECEMBER 31, 2004**  
**TABULATED BY VALUATION DIVISIONS**

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**DEFINED BENEFIT MEMBERS**

<b>Valuation Division</b>	<b>No.</b>	<b>Annual Payroll</b>	<b>Average Age</b>	<b>Average Service</b>	<b>Average Pay</b>
General	106	\$ 6,191,320	50.3 years	18.2 years	\$58,409
Public Safety	<u>80</u>	<u>6,381,054</u>	42.5 years	15.2 years	79,763
Totals	186	\$ 12,572,374			

**DEFINED CONTRIBUTION MEMBERS**

<b>Valuation Division</b>	<b>No.</b>	<b>Annual Payroll</b>	<b>Average Age</b>	<b>Average Service</b>	<b>Average Pay</b>
General	221	\$ 12,413,657	29.7 years	8.7 years	\$56,170
Public Safety	<u>65</u>	<u>5,059,949</u>	41.2 years	16.0 years	77,845
Totals	286	\$ 17,473,606			

**CITY OF TROY RETIREE HEALTH CARE PLAN**  
**RETIRED MEMBERS AS OF**  
**DECEMBER 31, 2004**  
**TABULATED BY VALUATION DIVISIONS**

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**DEFINED BENEFIT AND DEFINED CONTRIBUTION RETIREES**

<u>Valuation Division</u>	<u>No.</u>	<u>Average Age</u>
General – Defined Benefit	100	68.9 years
Public Safety – Defined Benefit	52	58.1 years
Defined Contribution	<u>32</u>	61.1 years
Totals	184	

## SECTION D



FINANCIAL PRINCIPLES,  
VALUATION METHODS  
AND  
ACTUARIAL ASSUMPTIONS

## BASIC FINANCIAL PRINCIPLES AND OPERATION OF A RETIREMENT BENEFIT PLAN

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*Benefit Promises Made Which Must Be Paid For.* A retirement program is an orderly means of handing out, keeping track of and financing retirement benefit promises to a group of employees. As each member of the retirement program acquires a unit of service credit the member is, in effect, handed an "IOU" which reads: "The Employer recognizes that you are earning eligibility for retiree health benefits commencing when you retire."

The principal related financial question is: When shall the money required to cover the "IOU" be contributed? This year, when the benefit of the employee's service is received? Or, some future year when the "IOU" becomes a cash demand?

Paying for retirement benefits in a regular, orderly manner while the employee is working assures that (i) the benefit promises will not be empty promises and (ii) the employer is making efforts to avoid the financial "surprises" involved when financing is put off until retirement.

This Association could meet this goal by having as its *financial objective the establishment and paying of contributions, expressed as percents of active employee payroll, which will remain approximately level* from year-to-year and will not have to be increased for future generations of taxpayers.

There are retirement programs designed to defer the bulk of contributions far into the future. Indeed, many employers do not pre-fund their retiree health benefits. The present outlay for such plans is **artificially low**. The fact that the disbursements are destined to increase relentlessly to a much higher level is often ignored.

## THE ENTRY AGE ACTUARIAL COST METHOD

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The entry age actuarial cost method has *two* components:

*Normal Cost* (the present value of future benefits assigned to members' service rendered in the current year),

**PLUS**

Amortization of the *Unfunded Actuarial Accrued Liability* (the difference between the present value of future benefits assigned to members' past service and the value of the plan's accumulated assets).

*The normal cost* was computed as follows:

The series of contributions necessary to accumulate the present value at time of retirement of an employee's health benefits was computed so that each contribution in the series, from entry age to retirement, was a constant percentage of the employee's year-by-year projected covered compensation.

*The accrued liability* was computed as follows:

Retirees: The discounted value of health benefits likely to be paid for retirees was computed using the investment return, health cost increase and mortality assumptions on the following pages.

Active Employees: The discounted value of health benefits likely to be paid for active employees was computed using the assumptions outlined on the following pages and was reduced by the value of normal costs to be paid for service after the valuation date.

## ACTUARIAL ASSUMPTIONS USED FOR THE VALUATION

*Investment Return* (net of expenses).

6.5% a year, compounded annually. This rate consists of a real rate of return of 2.5% a year plus a long-term rate of inflation of 4.0% a year.

### *Pay Projections*

Annual Rate of Pay Increase for Sample Ages			
Sample Ages	Base (Economic)	Merit and Longevity	Total
20	4.0 %	4.0 %	8.0 %
25	4.0	3.2	7.2
30	4.0	2.8	6.8
35	4.0	2.5	6.5
40	4.0	2.2	6.2
45	4.0	1.7	5.7
50	4.0	1.2	5.2
55	4.0	0.7	4.7
60	4.0	0.2	4.2

If the number of active members remains constant, the total active member payroll will increase 4.0% annually, the base portion of the individual pay increase assumptions. This increasing payroll was recognized in amortizing unfunded actuarial accrued liabilities for health benefits.

**Mortality Table.** The 1983 Group Annuity Mortality Table, for males and females. This table was first used for the December 31, 1995 valuation. Sample values follow:

Sample Attained Ages	Single Life Retirement Values			
	Present Value of \$1.00 Monthly for Life		Future Life Expectancy (Years)	
	Men	Women	Men	Women
50	\$151.83	\$163.46	29.18	34.92
55	141.54	155.23	24.82	30.24
60	129.07	144.87	20.64	25.67
65	114.32	132.18	16.69	21.29
70	98.49	116.95	13.18	17.13
75	82.32	100.04	10.15	13.37
80	66.65	83.10	7.64	10.20

This assumption is used to measure the probabilities of members dying before retirement and the probabilities of each benefit payment being made after retirement.

*The projected long-term rate of unit premium increase* used for the health valuation was 4.0% per year, compounded annually. This assumption is used to predict the amount of premium payments in future years .

**Election Percentage:** 25% of general members and 17% of public safety members were assumed to decline retiree health benefits. 90% of males and 90% of females who elect medical coverage were assumed to elect two-person coverage. For those that elect two-person coverage, it was assumed that coverage would continue to the spouse upon death of the retiree in 50% of the cases.

**Rates of separation from active membership.** The rates do not apply to members eligible to retire and do not include separation on account of death or disability. This assumption measures the probabilities of members remaining in employment.

Sample Ages	Years of Service	Percent Separating Within Next Year	
		General	Public Safety
ALL	0	30.00 %	15.00 %
	1	20.00	10.00
	2	15.00	8.00
	3	10.00	7.00
	4	7.00	6.00
25	5 & Over	6.00	5.00
30		6.00	4.50
35		6.00	3.55
40		6.00	1.45
45		3.50	0.75
50		1.50	0.75
55		1.50	0.75
60		1.50	0.75

**Rates of Disability.** These assumptions represent the probabilities of active members becoming disabled.

Sample Ages	Percent Becoming Disabled Within Next Year	
	Men	Women
20	0.08 %	0.10 %
25	0.08	0.10
30	0.08	0.10
35	0.08	0.10
40	0.20	0.36
45	0.26	0.41
50	0.49	0.57
55	0.89	0.77
60	1.41	1.02
65	1.66	1.23

The mortality table was set forward 10 years for projecting disability costs.

**Rates of Retirement.** These rates are used to measure the probabilities of an eligible member retiring during the next year.

Retirement Ages	Percent of Active Members Retiring Within Next Year			
	General	Public Safety		
		T.F.S.O.A. & Exempt	T.C.O.A.	T.P.O.A.
43			35	40
44			25	40
45			20	40
46			15	40
47			15	40
48			15	40
49			15	35
50	15	35	15	20
51	10	25	25	15
52	5	20	30	15
53	5	15	100	15
54	5	15		15
55	5	15		15
56	5	15		15
57	5	15		25
58	5	25		100
59	5	30		100
60	5	100		
61	5			
62	30			
63	10			
64	10			
65	100			

T.P.O.A, T.F.S.O.A. and T.C.O.A. members were assumed to be eligible for retirement after 25 years of service, or after attaining age 60 with 10 or more years of service. General AFSCME and General Clerical members were assumed to be eligible for retirement after attaining age 50 with 27 years of service, or after attaining age 60 with 10 or more years of service. Classified or Exempt members were assumed to be eligible for retirement after attaining age 50 with 27 years of service, or age 55 with 25 years of service; or age 60 with 10 years of service.

**Active Member Group Size.** The number of active members was assumed to remain constant.

**Retiree Premiums:** These are the initial retiree premiums used to determine projected health cost for current and future retirees.

	<b>Pre - 65 Premiums</b>		<b>Post - 65 Premiums</b>	
	<b>Member</b>	<b>Spouse</b>	<b>Member</b>	<b>Spouse</b>
AFSCME	\$413.36	\$496.58	\$521.69	\$521.69
Classified/Exempt	414.26	497.72	521.69	521.69
Clerical	418.17	502.62	521.69	521.69
TPOA/TCOA	418.17	502.62	477.91	477.89
TFSOA	413.36	496.58	477.91	477.89

## GLOSSARY

**Accrued Service.** The service credited under the plan which was rendered before the date of the actuarial valuation.

**Actuarial Accrued Liability.** The difference between (i) the actuarial present value of future plan benefits, and (ii) the actuarial present value of future normal cost. Sometimes referred to as "accrued liability" or "past service liability."

**Actuarial Assumptions.** Estimates of future plan experience with respect to rates of mortality, disability, turnover, retirement, rate or rates of investment income and salary increases. Decrement assumptions (rates of mortality, disability, turnover and retirement) are generally based on past experience, often modified for projected changes in conditions. Economic assumptions (salary increases and investment income) consist of an underlying rate in an inflation-free environment plus a provision for a long-term average rate of inflation.

**Actuarial Cost Method.** A mathematical budgeting procedure for allocating the dollar amount of the "actuarial present value of future plan benefits" between the actuarial present value of future normal cost and the actuarial accrued liability. Sometimes referred to as the "actuarial funding method."

**Actuarial Equivalent.** A single amount or series of amounts of equal value to another single amount or series of amounts, computed on the basis of the rate(s) of interest and mortality tables used by the plan.

**Actuarial Present Value.** The amount of funds presently required to provide a payment or series of payments in the future. It is determined by discounting the future payments at a predetermined rate of interest, taking into account the probability of payment.

**Amortization.** Paying off an interest-bearing liability by means of periodic payments of interest and principal, as opposed to paying it off with a lump sum payment.

## **GLOSSARY (CONCLUDED)**

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**Annual Required Contribution (ARC).** The ARC is the normal cost plus the portion of the unfunded actuarial accrued liability to be amortized in the current period. The ARC is an amount that is actuarially determined in accordance with the requirements so that, if paid on an ongoing basis, it would be expected to provide sufficient resources to fund both the normal cost for each year and the amortized unfunded liability.

**Governmental Accounting Standards Board (GASB).** GASB is the private, nonpartisan, nonprofit organization that works to create and improve the rules U.S. state and local governments follow when accounting for their finances and reporting them to the public.

**Medical Trend Rate (Health Inflation).** The increase in the plan's cost over time. Trend includes all elements that may influence a plan's cost, assuming that enrollments and the plan benefits do not change. Trend includes such elements as, pure price inflation, changes in utilization, advances in medical technology, and cost shifting.

**Normal Cost.** The annual cost assigned, under the actuarial funding method, to current and subsequent plan years. Sometimes referred to as "current service cost." Any payment toward the unfunded actuarial accrued liability is not part of the normal cost.

**Other Post-Employment Employee Benefits (OPEB).** OPEB are post-employment benefits other than pensions. OPEB generally takes the form of health insurance and dental, vision, prescription drugs or other healthcare benefits.

**Reserve Account.** An account used to indicate that funds have been set aside for a specific purpose and are not generally available for other uses.

**Unfunded Actuarial Accrued Liability.** The difference between the actuarial accrued liability and valuation assets. Sometimes referred to as "unfunded accrued liability."

**Valuation Assets.** The value of current plan assets recognized for valuation purposes.