



CALIFORNIA STATE AUDITOR

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FACT SHEET

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The California State Auditor released the following report today:

High-Risk Update—Other Postemployment Benefits

Significant Financial Risk Exists if the State Does Not Actively Manage the Costs of State Retirees' Health and Dental Benefits

BACKGROUND

In a May 2007 report on areas that present high risk to the State, the Bureau of State Audits (bureau) identified, among other issues, other postemployment benefits (OPEB)—benefits in addition to a pension—of retiring state employees as a statewide high-risk area because of the increasing cost to the State of providing these benefits to retired state employees. OPEB primarily encompasses medical and dental insurance. At that time, the bureau reported California's total OPEB liability—as of June 30, 2007, on an actuarial basis—as estimated to be \$48 billion. The report also highlighted that the State faces risk in at least two areas: providing the level of benefits promised to its employees and at the same time protecting its credit rating.

Historically, the State only appropriates enough money in its annual budget to pay the yearly premiums for retiree health (medical and dental) insurance rather than setting aside funds to cover any future costs to the State. This method of funding OPEB costs is known as *pay-as-you-go* and is used by many other governments as well.

KEY REVIEW RESULTS

In our review to assess the State's progress in managing its liability related to OPEB, we noted the following:

- The State must now estimate and disclose future OPEB costs in its financial statements beginning in fiscal year 2007–08 as required by new accounting rules. At least every two years the State must have an actuarial estimate of the amount the State needs to pay each year for these costs as well as the amount it would need to set aside now to fund benefits it is obligated to pay in the future.
- The OPEB liability reported by the State could affect the State's credit rating if the liability grows so large that it overshadows other liabilities in the State's financial statements. A weaker credit rating could compound the State's budget problems by increasing the costs of borrowing money when it issues bonds.
 - In fiscal year 2007–08, the State paid only \$1.25 billion of the \$3.59 billion annual required contribution for OPEB costs and recorded the difference of \$2.34 billion as an OPEB liability.
 - This liability is expected to increase to \$4.71 billion in fiscal year 2008–09.
- The State could significantly reduce its OPEB costs by "prefunding," or beginning to set aside some money to fund these costs, and interest earned from money set aside could be used to help fund these costs. OPEB will continue to be a high-risk area for the State as long as it continues to use the *pay-as-you-go* funding method.
- Although the State is exploring prefunding options, it has yet to set aside any funds and it remains unclear whether or when the State will begin prefunding OPEB obligations and how the State will manage the risks associated with its large and growing OPEB liability.

