STANDARD
& POOR'S
RATINGS SERVICES

RatingsDirect®

Criteria | Governments | U.S. Public Finance:

U.S. Local Governments General Obligation Ratings: Methodology And Assumptions

Primary Credit Analysts:
Jeffrey J Previdi, New York (1) 212-438-1796; jeff.previdi@standardandpoors.com
Christopher M Krahe, Chicago (1) 312-233-7063; christopher.krahe@standardandpoors.com
Lisa Schroeer, Charlottesville (1) 434-220-0892; lisa.schroeer@standardandpoors.com
Horacio G Aldrete-Sanchez, Dallas (1) 214-871-1426; horacio.aldrete@standardandpoors.com
Karl Jacob, Boston (1) 617-530-8134; karl.jacob@standardandpoors.com
Matthew T Reining, San Francisco (1) 415-371-5044; matthew.reining@standardandpoors.com
Jane H Ridley, Chicago (1) 312-233-7012; jane.ridley@standardandpoors.com

Criteria Officer, U.S. Public Finance:
Cathy L Daicoff, New York (1) 212-438-6766; cathy.daicoff@standardandpoors.com

Chief Credit Officer - Americas:
Lucy A Collett, New York (1) 212-438-6627; lucy.collett@standardandpoors.com

Table Of Contents

I. SCOPE OF THE CRITERIA

II. SUMMARY OF CRITERIA UPDATE

III. SUMMARY OF CHANGES FROM THE REQUEST FOR COMMENT

IV. IMPACT ON OUTSTANDING RATINGS

V. EFFECTIVE DATE AND TRANSITION

VI. METHODOLOGY

A. Local Government Rating Calibrations

Table Of Contents (cont.)

B. Framework For Determining A U.S. Local Government Rating

C. The Institutional Framework Score

D. Economic Score

E. Management Score

F. Budgetary Flexibility Score

G. Budgetary Performance Score

H. Liquidity Score

I. Debt And Contingent Liabilities Score

VII. APPENDIX I: Selected Historical Statistics

VIII. APPENDIX II: Relationship To The State Rating

IX. APPENDIX III: Changes Since The Request For Comment

X. GLOSSARY

XI. RELATED CRITERIA AND RESEARCH

Related Criteria

Related Research

Criteria | Governments | U.S. Public Finance:

U.S. Local Governments General Obligation Ratings: Methodology And Assumptions

1. Standard & Poor's Ratings Services is updating its methodology and assumptions for assigning issuer credit ratings (ICRs) and issue credit ratings based on general obligation (GO) pledges of local governments in the United States. This update follows our request for comment (RFC), "Request For Comment: U.S. Local Governments: Methodology And Assumptions," published on March 6, 2012. This update provides additional transparency and comparability to help market participants better understand our approach to assigning local government ratings, to enhance the forward-looking nature of these ratings, and to enable better comparisons between U.S. local government ratings, local government ratings in other countries, and all other ratings. The "Principles of Credit Ratings", published on Feb. 16, 2011, form the basis of this criteria.

2. For the ratings in scope, this criteria supersede the following articles:

- GO Debt, Oct. 12, 2006
- Key General Obligation Ratio Credit Ranges – Analysis Vs. Reality, April 2, 2008
- Does Bigger Always Mean Better? Sizing Up The Impact Of Size On Municipal Ratings, April 22, 2008
- Location, Location, Location: What Does It Mean For My Community's Rating? April 22, 2008

3. All capitalized terms are defined in the glossary, section X, paragraphs 90-97.

I. SCOPE OF THE CRITERIA

4. The criteria apply to all U.S. local government issuer credit ratings and issue ratings on GO bonds issued by municipal governments that are not special purpose districts. Examples of local government entities in the scope include cities, counties, towns, villages, townships, and boroughs, called municipalities in the criteria. Examples of special purpose districts excluded from the scope include school districts, library districts, park districts, and forest preserve districts, among others. The criteria also do not apply to U.S. states or territories but do apply to the District of Columbia.

II. SUMMARY OF CRITERIA UPDATE

5. The criteria use the same major elements as our criteria for rating local and regional governments outside the U.S. (see "Methodology For Rating International Local And Regional Governments", published Sept. 20, 2010). Specifically, the criteria assign ratings based on the assessment and scoring of seven key factors:

- Institutional framework;
- Economy;
- Management;
- Budgetary flexibility;
- Budgetary performance;

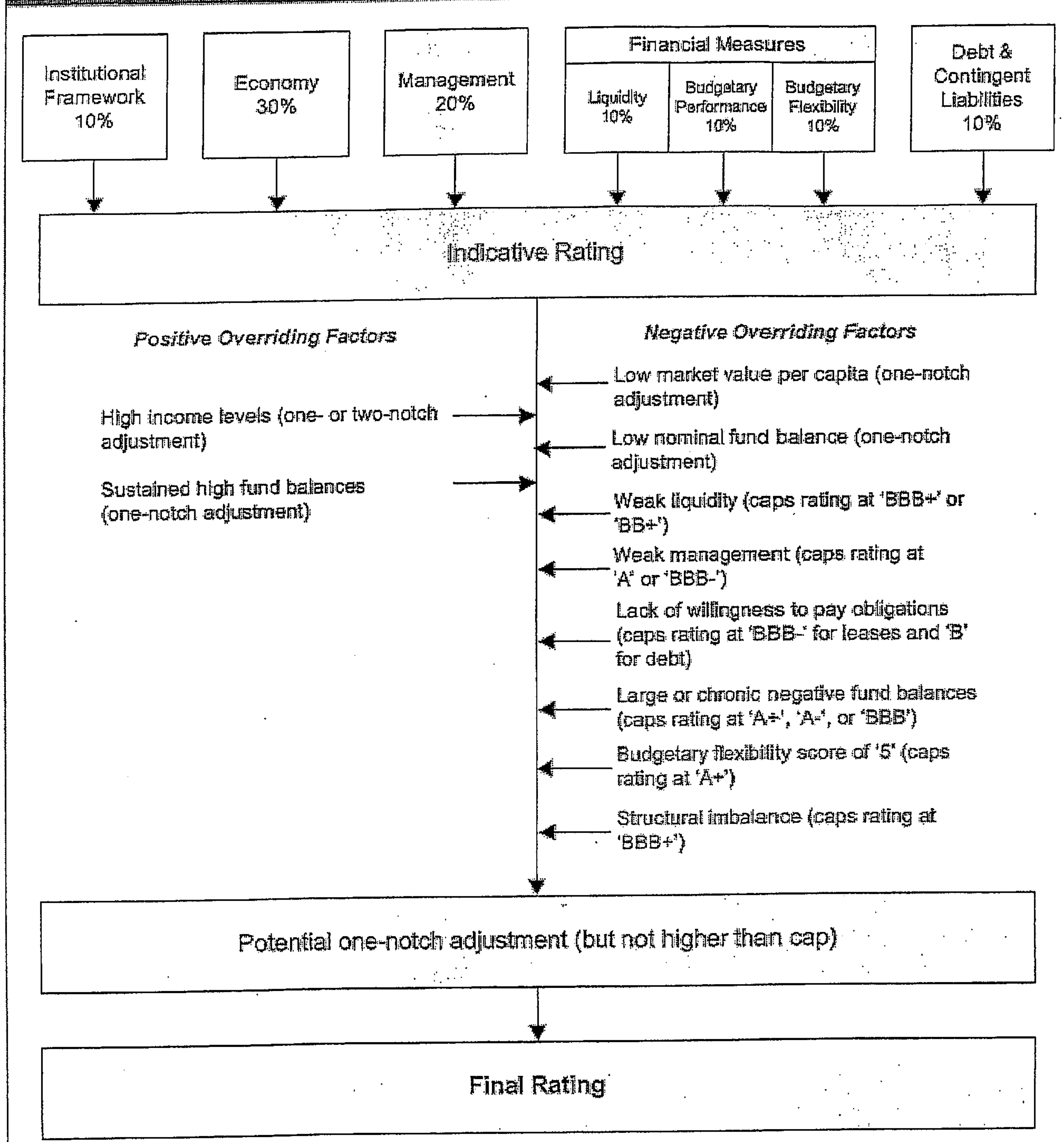
- Liquidity; and
- Debt and contingent liabilities.

Although the criteria assess the same factors, the measures used to assess these factors are detailed in a manner consistent with the characteristics and reporting conventions of U.S. public finance obligors.

6. The initial indicative rating results from a weighted average of the factors detailed above. The economy score receives a 30% weight, and the management score receives 20%. The financial-related scores, liquidity, budgetary performance and budget flexibility, each account for 10% of the total score. The institutional framework score also receives a 10% weight, as does the debt and contingent liabilities score. Certain score levels result in ratings different from those suggested by the weighted average. Chart 1 outlines a summary of the analytical framework for assigning a local government's GO rating.

Chart 1

Analytical Framework For Local GO Ratings



III. SUMMARY OF CHANGES FROM THE REQUEST FOR COMMENT

See Appendix III in Section IX.

IV. IMPACT ON OUTSTANDING RATINGS

7. Standard & Poor's maintains issuer credit ratings or ratings on GO debt (or debt equivalent to or based on the GO rating) for more than 4,000 governments included in the scope of the criteria. Assuming that governments maintain their current credit characteristics, testing suggests that about 60% of the ratings would remain unchanged under the criteria while about 30% of the ratings would increase and about 10% would decrease, generally by one notch.

V. EFFECTIVE DATE AND TRANSITION

8. The criteria described in this article are effective immediately and apply to all new and outstanding ratings within scope. We intend to complete our review of issuers affected within the next 12 months.

VI. METHODOLOGY

A. Local Government Rating Calibrations

1. Local Governments Globally

9. Local governments exist to provide services to the population. Services may be mandated by a higher-level government, but often the levels and choice of services to be provided are at the local government's discretion. Governments may rely on locally levied and collected taxes or user charges, or on taxes, grants, or aid distributed from higher levels of government to fund services. Local governments often have little direct control over funds distributed from higher levels of government, and higher-level governments may place restrictions on local taxing levels--if local taxes may be levied at all.

10. A local government's ability and willingness to make fiscal adjustments and its legal and political relationships with higher levels of government can be more important to its ability to meet debt service than its economic trends or financial position. An overall economic decline can threaten the ongoing paying ability of a company more directly than a government because the company may find it difficult to raise prices or reduce costs due to demand elasticity. Although unpopular, governments with sufficient autonomy may raise taxes or cut services without seeing mass outmigration from the jurisdiction relative to the demand volume reduction faced by a company. For governments without such autonomy, relationships with higher-level governments are key for restoring balance.

11. Variables such as economic conditions, debt levels, and financial performance can suggest when difficult decisions to restore fiscal balance might become necessary, but do little to suggest whether prudent decisions will be made. Different government responses can therefore produce different default outcomes for periods with the same level of

stress. Accordingly, predictions of precise default amounts and probabilities become more suspect. This complicates the calibration of criteria to economically-based stress scenarios but does not prohibit it. The long-term and repeating trend of higher local-government defaults following periods of significant economic stress is well-established and dates back to ancient Greece.

2. The Specific Case Of U.S. Local Governments

12. From a global perspective, U.S. local governments have a fairly high degree of autonomy. Virtually all U.S. local governments levy some sort of tax and levy various other fines, fees, and charges. U.S. census data show that own-source revenues account for 63% of local general government revenues. However, this total includes school districts which typically receive a large amount of state funding. For municipalities and counties specifically, data for credits rated by Standard & Poor's suggest this percentage is 79%. Direct funding from the federal government represents only about 4% of total local government revenues, much of which represents funds designated for capital spending.

13. Due to the federalist structure of the U.S. government, individual states, rather than the U.S. government, make most of the laws regarding what taxes local governments may raise, how much debt they can issue, and other matters of local government finance. A local government rating is not automatically constrained by the U.S. sovereign rating or its respective state rating. The economic and fiscal relationships, dependencies, and/or interdependencies between levels of governments will determine the credit linkages along with our framework to rate entities above a sovereign rating (see "Methodology And Assumptions: Request For Comment: Ratings Above The Sovereign—Corporate And Government Ratings" published April 12, 2013).

14. Although states do have significant power over their local governments, their use of this power pales in comparison to the use of such powers by sovereign or regional governments in other countries. Although states have at times tinkered with the mix of local government revenues and imposed various limits or regulations around the use of debt and taxes, the basic tenets of U.S. local government finance have remained largely in place since colonial times. Neither American independence, the American civil war, nor severe economic downturns, such as those witnessed in the late 1830s, late 1870s, and early 1930s, have changed the basic premise of local governments relying largely on own-source revenues to fund different service levels of their own choosing. Some studies suggest to us that this self-reliance drives the low debt levels and fiscal stability observed in U.S. local governments and similar jurisdictions (see Jonathan Rodden in Related Research).

15. Property taxes remain a cornerstone of U.S. local government finance and often provide stability to finances. This stability results from laws in many states that delink tax base growth from overall market volatility. In addition, the lag between market cycles and their effect on revenues allows public officials to adjust rates to offset market effects. The recent downturn illustrates this. Property tax revenues actually grew in 2009, while income tax revenues declined 17% and sales taxes declined 7.5%. Owing to the aforementioned lag, analysis done by the Pew Charitable Trusts using U.S. Census data shows that property tax revenue did decline in 2010, but only by 1.05%. Although conditions vary, data from local governments rated by Standard & Poor's show no decline in property tax revenues for the average government in fiscal 2010. For more information, see Lutz, Molloy, and Shan in Related Research.

3. The Strength Of The General Obligation Pledge And State Level Incentives For Debt Payment

16. A general obligation pledge usually obligates a local government to use all legally available funds to pay debt service and--if such current funds are not sufficient--to take actions necessary to increase those funds. This includes an obligation to levy additional property taxes specifically for debt service, although state tax caps may limit this pledge. A limited tax pledge may affect the rating (see "Standard & Poor's Refines Its Limited-Tax GO Debt Criteria", published Jan. 10, 2002).

17. In addition, some states have laws that empower state governments to take over local governments when their financial position deteriorates significantly or to direct state-appropriated monies for debt repayment. Even temporary relief from debt payments may elude local governments if GO debt enjoys the additional benefits of dedicated taxes or other "special revenues". About one-half of states' statutes either fail to provide specific authorization for municipalities to file for bankruptcy, as currently required for a bankruptcy filing under the U.S. Bankruptcy Code, or prohibit such a filing. Of the remaining 28 whose statutes authorize bankruptcy, 15 states only authorize municipal bankruptcy subject to approval or other conditions, and many states have used this approval power to intervene before a bankruptcy can occur.

18. While the nature of the GO pledge may best explain the miniscule net losses experienced on municipal debt during the Great Depression (net losses amounted to 0.4% of debt outstanding), in our view the limitations associated with Chapter 9 bankruptcy, and states' use of their additional oversight powers also contribute to the sector's extraordinarily low default rate by reducing political risk. Faced with the potential for longer-term costs of reduced market access and reputational damage for state and local officials, nonpayment of debt, in our view, makes little sense for most governments experiencing fiscal stress.

4. U.S. Local Government Payment Performance

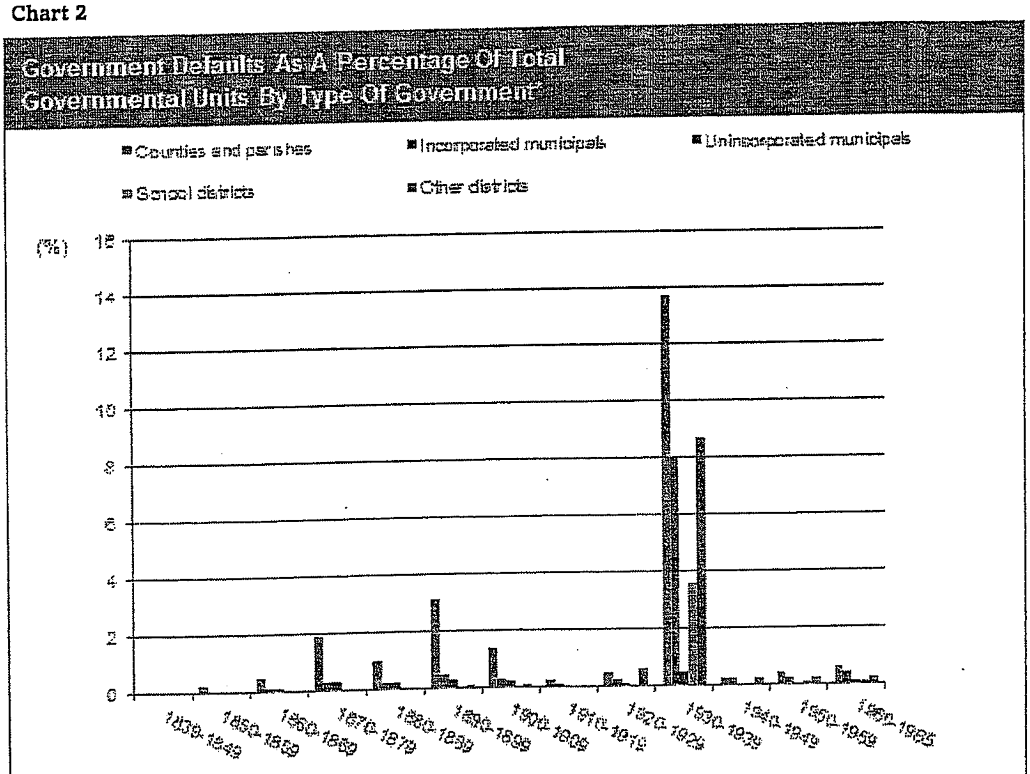
19. Some proponents of current local government stability criticize references to local government defaults in periods such as the Great Depression or earlier. They cite changes such as lower government debt levels, improved revenue diversification, stronger state oversight, and fundamental changes to the economic and banking sectors as reasons why such previous default performance is less relevant. While the criteria recognize and incorporate many of these changes, such statements, in our view, overlook important reasons to consider past payment performance. First, given the experience of the recent recession and current economic challenges, the idea that the municipal performance seen only since World War II will continue regardless of future conditions is itself suspect. Rather than blind speculation, past performance provides observable data with which to compare and contrast different scenarios. Second, the period since World War II generally does not provide sufficient stressful periods with which to calibrate general obligation criteria (see "Understanding Standard & Poor's Rating Definitions", published June 3, 2009). Although the recent recession may demonstrate that municipal credits in general are investment grade, it provides little insight as to whether the current criteria appropriately differentiate 'A', 'AA', and 'AAA' credits as suggested by the article above. That evaluation requires more stressful periods.

20. Several studies provide what we consider to be good summaries of past municipal credit performance. The work most often quoted is George Hempel's "The Postwar Quality of State and Local Debt", published by the National Bureau of Economic Research (NBER) in 1971. The criteria also take Hempel's 1964 University of Michigan dissertation, "The Postwar Quality of Municipal Bonds", on which the NBER publication is based as a resource because it provides a bit

more detail. A major source for Hempel's work that focuses specifically on local government debt is Albert M. Hillhouse's "Municipal Bonds: A Century of Experience". Both works provide summaries and discussion, but do not present the underlying data. Hillhouse's "Defaulted Municipal Bonds (1830-1930)", lists every recorded default over the 100-year period referenced. When considering relationships between state and local governments, William A. Scott's "Repudiation of State Indebtedness" provides details on the actions of states under stress.

21. Hillhouse and Hempel come to similar conclusions on municipal defaults. On the one hand, local government defaults occur across all types of governments (see Appendix I in Section VII), in both good and bad economic times. On the other hand, the number of local government defaults becomes worrisome only during very stressful periods, and even then a majority of governments continue to pay their debts (see chart 2 and Appendix I). Both agree that the ultimate repayment record for local governments when they default is very strong.

Chart 2



* See table 16

22. The criteria consider the overall strong payment performance even after adjusting for differences in economic stress. The criteria are calibrated to provide rating results consistent with the extraordinarily historically low levels of local government defaults.

23. We do not expect a change in the historically extraordinarily low default rates in this sector. When there is a rapid deterioration, we do expect to continue to see multiple-notch downgrades. Please see "The Time Dimension Of Standard & Poor's Credit Ratings", published Sept. 22, 2010, for a description of potential ratings migration.

B. Framework For Determining A U.S. Local Government Rating

24. The criteria assess seven factors:

- Institutional framework (see paragraphs 36-40);
- Economy (see paragraphs 41-47);
- Management (see paragraphs 48-58);
- Budgetary flexibility (see paragraphs 59-64);
- Budgetary performance (see paragraphs 65-68);
- Liquidity (see paragraphs 69-77); and
- Debt and contingent liabilities (see paragraphs 78-84).

Scores for each factor range from '1' (the strongest) to '5' (the weakest). The economy score receives a 30% weight and management receives 20%. These scores receive the highest weight because of management's ability to tap the local economic base for additional revenues if it chooses to do so in a timely manner. The financial scores combined receive 30%, with liquidity, budgetary performance, and budgetary flexibility each accounting for one third of the 30%. The institutional framework score and debt and contingent liabilities score each receive 10% (see chart 1). Table 1 shows the indicative rating outcomes that result from the weighted average of these scores. Absent the overriding factors detailed in table 2, the final rating assigned to the GO issue or the ICR will be within one notch of the indicative rating shown in table 1, with one-notch differentials determined based on trends and comparisons with similarly rated peers. When the overriding factors detailed in table 2 notch the rating (rather than cap the rating), the one-notch differentials of the prior sentence can still be applied. Importantly, certain data are adjusted to facilitate comparability and consistency. Please refer to paragraphs 94 to 102 for a list of defined terms and related adjustments. In addition, please refer to the article, "Standard & Poor's U.S. Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency", published Sept. 12, 2013, for a more extensive summary of data adjustments.

Table 1

Indicative Rating Outcomes Resulting From The Weighted Average Of Seven Factors

Factor Score Weighted Average	Indicative Rating
1.00 – 1.64	AAA
1.65 – 1.94	AA+
1.95 – 2.34	AA
2.35 – 2.84	AA-
2.85 – 3.24	A+
3.25 – 3.64	A
3.65 – 3.94	A-
3.95 – 4.24	BBB+
4.25 – 4.54	BBB
4.55 – 4.74	BBB-

Table 1

Indicative Rating Outcomes Resulting From The Weighted Average Of Seven Factors (cont.)	
4.75 – 4.94	BB
4.95 – 5.0	B

The indicative rating results from the weighted average outcomes as shown above. The final rating may differ from the indicative rating above by one notch based on trends and comparisons with peers in that range. The final rating may also differ from the indicative rating due to the presence of overriding factors described in paragraphs 25-35. For ratings below 'B-' please see "Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings" published Oct. 1, 2012, and "Standard & Poor's Ratings Definitions", published June 17, 2013.

Overriding Factors

25. The criteria employ a series of overriding factors that can result in the final rating assigned to the local government being different from the indicative rating outcome suggested by table 1. Table 2 summarizes these factors. Certain conditions result in the final rating moving a specified number of notches above or below the indicative rating. If multiple notch overrides exist, the final rating is based on the net effect of those overrides.

26. Certain other conditions result in the final rating being capped at a certain level. When such conditions exist, the final rating could be lower than the cap depending on the severity of the condition present, and the final rating could be lower than the indicative rating even if the indicative rating is lower than the ratings cap in table 2. Rating caps are absolute, meaning that the positive relative adjustments described below do not allow ratings to exceed the cap. If multiple cap overrides exist, the rating cap used is the lowest cap of all the individual overrides that apply.

27. If multiple overrides involving both caps and notches exist, the final rating will be based on the lower of the lowest rating cap or the indicative rating as adjusted by the notch overrides. For example, a local government could have an indicative rating of 'A', a negative one-notch override, and a condition that results in a capped rating of 'A+'. In such a case, the indicative rating as adjusted by the notch override would equal 'A-'. Since 'A-' is lower than the rating cap, the final rating could be at most 'A' (if the one-notch adjustment described in paragraph 24 were applied) or any lower rating given that a cap override applies. If, instead, the indicative rating were 'AA' in this example, then the indicative rating as adjusted by the notch override would be greater than the rating cap of 'A+'. Therefore, the rating outcome could be no higher than 'A+' (the one-notch adjustment cannot increase a rating above a rating cap), but could be any lower rating given that a cap override applies. We acknowledge that the assignment and removal of caps may cause an increase in ratings volatility and potentially steeper rating transitions.

Table 2

Summary Of Overriding Factors (see paragraphs 25-35)

Overriding Factor	Result
Notch Overrides	
Projected per capita EBI* > 225% of U.S. projected per capita EBI	Final rating one notch higher than that suggested by table 1
Projected per capita EBI* > 300% of U.S. projected per capita EBI	Final rating two notches higher than that suggested by table 1
Total Market Value per capita < $30,000	Final rating one notch lower than that suggested by table 1
Available Fund Balance > 75% of general fund expenditures for the most recently reported year, the current year and next year and is expected to continue	Final rating one notch higher than that suggested by table 1

Table 2

Summary Of Overriding Factors (see paragraphs 25-35) (cont.)	
Available Fund Balance < $500,000	Final rating one notch lower than that suggested by table 1
Cap Overrides (rating capped)	
Liquidity score equals '4'	Final rating capped at 'BBB+'
Liquidity score equals '5'	Final rating capped at 'BB+'
Management score equals '4'	Final rating capped at the lower of 'A' and one notch lower than that suggested by table 1
Management score equals '5'	Final rating capped at the lower of 'BBB-' and two notches lower than that suggested by table 1
Management score equals '5' due to a lack of willingness to support unconditional debt obligations	Final GO rating on debt not in default capped at 'B'
Available Fund Balance < -10% of general fund expenditures for the most recently reported year or budget flexibility score equals '5'	Final rating capped at 'A+'
Available Fund Balance < -5% of general fund expenditures for the two most recently reported years	Final rating capped at 'A-'
Available Fund Balance < -5% of general fund expenditures for the three most recently reported years	Final rating capped at 'BBB'
Budget performance: For local governments that exhibit characteristics of structural imbalance expected to continue and the government does not have a credible plan to restore balance	Final rating capped at 'BBB+'

*EBI--Effective Buying Income (see glossary)

Factors That Notch From The Indicative Rating

a) Rating adjustments for certain economic measures

28. When variables measured as part of the overall economic score take on extreme values, adjustments from the indicative rating occur. When projected per capita Effective Buying Income (EBI) as a percentage of the U.S. projected per capita EBI exceeds 225% (50% higher than the top income threshold in table 8), the final rating is raised by one notch to account for the extreme income levels in the tax base. When projected per capita EBI exceeds 300% of the U.S. level, the final rating is raised by two notches. No similar adjustment applies to Total Market Value (TMV) per capita because high scores often result from concentrated tax bases. When TMV per capita is less than $30,000, however, the final rating is lowered by one notch to reflect the limited tax base supporting debt.

b) Sustained large positive fund balances

29. An abnormally large sustained Available Fund Balance signifies heightened flexibility if projections suggest that it will endure. Accordingly, the maintenance of an Available General Fund Balance exceeding 75% of general fund expenditures for the most recently reported year, the current and next year, and that is projected to continue at that level raises the final rating by one notch.

c) Low nominal fund balances

30. The Available Fund Balance as a percentage of expenditures measure, used in the budgetary flexibility score, can mask vulnerability when absolute nominal levels of reserves are low. Accordingly, when the Available General Fund Balance for the most recently reported year is below $500,000 (but above a level that causes a rating cap to occur -- see paragraph 34), the final rating is lowered by one notch to reflect this vulnerability.

Factors That Cap The Final Rating

d) Liquidity

31. Although liquidity receives limited weight in determining the indicative rating because of a local government's ability to make fiscal adjustments, its importance grows as the liquidity score weakens. A liquidity score of '4' caps the final rating on a local government at 'BBB+' regardless of other strengths. An overall liquidity score of '5' limits the final rating to no higher than 'BB+'.

e) Management

32. The decentralized and autonomous nature of U.S. local governments creates a stronger link between management and credit quality, particularly when limited or weak management exists. Accordingly, an overall management score of '4' results in a final rating at least one notch below the indicative rating outcome and limits the rating to no higher than 'A'. A score of '5' results in a final rating at least two notches below the indicative rating outcome and limits the rating to no higher than 'BBB-'.

33. When a management score of '5' results from a current lack of willingness to pay a debt, capital lease obligation, or a moral obligation pledge (see paragraph 53), the rating cap depends on the nature of the obligation. A current lack of willingness to pay an unconditional debt obligation of the government would cap the final rating on other GO debt of the government at no higher than 'B' and would likely be lower. While the ICR of a local government would fall to 'D' or 'SD' following a default on an actual debt obligation, the payment prospects for other GO debt may remain stronger (such as when the default results from insufficient funds for limited-tax GO debt and other GO debt enjoys an unlimited-tax pledge). Consistent with our criteria for appropriation-backed obligations, a failure to pay a capital lease obligation also caps the GO rating (see "Appropriation-Backed Obligations", published June 13, 2007). A current lack of willingness to pay a capital lease or other obligation subject to annual appropriation by the government, including a moral obligation pledge, would limit the GO rating to no higher than 'BBB-' even though the government was not legally obligated to make payment on the appropriation obligation without the appropriation.

f) Large or chronic negative fund balances

34. A government's Available Fund Balance forms the initial score for budgetary flexibility. Even when other forms of flexibility exist, however, a nontrivial fund balance deficit signifies heightened pressure, especially when the deficit endures. The presence of such pressure is consistent with the capped ratings suggested by table 2, even though the government may retain a significant capacity to repay debt. Accordingly, an Available Fund Balance of less than negative 10% of general fund expenditures in the most recently reported year caps the final rating at 'A+'. Ratings above 'A-' are typically for cases where we believe the Available Fund Balance will not be less than negative 5% beyond the most recently reported year. A budget flexibility score of '5' signifies limited flexibility and also caps the final rating at 'A+'. An Available Fund Balance of less than negative 5% for the two most recently reported years caps the final rating at 'A-'. Ratings above 'BBB' are typically for cases where we believe the Available Fund Balance will not be less than negative 5% beyond the most recently reported year. The existence of such Available Fund Balance for the three or more of the most recently reported years signifies to us a chronic problem and caps the final rating at 'BBB'.

g) Structural imbalance

35. The final rating is capped at 'BBB+' when the entity has structural imbalance. For this purpose structural imbalance is determined over a four-year horizon (past two years, current year, and next fiscal year). Additionally, management does not have a credible plan to adequately correct the imbalance. Characteristics of structural imbalance include:

- Significant use of one-time revenue,
- Borrowing for ongoing operations,
- Unplanned fund balance drawdowns,
- Recurring unbudgeted expenditure and revenue mismatch, and
- Significant dependence on volatile revenue.

C. The Institutional Framework Score

36. The institutional framework score assesses the legal and practical environment in which the local government operates. Accordingly, all governments of the same type within the same state receive the same score. Since state constitutions and state laws generally dictate the terms under which local governments may operate, the score reflects these state-specific elements. To enhance comparability with local governments outside the U.S., the criteria assess the same areas as detailed in paragraph 39 of our criteria, "Methodology For Rating International, Local, And Regional Governments", published Sept. 20, 2010. Specifically, these areas include predictability, revenue and expenditure balance, transparency and accountability, and system support. Scores for each area, however, use slightly different measures that are more specific and more relevant to the U.S. and range from '1' (the best) to '5' (the worst). The criteria then average each of the scores equally to determine the overall institutional framework score as detailed in table 3.

Table 3

Institutional Framework Score Outcomes

Score Range	Institutional Framework Score
1 – 1.5	1 (very strong)
1.75 – 2.75	2 (strong)
3.0 – 3.75	3 (adequate)
4 – 4.5	4 (weak)
4.75 – 5	5 (very weak)

The institutional framework score results from the average of the scores for predictability, revenue and expenditure balance, transparency and accountability, and system support (see paragraphs 37-40). Each score receives equal weight in the average.

1. Predictability

37. Predictability assesses the extent to which a local government can forecast its revenues and expenditures on an ongoing basis. The ability and frequency of changes to municipal responsibilities or revenue raising capabilities resulting from state or statewide voter actions can complicate local government decision making. An inability to sufficiently plan and implement strategies to accommodate these changes can affect a government's fiscal position. Table 4 details the scoring for predictability.

Table 4

Assessing Predictability

Score	Description
1 (very strong)	None of the following elements are true: voter initiative or referenda rights exist to automatically alter revenues or expenditure responsibilities; the state has significantly changed its statutes governing local government revenues or expenditure responsibilities in the past eight years (to the detriment of this type of municipality); the state has changed the disbursement pattern of state-shared revenues in the past eight years (to the detriment of this type of municipality) and these revenues are a major portion of local government revenues.
2 (strong)	One of the elements in 1 is true, but such events are not frequent from a long-term perspective. The nature of deliberation and implementation of change allow sufficient time for local government planning and adjustment.
3 (adequate)	More than one of the elements in 1 is true, or at least one of the elements is recurring. The nature of deliberation and implementation of change allow sufficient time for local government planning and adjustment.
4 (weak)	At least one of the elements in 1 is true, but the pace of change does not allow for planning and adjustment.
5 (very weak)	The system is volatile, with ongoing and ill-prepared large-scale transformations that do not allow for planning and adjustment. Legal rights and obligations between the state and local level are unclear, adding to the lack of clarity.

2. Revenue and expenditure balance

38. Revenue and expenditure balance assesses the extent to which local governments have the ability to finance the services they provide. The focus is on revenue raising capability in scores one, two and three under the presumption that most municipalities have significant control over their expenditures. Only when revenue raising capacity is limited, and there are significant unfunded or partially unfunded expenditure mandates, are scores of four or five likely. Additionally, the criteria treat state provisions that require minimum balances as enhancing flexibility, while those that limit balances diminish it. Table 5 details the scoring for this measure.

Table 5

Assessing Revenue And Expenditure Balance

Score	Description
1 (very strong)	Local governments within the state have statutory flexibility to raise local source revenues for operating purposes without voter approval. Where limits on the ability to raise revenues exist, they are such that most governments within the state still retain significant capacity to raise revenues.
2 (strong)	Local governments within the state have some flexibility to raise local source revenues for operating purposes without voter approval. Limitations (such as property tax caps) restrict flexibility, but still allow for most local governments to raise such revenues.
3 (adequate)	Virtually no ability exists to raise local source revenues for operating purposes without voter approval. Additional flexibility may come from state revenue sharing.
4 (weak)	No ability exists to raise local source revenues even with voter approval, or there are significant unfunded or partially unfunded expenditure mandates that overwhelm the average entity's budget.
5 (very weak)	No ability exists to raise local source revenues even with voter approval, and there are significant unfunded or partially unfunded expenditure mandates that overwhelm the average entity's budget.

A statutory minimum fund balance improves the score by one point and a statutory maximum fund balance worsens the score by one point.

3. Transparency and accountability

39. Transparency and accountability assess the overall institutional framework's role in encouraging the transparency and comparability of relevant financial information. When states require annual audits, this increases the likelihood that audits will be done and that late audits will be noted. States' regulations requiring audits and strong accounting standards such as generally accepted accounting principles (GAAP) usually enhance reporting detail and consistency across municipal credits, making it easier to have a sufficient uniform method of interpretation. States that allow cash

accounting tolerate a lesser degree of completeness and consistency. Table 6 details the scoring for this measure.

Table 6

Assessing Transparency And Accountability

Score	Description
1 (very strong)	State statutes or other provisions require annual financial statements that comply with GAAP.
2 (strong)	State statutes or other provisions require audited annual financial statements, but no GAAP requirement exists. Most audits utilize accrual and/or modified accrual accounting.
3 (adequate)	State statutes or other provisions require annual financial statements, but no GAAP requirement exists. Most audits utilize cash or modified cash accounting.
4 (weak)	No requirement for annual financial statements exists or there is no requirement for an audit. Interim reports provide the only source of financial information for most local governments in some years.
5 (very weak)	No requirement for financial statements exists. Cash-basis reports provide the sole source of financial information for most local governments in most years.

4. System support

40. System support addresses the extent to which local governments receive extraordinary support from a state government when the local government is under extreme stress. Forms of extraordinary support range from state government control and oversight to emergency loans or other liquidity assistance. Table 7 details the scoring for this measure.

Table 7

Assessing System Support

Score	Description
1 (very strong)	A tested, formal mechanism for providing extraordinary support for local governments exists, which has restored fiscal stability. Such mechanisms may help with liquidity, capital market access, government management, or capital funding.
2 (strong)	Mechanisms for providing extraordinary support are less formalized, untested, or have not consistently restored fiscal stability but ongoing mechanisms to help with liquidity, capital market access, government management, or capital funding do exist.
3 (adequate)	No mechanisms for providing extraordinary support exist, but state statutes do not authorize local governments to file for bankruptcy or require further state approval.
4 (weak)	No mechanisms for providing extraordinary support exist and state statutes specifically authorize local governments to file for bankruptcy without state approval.
5 (very weak)	No mechanisms for providing extraordinary support exist, and the state has recently passed legislation that threatens the solvency of local governments without providing adjustment capabilities.

D. Economic Score

41. The economic score assesses both the health of the asset base relied upon to provide both current and future locally derived revenues as well as the likelihood of additional service demands resulting from economic deterioration. Projected per capita EBI as a percentage of the U.S. level, and TMV per capita combine to form the initial economic score due to the data availability of these statistics at the local level and their correlation with overall economic activity and local government revenues. Table 8 details the manner in which different values of these two statistics combine to form the initial economic score.

Table 8

Assessing The Economic Score (see paragraphs 41-47)

	Total Market Value Per Capita				
Projected per capita effective buying income as a % of U.S. projected per capita EBI	>$195,000	$100,000 to $195,000	$80,000 to $100,000	$55,000 to $80,000	<$55,000
>150	1	1.5	2	2.5	3
110 to 150	1.5	2	2.5	3	3.5
85 to 110	2	2.5	3	3.5	4
70 to 85	2.5	3	3.5	4	4.5
≤70	3	3.5	4	4.5	5

A score of '1,' '2,' '3,' '4,' and '5' means very strong, strong, adequate, weak, and very weak, respectively.

Qualitative factors with a positive impact on the initial score	Qualitative factors with a negative impact on the initial score
Participation in a larger broad and diversified economy (see paragraphs 45-47).	Negative budget impact from demographic profile: population decrease and/or high share of dependent population (>55%) have a material negative impact on future revenue growth and expenditure needs.
A stabilizing institutional influence with a longstanding role as a major employer, such as higher education, health care, military, or large and stable corporate presence.	High county unemployment rate (>10%).
	If employment concentration where an individual sector (excluding education/health, government, and transportation, trade and utilities) represents more than 30% of the nonfarm work base, or tax base concentration where the top 10 taxpayers represent more than 35% of the tax base exists, the score worsens by one point (1). If the top 10 taxpayers exceed 45% of the tax base, the score worsens by two points (2.0).

The adjustment impact of each qualitative factor counts for one point (1.0), except for employment and tax base concentration, where the score may differ by two points (2.0) as described above. The final economic score equals the initial score adjusted up or down based on the net effect of the qualitative factors. Metrics that equal a cut-off point between two initial scores will equate to the worse score. To calculate the market value per capita, the criteria use the most recent estimate available. To calculate projected per capita EBI, the criteria use the most recent local level EBI available, adjusted for per capita personal income growth expectations for the next five years. IHS Inc.(known as Global Insight) or another similar source is used for county-level data and U.S. income projections, while Nielsen (Claritas) or another similar source is used for local level data. To measure unemployment, the criteria use county-level data from the Bureau of Labor Statistics and take the annual rate for the last calendar year. For local governments located with multiple counties, county-level data is weight-averaged based on the percentage of the population of the local government in each county.

42. The final economic score will vary from that suggested by the initial score depending on the presence of one or more conditions, as shown in the table 8.

43. Local income and TMV statistics may underestimate fundamental economic strength. For example, local TMV statistics will not accurately reflect the economic activity and stability brought by a university, nor will student income

levels reflect their additional spending power coming from parent financing or student loans. Participation in a broader metropolitan area may bring nonresident spending into a community or provide additional job opportunities for residents beyond its borders--especially when the metropolitan area is economically strong.

44. By contrast, income and TMV per capita may fail to account for additional risks. The impact on income and economic activity from job losses may not immediately show up in income levels and market prices, and such losses are more likely to occur in more cyclical and concentrated tax bases. Because they do not exhibit strong cyclicality, concentration in the education/health, government, and transportation, trade and utilities sectors are not considered for this adjustment. County-level unemployment rates are used to reflect the wider view of the local economy. Population declines may also dampen the impact on per capita measures, and high Dependent Population levels can mean additional service requirements or different levels of willingness to support tax increases.

45. We assess participation in a larger broad and diversified economy at the Metropolitan Statistical Area (MSA) level. When the MSA is deemed to be broad and diverse, a positive adjustment of one point is applied to the initial economic score. The determination is based on an evaluation of three components--employment diversity, employment growth, and the employment base. Each of the three components is scored as strong, moderate, or weak and is equally weighted. Strong and weak scores offset each other, while a moderate score remains neutral. MSAs are considered to be broad and diverse when the net score of the three components is strong, and are not considered broad and diverse when the net score is weak. If the net score is moderate, applying the broad and diverse adjustment to the initial economic score may be warranted if we determine the local government benefits significantly from participation within its respective MSA.

46. Employment diversity within an MSA is primarily assessed using a Herfindahl Index that includes the share of total employment distributed across 12 general employment sectors. For this index, we consider less than 0.15 to be strong, between 0.15 and 0.18 to be moderate, and greater than 0.18 to be weak. Employment growth is primarily measured by the percentage change in total employment within an MSA for the prior five-year period. For this measure, we consider an MSA with a rate better than the sum of all MSAs as strong; if the MSA's rate is worse but within three percentage points of the sum of all MSAs it is considered moderate, and a rate more than three percentage points worse is considered weak. The employment base measures total employment within the MSAs across all sectors. For this measure, we consider population greater than 250,000 to be strong, between 100,000 and 250,000 to be moderate, and less than 100,000 to be weak.

47. Additional considerations include employment concentration within specific sectors if: 1) the Herfindahl index is greater than 0.067, excluding the education/health, government, and transportation, trade, and utilities sectors, or 2) any volatile sector is more than double the level found in the sum of all MSAs and a large 10-year percentage decline in total employment (greater than 10%). If any of these considerations exist, they may reduce the overall score from strong to moderate or moderate to weak.

E. Management Score

48. The rigor of a government's financial management practices is an important factor in Standard & Poor's analysis of

that government's creditworthiness. Managerial decisions, policies, and practices apply directly to the government's financial position and operations, debt burden, and other key credit factors. A government's ability to implement timely and sound financial and operational decisions in response to economic and fiscal demands is a primary determinant of near-term changes in credit quality. The management score assesses the impact of management conditions on the likelihood of repayment. The score does not measure individual managerial quality, organizational efficiency, or any other performance indicator associated with management. Table 9 summarizes the scoring for the management score.

49. The Financial Management Assessment (FMA) methodology (see "Financial Management Assessment", published June 27, 2006) used in U.S. public finance forms the starting point for the management score. The FMA assesses only the policies and practices of a local government. Our criteria recognize the mere development of such practices as a principal method for preventing default as early as the 1930s evidenced in Hillhouse.

Table 9

Assessing The Management Score (see paragraphs 48-58)

Score	Characteristics
1 (very strong)	FMA score of "Strong" and none of the factors in scores '4' or '5' are present.
2 (strong)	FMA score of "Good" and none of the factors in scores '4' or '5' are present.
3 (adequate)	FMA score of "Standard" and none of the factors in scores '4' or '5' are present.
4 (weak)	FMA score of "Vulnerable" or any of the following is present: there is a financial reporting restatement that has a material negative impact; any of the conditions in score '5' existed within the past three years; the structural imbalance override condition exists or existed within the past three years; or a very high debt, pension, and OPEB burden.
5 (very weak)	Regardless of the FMA score, any of the following is present: a management team that lacks relevant skills resulting in a weak capacity for planning, monitoring, and management; an auditor has delivered a going concern opinion; the government is exhibiting an unwillingness to support a debt or capital lease obligation; or the government is actively considering bankruptcy in the near term.
Qualitative factors with a positive impact on the initial score	Qualitative factors with a negative impact on the initial score
Consistent ability to maintain balanced operations.	Frequent management turnover inhibiting a current understanding of the government's financial position and its ability to adjust, or political gridlock, or instability that brings the same results.
Government service levels are limited.	Consistent inability to execute approved structural reforms for two consecutive years.

For each relevant qualitative factor, the score changes by one point. The final management score equals the initial score adjusted up or down based on the net effect of the qualitative adjustments. Qualitative adjustments cannot improve an initial management score of '5' or, in certain cases, a score of '4' (see paragraph 57).

50. Regardless of the initial management score resulting from the FMA and any adjustment factors, certain conditions automatically cap the score at '4' or '5'. A capped score of '4' can occur if the financial reporting of the municipality is subject to material restatements to an extent that the uncertainty created is consistent with ratings no higher than 'A'. This does not include required accounting adjustments such as required changes by the Governmental Accounting Standards Board (GASB). Another instance when a capped score of '4' may occur is within three years after a condition that would cause or caused a management score of '5'. In such cases, the uncertainty surrounding management's ability to rebound from the condition(s) is also consistent with ratings no higher than 'A'. The same result can exist while the local government's finances are structurally imbalanced (see paragraph 35) or during the three-year period thereafter when management is rebounding from the structural imbalance condition. Finally, a capped score of '4' may result from having a debt, pension, and other postemployment benefits (OPEB) burden that is considered very high and management's lack of a credible plan to address the situation. Characteristics of a very high burden include:

- Total governmental funds debt service plus required annual pension payment plus annual OPEB payment as a percentage of total governmental funds expenditures above or expected to exceed 50%;
- A growing recent and near-term expected trend of these fixed-cost charges; and
- Fiscal flexibility unable to compensate for these elevated fixed-cost charges;

51. The first instance in which a municipality can receive a capped score of '5' occurs when a management team lacks the relevant skills to adequately plan, monitor, and manage the government's finances. Although rare, these conditions usually occur when the management organization concentrates nearly all management functions with one individual who then leaves. To receive a score of '5', a lack of qualified subordinates and delays in replacing the departed individual usually exist. As this period lengthens, the government's true financial position becomes less clear, and an auditor may have difficulty rendering an opinion on the government's financial statements.

52. The second instance occurs when an auditor has delivered a going concern opinion with the most recent review of the government's financial position. Other forms of qualified audit opinions do not result in a score of '5'.

53. The third instance occurs when a government shows an unwillingness to support a debt, capital lease obligation, or moral obligation pledge. A current lack of willingness to pay vendors, vendor leases, or other commercial obligations would not automatically result in a score of '5', although it could indicate increased financial pressure that could bring lower ratings through the other elements considered by the criteria. A current lack of willingness may or may not be clearly established before the actual payment date of the obligation concerned. Even before a government has formally chosen not to pay an obligation, downward rating adjustments could result from the expectation of such events.

54. The fourth instance occurs when representatives of the government take actions that indicate active consideration of bankruptcy filing in the near-term.

55. Various qualitative factors may raise or lower the final management score relative to the initial score, as shown in table 9.

56. Even when limited policies exist, the risk management poses to credit quality may still be limited. First, management may excel in consistently balancing operations despite the absence of formal policies. Second, when the government provides limited services, operational risk declines. The management score improves by one point when either of

Table 10
Assessing The Budgetary Flexibility Score (see paragraphs 59-64)

	Available Fund Balance As A % Of Expenditures				
%	>15	8-15	4-8	1-4	≤1
Score	1	2	3	4	5

A score of '1', '2', '3', '4', and '5' means very strong, strong, adequate, weak, and very weak, respectively.

Qualitative factors with a positive impact on the initial score:	Qualitative factors with a negative impact on the initial score:
If projections for the current year and the following year suggest a better initial score.	If projections for the current year and the following year suggest a worse initial score.
Ability to avoid financial imbalances with demonstrated capacity and willingness to cut operational spending (by more than 2%), resulting from a flexible cost structure, flexible legislation, and/or widespread political support.	High levels of questionable receivables or amounts due from other funds with deficit balances.
Existing state tax caps do not apply to the government, or the government retains substantial flexibility under the caps.	Limited capacity to cut expenditures due to infrastructure or operational needs or political resistance.
Demonstrated ability and willingness to raise taxes when needed (and voter support is usually obtained when such approval is required).	Limited capacity to raise revenues due to consistent and ongoing political resistance which can include self-imposed restrictions through charter or local initiative processes.
Timing of fiscal year and tax billing dates result in high cash with abnormally low fund balance levels.	Where cash accounting is used, the criteria use cash balances instead of fund balances and the score is worsened by one point.
Maintenance of an available fund balance exceeding 30% of general fund expenditures for the most recently reported year, the current year and next year.	

For each relevant qualitative factor, the score changes by one point. The final budgetary flexibility score equals the initial score adjusted up or down based on the net effect of the qualitative factors. A metric that equals a cutoff point between two initial scores will equate to the worse score.

60. Various qualitative factors may raise or lower the final budget flexibility score relative to the initial score, as shown in table 10.

61. The existing Available Fund Balances reflect the most obvious and measurable form of flexibility. However, we recognize that municipalities may have ongoing balances legally available for operations outside the general fund. Therefore, the Available Fund Balance in the initial score reflects all available funds legally available for operations. The initial score is the Available Fund Balance as a percentage of general fund expenditures. The measure uses data from the most recent reported year.

62. Qualitative adjustments to the budgetary flexibility score generally compensate for shortcomings in the fund balance measure or assess other forms of flexibility. GASB Interpretation No. 5 specifies how much of taxes already levied and possibly even collected must be deferred from a recognition perspective based on the timing of these elements relative

these conditions exists. The criteria measure government operational risk by distinguishing between the following two categories:

- Typical services: the municipal government provides public safety, roads, basic planning and permitting, and some utility services. Governments providing significantly higher levels of complex or resource-intensive services also receive a score of 'typical'.
- Limited services: the municipal government maintains roads and provides only limited additional services that are mostly administrative or non-labor-intensive. It either does not provide public safety services or contracts them out to other governments. Any other services are limited and could be scaled back or discontinued if they became a burden.

57. No qualitative adjustment may raise the score if the initial score equals '5'. In some instances a score of '4' cannot be adjusted in a positive direction. No improvement in the final score occurs when a capped score of '4' is assigned because of the conditions described in paragraph 50.

58. Negative adjustments to the initial management score address circumstances or obstacles that prohibit management from planning and executing. Such conditions could include rapid management turnover or political gridlock or instability. The criteria also recognize that not all obstacles can be foreseen and use two consecutive years of failure to implement planned structural reforms as evidence that such an obstacle exists even if it has not been precisely identified.

F. Budgetary Flexibility Score

59. The budgetary flexibility score measures the degree to which the government can look to additional financial flexibility in times of stress. Table 10 details the scoring for budgetary flexibility.

to the fiscal year. In some jurisdictions, this results in the accounting creation of low fund balances in a small number of credits that in reality have substantial resources. On the other hand, high fund balances as a percentage of expenditures may overestimate flexibility if the quality of receivables recognized is suspect. The Available Fund Balance measure will be net of any Available Fund Balance that includes questionable receivables that we do not expect to be collected, but if receivables are unable to be projected with confidence, the negative "questionable receivables" score adjustment is used instead of making an adjustment to the data (see table 10). For entities that report on a cash basis, the criteria use cash balances instead of fund balances. The score is worsened by one, however, to compensate for the lack of clarity on what funds are truly available. The maintenance of a consistently high fund balance -- exceeding twice the level associated with the top score -- that we expect to continue represents a positive adjustment that may offset a negative adjustment when both conditions exist.

63. Other forms of flexibility primarily include the ability to raise additional revenues or reduce expenditures. These tools are at least equal in power to the use of existing balances, but qualitative adjustments better suit their complexity due to the various forms they can take. With regard to tax caps, the institutional framework score incorporates the extent to which statewide tax caps exist, but the budgetary flexibility score differentiates those credits that retain flexibility despite the tax caps. The criteria separately assess local political support for increases, including cases where there are self-imposed limitations as a result of local charter initiatives or referenda.

64. The option to use fund balance in the near term can provide fiscal flexibility although fund balance drawdowns may impair future fiscal flexibility. Likewise, increasing fund balances can enhance fiscal flexibility. Our forward-looking analysis evaluates the budget performance for the current and next fiscal year. If our projections result in a score change, either up or down, the score is adjusted by one point in the relevant direction.

G. Budgetary Performance Score

65. The budgetary performance score measures the current fiscal balance of the government, both from a general fund and total governmental funds perspective. Table 11 details the scoring for this measure.

Table 11
Assessing The Budgetary Performance Score (see paragraphs 65-68)

	Total Governmental Funds Net Result (%)				
General Fund Net Result (%)	> -1	-1 to -5	-5 to -10	-10 to -15	≤ -15
(> 5)	1	2	3	3	4
(-1 to 5)	2	3	3	4	5
(≤ -1)	3	4	4	5	5

A score of '1', '2', '3', '4' and '5' means very strong, strong, adequate, weak, and very weak, respectively.

Qualitative factors with a positive impact on the initial score:	Qualitative factors with a negative impact on the initial score:
Expected structural improvement: if projections for the current year and following year suggested a better initial score, the score would improve by one point. The score would improve by two points only if required adjustments to revenues or expenditures to produce the result were already approved.	Expected structural deterioration: if projections for the current year and following year suggested a worse initial score, the score would worsen by one or two points. To worsen by two points, expected performance must fall to the commensurate level within the current year.
	Deferred payments on a cash basis: in cases where good ratios hide significant underspending due to deferred payments, the deferral produces a better score.
	Significant historic volatility in performance because of very cyclical revenues, (e.g. oil & gas or sales taxes on luxury goods and/or dependence on volatile state transfers) or exposure to event-related risks, and the sources of volatility remain.

For each relevant qualitative factor, the score changes by one point, except for expected structural improvement or deterioration which could result in a difference of two points relative to the initial score. The final budget performance score equals the initial score adjusted up or down based on the net effect of the qualitative factors. Metrics that equal a cut-off point between two initial scores will equate to the worse score.

66. Various qualitative factors may raise or lower the final budget performance score relative to the initial score, as shown in table 11.

67. The budgetary performance score begins with a measure based on the most recent year reported because it is observable and verifiable. The criteria will usually smooth planned capital expenditures to arrive at a more sustainable view of ongoing performance by eliminating the spending of borrowed funds for capital expenditures. Adjustments are also made for net transfers to identify the structural result.

68. However, future credit quality is dependent on current and future performance. Accordingly, the score can be adjusted by one or at most two points if actions or events subsequent to the date of the measure suggest different results in the coming years. Examples of actions warranting such adjustments include updated current-year estimates, new budgets, or budget amendments featuring approved revenue or expenditure adjustments. The criteria also compensate for artificially positive outcomes resulting from deferred expenditures, such as underfunding required pension

contributions, with a negative adjustment of one point. A negative adjustment of one point also exists for the uncertainty associated with governments facing increased volatility in revenues with a more-than 10% year-to-year decline, such as those highly dependent on oil and gas-related revenues or sales taxes on luxury goods or subject to event-related risk. The criteria include financial reporting restatements that are not material enough to warrant a management score (see paragraph 50) of '4' but inject a degree of uncertainty to the performance score, as a one-point negative adjustment. Event-related risk can also include sudden and material negative financial performance from enterprises owned by the entity.

H. Liquidity Score

69. The liquidity score measures the availability of cash and cash equivalents to service both debt and other expenditures. Table 12 details the calculation of the initial score, as well as the manner in which other factors affect the liquidity score. The measure uses data from the most recently reported year.

Table 12
Assessing The Liquidity Score (see paragraphs 69-77)

	Total Government Available Cash As % Of Total Governmental Funds Debt Service				
Total Government Available Cash As % Of Total Governmental Funds Expenditures	>120	100 to 120	80 to 100	40 to 80	≤40
>15	1	2	3	4	5
8 to 15	2	2	3	4	5
4 to 8	3	3	3	4	5
1 to 4	4	4	4	4	5
<1	5	5	5	5	5

A score of 1, 2, 3, 4 and 5 are very strong, strong, adequate, weak and very weak, respectively.

Qualitative factors with a positive impact on the initial score:	Qualitative factors with a negative impact on the initial score:
If projections for the current year (and the following year) suggest a better initial score, the score improves by one point.	If projections for the current year (and the following year) suggest a worse initial score, the score worsens by one point.
If access to external liquidity is 'exceptional' as defined in table 13, the score improves by two points; if 'strong', the score improves by one point.	If access to external liquidity is 'uncertain' as defined in table 13, the score worsens by two points; if 'limited', the score worsens by one point.
Very robust and stable internal cash flow generation capacity compared with peers in this category.	High refinancing risk over the next 24 months.
	Aggressive use of investments.
	Exposure to non-remote contingent liability risk that could come due within 12 months.

See paragraph 77 for circumstances resulting in an automatic score of '4' or '5'. Extraordinary proceeds (such as unused short-term borrowing) that span fiscal years or that are otherwise dedicated will be adjusted out of Total Government Available Cash.

For each relevant qualitative factor, the score changes by one point, except for access to external liquidity which could change the final score by two points and contingent liability exposure which could cap the score at '4' or '5'. The final liquidity score equals the initial score adjusted up or down based on the net effect of the qualitative factors. Metrics that equal a cut-off point between two initial scores will equate to the worse score.

70. Various qualitative factors may raise or lower the final liquidity score relative to the initial score, as shown in table 12.

71. Because governments hold monies in various funds that may be accessed for short-term liquidity, the measure uses Total Government Available Cash held by the government and recognizes most governments' ability to engage in interfund borrowing. Undrawn amounts under committed bank lines and other facilities are included as cash, and drawn amounts are included with both debt service and total expenditures if due within the next 12 months.

72. Through adjustment factors, the criteria also recognize the role that capital markets and bank financing can play in local government liquidity, as well as the strengths and weaknesses associated with other conditions.

73. The access to external liquidity score detailed in table 13 measures a local government's access to capital market and bank financing.

74. Availability of liquidity varies and in part is a function of the current and near term financial condition. Our forward-looking analysis evaluates the cash, expenditures and debt service for the current and next fiscal year. If our projections result in a score change, either up or down, the score is adjusted one point in the relevant direction.

Table 13

Assessment Of Access To External Liquidity (see paragraph 75)

Access To External Liquidity	Typical Characteristics
Exceptional	There is well-tested access to capital markets through different capital financing programs as well as a history of tapping these markets for over 15 years through different economic cycles.
Strong	There is a record of sufficient access to capital markets, and no reason to believe access has diminished.
Satisfactory	There is no record of access to the capital markets in the last 20 years, but there is also no reason to believe that external financing could not be obtained at a price acceptable to the government.
Limited	Legal or market obstacles to the use of debt instruments for liquidity management exist; the availability of bank loans is limited.
Uncertain	Access to external liquidity is highly questionable, considering both capital market and bank sources.

75. Although local governments in general have enjoyed good market access even through the last economic downturn and credit tightening, the score assesses access relative to the specific local government rather than to the sector as a whole. Absent a market-based or issuer-specific reason to question future market access, the score will use the government's own record of market access in addition to any state-specific sources.

76. The criteria also recognize that future cash balances may be understated for credits with strong cash flow generation capabilities. Often, this results from conservative budgeting procedures that consistently produce positive budget variances.

77. By contrast, projected cash balances may be more at risk under certain conditions, including aggressive use of investments, high refinancing risk over the next 24 months, or exposure to other contingent liability risk that could come due within the next 12 months. Aggressive use of investments includes the use of derivatives for investment rather than hedging purposes, a focus on return over preservation of principal and liquidity, and the use of nontraditional instruments without an ability to articulate their risks and how they will be mitigated. High refinancing risk includes instances where the issuer could be forced to access outside financing due to a lack of internal liquidity, but the issuer will have limited warning when the need arises and has no credible plan to do so on a timely basis. Other contingent liquidity risks include payments resulting from rating triggers, legal judgments, deficits of other enterprises,

or other events that are foreseeable within our current-year estimate. When such events are likely, the coming year's cost of these obligations exceeds 25% of general fund revenues, and the government lacks a commitment to implement a credible plan to finance the obligation, the final liquidity score is capped at '5'. When such events are likely, the coming year's cost of these obligations exceeds 10% of general fund revenues, and the government lacks a commitment to implement a credible plan to finance the obligation, the final liquidity score is capped at '4'. Otherwise, the presence of such obligations worsens the liquidity score by one point. Any such element deemed certain is included as an expenditure in total cash as a percentage of total governmental funds expenditures. If the event would result in a higher debt obligation, the criteria also include the item as debt service in the total government cash as a percentage of total governmental funds debt service measure. For more information on contingent liquidity risks, see "Contingent Liquidity Risks In U.S. Public Finance Instruments: Methodology And Assumptions", published March 5, 2012.

I. Debt And Contingent Liabilities Score

78. The criteria form the initial debt and contingent liabilities score from the combination of two measures: total governmental funds debt service as a percentage of total governmental funds expenditures and net direct debt as a percentage of total governmental funds revenue. Debt service as a percentage of expenditures measures the annual fixed-cost burden that debt places on the government. Debt to revenues measures the total debt burden on the government's revenue position rather than the annual cost of the debt, which can be manipulated by amortization structures. Net direct debt is calculated as of the date of our analysis, including any debt issuance we are currently rating. Debt to expenditures is measured similarly, recognizing any near-term changes due to the government's debt structure. Table 14 details the scoring for the debt and contingent liabilities score. For more information on debt measurement, see "Debt Statement Analysis", published Aug. 22, 2006.

Table 14

Assessing The Debt And Contingent Liabilities Score (see paragraphs 78-84)

	Net Direct Debt As % Of Total Governmental Funds Revenue				
Total Governmental Funds Debt Service As A % of Total Governmental Funds Expenditures	<30	30 to 60	60 to 120	120 to 180	≥180
< 8	1	2	3	4	5
8 to 15	2	3	4	4	5
15 to 25	3	4	5	5	5
25 to 35	4	4	5	5	5
≥35	4	5	5	5	5

A score of 1, 2, 3, 4 and 5 are very strong, strong, adequate, weak and very weak, respectively.

Qualitative factors with a positive impact on the initial score:	Qualitative factors with a negative impact on the initial score:
Overall net debt as a percentage of market value below 3%.	Significant medium-term debt plans produce a higher initial score when included.
Overall rapid annual debt amortization, with more than 65% coming due in 10 years.	Exposure to interest-rate risk or instrument provisions that could increase annual payment requirements by at least 20%.
	Overall net debt as a percentage of market value exceeding 10%.
	Unaddressed exposure to large unfunded pension or OPEB obligations leading to accelerating payment obligations over the medium term that represent significant budget pressure (see paragraph 82). If there is a plan to address the obligations, the final score worsens by one point; otherwise the score worsens by two points.
	Speculative contingent liabilities or those otherwise likely to be funded on an ongoing basis by the government representing more than 10% of total governmental revenue .

For each relevant qualitative factor, the score changes by one point, except for unaddressed exposure to unfunded pension or OPEB obligations which can worsen the final score by two points. The final debt and contingent liabilities score equals the initial score adjusted up or down based on the net effect of the qualitative factors. Metrics equal a cutoff point between two initial scores will equate to the worse score.

79. Qualitative adjustments may raise or lower the final debt and contingent liabilities score relative to the initial score, as shown in table 14. The criteria consider pending debt issuance through an upward score adjustment when including

the planned or recently issued debt results in a worse score.

80. The criteria improve the final score by one point when above-average annual debt amortization (based on total direct debt) inflates the debt service as a percentage of expenditures score and masks the future flexibility stemming from an early deleveraging. The criteria do not apply this adjustment when the early amortization results from a near-to-medium term bullet maturity that will not be retired with funds on hand. Exposure to interest-rate risk or instrument provisions that cause amortization or interest-rate changes beyond the issuer's control increase the score by one point, reflecting additional uncertainty as to whether current debt service levels are representative of those going forward. Examples include unhedged variable-rate debt or higher interest rates resulting from failed remarketings in instruments such as auction-rate securities, variable-rate demand bonds, and certain direct purchase obligations.

81. An overall net debt to TMV level of above 10% worsens the score by one point, while a low level, below 3%, improves the score by one point. This statistic captures the burden of the local government's debt in addition to that of overlapping jurisdictions on the overall tax base. An atypical debt burden can present extra challenges or flexibility over and above that suggested by the individual government's debt burden alone.

82. The impact of pension and OPEB obligations depends on the degree to which such costs will likely escalate and whether the government has plans to address them. Relative to debt, governments have a higher level of flexibility to address these costs, both from a temporal payment perspective and from an obligation level perspective. Many governments have the flexibility to alter benefit levels, and some governments already have availed themselves of this ability. Most governments also can pay less than the annual required contribution without leaving the fund unable to meet actual payments in the current and following year. On the other hand, such delays accelerate the growth rate of future payments. When the potential for such accelerations exists and the increased payments increase budget stress, the final debt and contingent liabilities score worsens by one point when a specific and credible plan to address this burden is in place. Otherwise, the score worsens by two points relative to the initial score. Among the areas of analytic focus when assessing the pension and OPEB burden will be:

- The required annual pension payment plus annual OPEB payment as a percentage of total governmental funds expenditures. A combined carrying charge of 10% or more will be considered elevated, however, we will consider whether we expect the elevated payments to result in lower future obligations.
- The actuarial funded ratio(s) of the pension plan(s) a local government participates in or sponsors. If the ratio(s) are less than 80%, they will receive further review especially when the carrying charge is elevated. We also consider the magnitude of the unfunded obligation in tandem with the funded ratio(s) when assessing the potential for stress.
- The contributions actually made to all pension plans a local government participates in or sponsors. The degree to which a local government contributes less than its full required contribution(s) could be an indication of either short-term cash flow issues or a willingness of management to defer difficult decisions.
- The OPEB costs exceed 5% of total governmental funds expenditures and the local government has limited flexibility to change or amend these benefits.

83. Finally, another adjustment considers additional future contingent liabilities not yet requiring government support. While our debt burden calculation already considers other nondirect debt requiring government support and our liquidity score considers the near-term impact of any contingent liabilities, the adjustment to the debt score results

from a likelihood of ongoing payment obligations not yet occurring that represent more than 10% of total governmental funds revenues. Once the payment obligations become reality, they are included in the debt measure. Examples of contingent liabilities include potential legal judgments, currently self-supporting government enterprise debt that is likely to require support in the near future, guaranteed debt likely to need support in the near future, and additional costs resulting from pending changes in law.

84. As discussed in paragraph 50, a very high debt, pension, and OPEB burden can lead to a management score of '4', which caps the final rating at the lower of 'A' and one notch lower than that suggested by table 1. In cases where these liabilities are not determined to be excessive, the one-notch flexibility described in paragraph 24 may be used to account for the impact that elevated levels of these liabilities can have on credit quality.

VII. APPENDIX I: Selected Historical Statistics

85. Selected historical statistics on local government defaults taken or derived from George Hempel's "The Postwar Quality of State and Local Debt" are shown in tables 15 and 16.

Table 15

Number Of Recorded Defaults From 1839-1965 By Type Of Governmental Unit

Year	States	Counties and parishes	Incorporated municipals	Unincorporated municipals	School districts	Other districts
1839-1849	9		4			
1850-1859	2	7	4	4		
1860-1869	1	15	13	9		
1870-1879	9	57	50	46	4	2
1880-1889		30	30	31	5	1
1890-1899		94	93	50	9	12
1900-1909		43	51	33	11	11
1910-1919		7	17	5		7
1920-1929	1	15	39	10	14	107
1930-1939		417	1,434	88	1,241	1,590
1940-1949		6	31	7	5	30
1950-1959		12	31	4	23	42
1960-1965		17	70	20	41	44
Total defaults	22	720	1,867	307	1,353	1,846
Total state and local governmental units in 1963	50	3,043	17,997	17,144	34,678	18,323

Table 16

Government Defaults As A Percentage Of Total Governmental Units By Type Of Government

Year	Counties and parishes (%)	Incorporated municipals (%)	Unincorporated municipals (%)	School districts (%)	Other districts (%)
1839-1849	0	0	0	0	0
1850-1859	0.2	0	0	0	0
1860-1869	0.5	0.1	0.1	0	0

Table 16

Government Defaults As A Percentage Of Total Governmental Units By Type Of Government (cont.)					
1870-1879	1.9	0.3	0.3	0	0
1880-1889	1	0.2	0.2	0	0
1890-1899	3.1	0.5	0.3	0	0.1
1900-1909	1.4	0.3	0.2	0	0.1
1910-1919	0.2	0.1	0	0	0
1920-1929	0.5	0.2	0.1	0	0.6
1930-1939	13.7	8	0.5	3.6	8.7
1940-1949	0.2	0.2	0	0	0.2
1950-1959	0.4	0.2	0	0.1	0.2
1960-1965	0.6	0.4	0.1	0.1	0.2

To derive the percentages, the table uses the study's total number of governments in 1963 for the total number of governments in all periods because this statistic is not available for all periods and the number of governments did not vary dramatically over these periods. The percentages above will overestimate annual default rates in many cases due to the multiyear nature of the periods.

VIII. APPENDIX II: Relationship To The State Rating

86. Local governments have a number of connections to their state governments. State governments may change the levels of funding provided to local governments. State legislatures may also change laws on local government funding, debt issuance, or even expenditure responsibilities. In smaller or more concentrated states, the nature of the economic bases may also be similar.

87. Given the historical record and ongoing localized nature of local government finance, the criteria measure the impact of additional stress by state governments through the standard scores. Were a state to alter local government funding statutes or mechanisms for its own fiscal purposes, such decisions could result in changes to the predictability, revenue and expenditure balance, and system support scores for all related local governments (see paragraphs 37-40). As the direct impact on a local government's fiscal balance becomes clear, changes to the budgetary flexibility and budgetary stress scores could occur.

88. Probably due to the historical trends of ongoing local control described in subsection A, there is limited data to show that state credit stress directly brings local government stress. Where correlation does exist, there is little evidence to suggest causation. Hempel notes that following the panic of 1837, nine states defaulted, namely Arkansas, Florida, Illinois, Indiana, Louisiana, Maryland, Michigan, Mississippi, and Pennsylvania. He cites only two municipal defaults following the panic, only one of which was in these states (Mobile, Ala. and Detroit, Mich.). The low level of municipal debt outstanding at the time, however, also likely limited defaults.

89. By the time of the depression of 1873 through 1879, local government debt had also significantly increased, in part because of prior restrictions on state debt issuance following the 1837 experience. Based on statements from Hempel and Scott, 12 states appear to have defaulted on or repudiated their debt during this period. Exact numbers of local government defaults by state during this period are elusive. Hillhouse's "Defaulted Municipal Bonds (1830-1930)" provides perhaps the best source. The author does not provide dates for the more-than 860 defaults cited, but instead provides citations for pieces that provide further information on these defaults. Using these citations as a proxy for the

period in which these defaults occurred allows for an analysis of whether credits presumably defaulting in this period were also in states that defaulted. Table 17 provides this detail.

Table 17

Reported Local Government Defaults In Defaulting And Nondefaulting States Over Various Periods (see paragraphs 19-23)

	Local defaults 1837-1843	Local defaults 1873-1880	Local defaults 1936
In states that defaulted	0	56	290
In states that did not default	2	85	2,869

Source: "Defaulted Municipal Bonds and Municipal Bonds, A Century of Experience"

90. Finally, Hillhouse's primary work, "Municipal Bonds, A Century of Experience", also lists municipal defaults by state during the Great Depression. Of the 3,159 credits in default as of January 1936, 290 were in Arkansas, the one state experiencing payment difficulties. Of this total however, 279 were school districts or other special districts. With regard to cities with populations of 10,000 or more in default, Arkansas had one out of nine such cities in default. In comparison, Ohio had 24 of 61 such cities in default, Michigan had 21 of 41, and New Jersey had 18 of 54.

91. Of course many other municipal defaults occurred between the periods referenced in table 17, and others have followed since, despite the lack of periods generating additional state payment defaults. Common reasons for these defaults include periods of overleveraging followed by a decline in local revenues, real estate or other development speculation, and fraud or mismanagement. Sometimes these defaults occurred in a regional pattern, while other times they were idiosyncratic.

92. Although no additional state defaults have occurred recently, several were significantly tested during the last recession. Despite budget gaps too large for one-item solutions, state cutbacks have posed no serious credit threat to municipal governments. The reduction of aid in some states has resulted in the need for local government adjustment, but, in our view, the size of these cutbacks in no way threatened the outright solvency of municipalities or their ability to service debt.

IX. APPENDIX III: Changes Since The Request For Comment

93. On March 6, 2012 Standard & Poor's published "Request For Comment: U.S. Local Governments: Methodology And Assumptions". Market participants who responded were generally positive about the increased transparency and clarity of the criteria. Some of them provided specific comments about certain metrics, data sources. and weighting of analytical factors (see "What's Happening With The Proposed U.S. Local Government Criteria? An Update On Feedback And Implementation", published Sept. 19, 2012). These comments and further analysis led to the following main changes between the criteria and the proposal presented in the RFC:

- Several overriding factors have been added (see table 2). Among them are: Available Fund Balance of less than $500,000, a budgetary flexibility score of '5', and exhibiting characteristics of structural imbalance.
- The positive qualitative adjustment for participation in a broad and diversified economy in the economic score has been modified to reflect a more-robust analysis of MSAs to help determine if the adjustment will be made.
- To further augment the forward-looking nature of our analysis, positive and negative qualitative adjustments have

been added to the budgetary flexibility and liquidity scores to account for situations when projections suggest better or worse scores. These adjustments had previously existed only in the budgetary performance score in the RFC.

- The liquidity score can be capped at '4' or '5' if certain levels of non-remote contingent liability risks exist to capture the significant stress these obligations can pose.
- Chiefly due to the changes listed above, the ranges for the indicative rating outcomes in table 1 were changed slightly to keep consistent our view of credit quality for the sector.
- Finally, additional characteristics were added to the description of the management score of '4' to capture situations where management is enduring or has recently endured conditions that pose credit stress.

X. GLOSSARY

94. Available Fund Balance: the sum of the Available General Fund Balance + any other fund balances of the government legally available for operations. For entities that report on a cash basis, the criteria use cash balances instead of fund balances.

95. Available General Fund Balance: the portion of the general fund balance that is legally available for operations. Based on GASB 54 designations, this generally includes assigned and unassigned balances but may include committed if committed for emergencies or other uses intended to support operations if necessary.

96. Dependent Population: the total population of an area that is younger than 15 years plus the total population of an area older than 65.

97. Effective Buying Income (EBI): personal income (wages, salaries, interest, dividends, profits, rental income, and pension income) - federal, state, and local taxes and nontax payments (such as personal contributions for social security insurance).

98. General Fund Net Result (%) (total general fund revenues - total general fund expenditures + transfers in from other funds - transfers out to other funds) divided by general fund expenditures.

99. Metropolitan Statistical Area: geographic entities delineated by the federal government that contain a core urban area of 50,000 or more population. MSAs consist of one or more counties that include the core urban area as well as any adjacent counties that are highly integrated.

100. Total Government Available Cash: total cash (cash, and cash equivalents + investments (when grouped with cash in the audit)) – proceeds of borrowings that are otherwise dedicated – other encumbered cash + liquidation of certain highly liquid securities.

101. Total Governmental Funds Net Result (%): (total governmental revenues - total governmental expenditures) divided by total governmental fund expenditures.

102. Total Market Value: the estimated market value of all real and personal property within the jurisdiction, typically determined as part of a government or other independent appraisal to determine taxable or assessed value.

XI. RELATED CRITERIA AND RESEARCH

Related Criteria

Articles complementing the criteria

- Appropriation-Backed Obligations, June 13, 2007
- Contingent Liquidity Risks In U.S. Public Finance Instruments: Methodology And Assumptions, March 5, 2012.
- Debt Statement Analysis, Aug. 22, 2006
- Financial Management Assessment, June 27, 2006
- Methodology For Rating International Local And Regional Governments, Sept. 20, 2010
- The Time Dimension Of Standard & Poor's Credit Ratings, Sept. 22, 2010
- Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings, Oct. 1, 2012

Related Research

- What's Happening With The Proposed U.S. Local Government Criteria? An Update On Feedback And Implementation, Sept. 19, 2012)
- Municipal Bankruptcy: Standard & Poor's Approach And Viewpoint, Oct. 4, 2012
- Hempel, George Henry, "The Postwar Quality of Municipal Bonds", University of Michigan doctoral dissertation, 1964
- Hempel, George Henry, "The Postwar Quality of State and Local Debt", National Bureau of Economic Research, 1971
- Hillhouse, A.M., "Defaulted Municipal Bonds (1830-1930)", Municipal Finance Officer's Association of the United States and Canada, December 1935
- Hillhouse, A.M., Municipal Bonds, "A Century of Experience", Prentice-Hall, New York, 1936
- Hoene, Christopher W. and Pagano, Michael A., "City Fiscal Conditions in 2010", National League of Cities Research Brief on America's Cities, October 2010
- Lutz, Byron, Molloy, Raven, and Shan, Hui, "The Housing Crisis and State and Local Government Tax Revenue: Five Channels", Finance and Economics Discussion Series, Divisions of Research and Statistics and Monetary Affairs, Federal Reserve Board, Washington D.C., August 2010
- Rodden, Jonathan, "The Dilemma of Fiscal Federalism: Grants and Fiscal Performance around the World", MIT Draft Working Paper, Sept. 28, 2001
- Standard & Poor's Refines Its Limited-Tax GO Debt Criteria, Jan. 10, 2002
- Understanding Standard & Poor's Rating Definitions, June 3, 2009
- Standard & Poor's U.S. Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Methodology And Assumptions: Request For Comment: Ratings Above The Sovereign—Corporate And Government Ratings, April 12, 2013

These criteria represent the specific application of fundamental principles that define credit risk and ratings opinions. Their use is determined by issuer- or issue-specific attributes as well as Standard & Poor's Ratings Services' assessment of the credit and, if applicable, structural risks for a given issuer or issue rating. Methodology and assumptions may change from time to time as a result of market and economic conditions, issuer- or issue-specific factors, or new empirical evidence that would affect our credit judgment.

Additional Contact:
Steven J Murphy, New York (1) 212-438-2066; steve.murphy@standardandpoors.com

Print

PART I ADMINISTRATION OF THE GOVERNMENT	
TITLE VII CITIES, TOWNS AND DISTRICTS	
CHAPTER 40 POWERS AND DUTIES OF CITIES AND TOWNS	
Section 5B Stabilization funds; establishment	

Section 5B. For the purpose of creating 1 or more stabilization funds, cities, towns and districts may appropriate in any year an amount not exceeding, in the aggregate, 10 per cent of the amount raised in the preceding fiscal year by taxation of real estate and tangible personal property or such larger amount as may be approved by the director of accounts. The aggregate amount in such funds at any time shall not exceed 10 per cent of the equalized valuation of the city or town as defined in section 1 of chapter 44. Any interest shall be added to and become part of the fund.

The treasurer shall be the custodian of all such funds and may deposit the proceeds in national banks or invest the proceeds by deposit in savings banks, co-operative banks or trust companies organized under the laws of the commonwealth, or invest the same in such securities as are legal for the investment of funds of savings banks under the laws of the commonwealth or in federal savings and loans associations situated in the commonwealth.

At the time of creating any such fund the city, town or district shall specify, and at any later time may alter, the purpose of the fund, which may be for any lawful purpose, including without limitation an approved school project under chapter 70B or any other purpose for which the city, town or district may lawfully borrow money. Such specification and any such alteration of purpose, and any appropriation of funds into or out of any such fund, shall be approved by two-thirds vote, except as provided in paragraph (g) of section 21C of chapter 59 for a majority referendum vote. Subject to said section 21C, in a town or district any such vote shall be taken at an annual or special town meeting, and in a city any such vote shall be taken by city council.

Print

PART I ADMINISTRATION OF THE GOVERNMENT

TITLE VII CITIES, TOWNS AND DISTRICTS

CHAPTER 40 POWERS AND DUTIES OF CITIES AND TOWNS

Section 6 Towns; reserve funds for extraordinary expenditures; establishment

Section 6. To provide for extraordinary or unforeseen expenditures, a town may at an annual or special town meeting appropriate or transfer a sum or sums not exceeding in the aggregate five per cent of the levy of the fiscal year preceding the fiscal year for which the fund, to be known as the reserve fund, is established. No direct drafts against this fund shall be made, but transfers from the fund may from time to time be voted by the finance or appropriation committee of the town, in towns having such a committee, and in other towns by the selectmen; and the town accountant in towns having such an official, and in other towns the auditor or board of auditors, shall make such transfers accordingly.

Print

PART I ADMINISTRATION OF THE GOVERNMENT
TITLE VII CITIES, TOWNS AND DISTRICTS
CHAPTER 44 MUNICIPAL FINANCE
Section 10 Debt limit

Section 10. Except as otherwise provided by law, a city or town shall not authorize indebtedness to an amount exceeding 5 per cent of the equalized valuation of the city or town. A city or town may authorize indebtedness in excess of 5 per cent but not in excess of 10 per cent, of the aforesaid equalized valuation; provided, however, that the amount of indebtedness so authorized shall be subject to the approval of the members of the municipal finance oversight board, which approval may be given either before or after such authorization.

In determining the debt limit for Boston hereunder the provisions of chapter ninety-three of the acts of eighteen hundred and ninety-one and of section one of chapter one hundred and ninety-one of the acts of nineteen hundred and three shall apply.

The debt limit for a district shall be based on an amount determined by applying to the equalized valuation of the town the same ratio which the assessors' valuation of the taxable property of the district for the preceding fiscal year bears to the assessors' valuation of the taxable property of the town for the preceding fiscal year. In the case of the district which is located in two or more towns, said debt limit shall be based on the total amount determined by applying to the equalized valuation of each of the towns in which any part of the district is located the same ratio which the assessors' valuation of the taxable property of the district in the respective towns for the preceding fiscal year bears to the assessors' valuation of the taxable property of said town for the preceding fiscal year.

All authorized debts, except those expressly authorized by law to be incurred outside the debt limit, shall be reckoned in determining the limit of indebtedness under this section.

thirty B and sections forty-four A to forty-four M, inclusive, of chapter one hundred and forty-nine of the General Laws, the town of Walpole is hereby authorized, to enter into an agreement with the Youth Soccer Association of the town of Walpole and Omega Associates, upon such terms and conditions as the board of selectmen shall deem appropriate, for the lease and use of all of a portion of a certain parcel of land shown as Parcel A08-0803 on a plan known as "Exhibit B plan of recreation and conservation uses", for recreation purposes, said land to be leased for the consideration of one dollar annually for a period of up to twenty years, said lease to be renewable every five years; provided, however, that any improvements to said land made pursuant to such agreement shall be paid by the said Youth Soccer Association and Omega Associates.

SECTION 6. This act shall take effect upon its passage.

Approved May 12, 1993.

Chapter 45. AN ACT ESTABLISHING A SICK LEAVE BANK FOR MAURICE J. O'BRIEN, AN EMPLOYEE OF THE MIDDLE DISTRICT, DISTRICT ATTORNEY'S OFFICE.

Whereas, The deferred operation of this act would tend to defeat its purpose, which is to immediately establish a sick leave bank for Maurice J. O'Brien, an employee of the Middle district, district attorney's office, therefore it is hereby declared to be an emergency law, necessary for the immediate preservation of the public convenience.

Be it enacted, etc., as follows:

Notwithstanding the provisions of any general or special law, rule or regulation to the contrary, the Middle district, district attorney's office is hereby authorized and directed to establish a sick leave bank for Maurice J. O'Brien, an employee of said office. Any employee of the Middle district, district attorney's office may voluntarily contribute one or more of his sick, personal or vacation days to said sick leave bank for use by said Maurice J. O'Brien.

The foregoing was laid before the Governor on the fourth day of May, 1992 and after ten days had the force of law as prescribed by the Constitution as it was not returned by him with his objections thereto within that time.

Chapter 46. AN ACT PROVIDING FOR A CAPITAL EXPENDITURE FOR THE TOWN OF HOLLISTON.

Be it enacted, etc., as follows:

SECTION 1. Notwithstanding the provisions of any general or special law to the contrary, the town of Holliston is hereby authorized to create and maintain a special fund to be known as the Capital Expenditure Fund, which shall be kept separate and apart from all other monies of said town by the town treasurer. Said treasurer shall be the custodian of the Capital Expenditure Fund and may deposit the proceeds or invest the same in accordance with the provisions of sections fifty-four and fifty-five of chapter forty-four of the General Laws. Any interest or income shall be added to and become a part of the Capital Expenditure Fund.

Said town of Holliston may appropriate in any year an amount not exceeding five percent of the amount raised in the preceding fiscal year by taxation of real estate and tangible personal property into the Capital Expenditure Fund by a majority vote at an annual or special town meeting. The aggregate amount in the Capital Expenditure Fund at any time shall not exceed one percent of the equalized valuation of said town of Holliston as defined in section one of said chapter forty-four.

Said town of Holliston may appropriate money from the Capital Expenditure Fund by a two-thirds vote at an annual or special town meeting for any purpose for which the town would be authorized to borrow money under sections seven or eight of said chapter forty-four.

SECTION 2. This act shall take effect upon its passage.

Approved May 17, 1993.

Chapter 47. AN ACT RELATIVE TO INDIGENT PATIENT PROGRAMS.

Be it enacted, etc., as follows:

SECTION 1. Subsection (b) of section 9 of chapter 94C of the General Laws, as most recently amended by section 4 of chapter 10 of the acts of 1992, is hereby further amended by striking out the last two paragraphs and inserting in place thereof the following two paragraphs:-

This section shall not prohibit or limit the dispensing of any prescription medication that is classified by the department of public health as schedule VI and that is provided free of charge by the manufacturer as part of an indigent patient program or for use as samples if such prescription medications are: (1) dispensed to the patient by a professional authorized to dispense controlled substances pursuant to this section; (2) dispensed in the package provided by the manufacturer; and (3) provided at no charge to the patient.

The department shall promulgate rules and regulations governing the dispensing of medication pursuant to this section. Said rules and regulations shall include, but need not be limited to, the types and amounts of medications that can be dispensed, and the appropriate safeguards for the labeling and dispensing of such medications.

SECTION 2. The rules and regulations governing the dispensing of medications pursuant to subsection (b) of section nine of chapter ninety-four C of the General Laws shall be promulgated and shall be effective no later than October first, nineteen hundred and ninety-three. The department of public health shall establish a program of notification to inform physicians of said rules and regulations. No medication shall be dispensed as part

Print

Acts
2013
Chapter 189 AN ACT AUTHORIZING THE TOWN OF HOLLISTON TO ESTABLISH AN OTHER POST-EMPLOYMENT BENEFITS TRUST FUND.

Be it enacted by the Senate and House of Representatives in General Court assembled, and by the authority of the same as follows:

SECTION 1. As used in this act, the following words shall have the following meanings:
"GASB 43 and 45", statements 43 and 45 of the Governmental Accounting Standards Board as amended from time to time and their successors.
"Other post-employment benefits" or "OPEB", post-employment benefits other than pensions as that term is defined in GASB 43 and 45, including post-employment healthcare benefits, regardless of the type of plan that provides them, and all post-employment benefits provided separately from a pension plan, excluding benefits defined as termination offers and benefits.
SECTION 2. (a) There shall be in the town of Holliston an OPEB Trust Fund which shall be under the supervision and management of a 5-member board of trustees. The board of trustees shall be comprised of the chair of the board of selectmen, the town administrator, the town treasurer and tax collector, the chair of the school committee and a resident appointed by the board of selectmen. The town treasurer and tax collector shall be the custodian of the fund and may employ an outside custodial service.
(b) Beginning in fiscal year 2013, the OPEB Trust Fund shall be credited with all amounts appropriated or otherwise made available by the town to meet the current and future OPEB costs payable by the town. The fund shall be credited with all amounts contributed or otherwise made available by employees of the town to meet future OPEB costs payable by the town. Any interest or other income generated by the fund shall be added to and become part of the fund. Any reimbursements that the town receives as a participant in the Retiree Drug Subsidy Program created pursuant to the Medicare Prescription Drug Improvement and Modernization Act of 2003, Public Law 108-173, or in a qualified retiree prescription drug plan pursuant to 42 U.S.C. 1395w-132 may be added to and become part of the fund. Amounts in the fund, including any earnings or interest accruing from the investment of these amounts, shall be expended only for the payment of the costs payable by the town for OPEB in consultation with the retirement board. Subject in each instance to the approval of the board of trustees, the town treasurer and tax collector shall invest and reinvest the amounts in the fund not needed for current disbursement consistent with the prudent person rule and sections 3, 4, 5, 8 and 9 of chapter 203C of the General Laws, but no funds shall be invested directly in mortgages or collateral loans. All monies held in the fund shall be segregated from other funds and shall not be subject to the claims of any general creditor of the town.

(c) The board of trustees may employ any qualified bank, trust company, corporation, firm or person to advise it on the investment of the OPEB Trust Fund and may pay from the fund for this advice and other services determined by the board of trustees. Procurement for these services shall be subject to chapter 30B of the General Laws.

SECTION 3. (a) An actuary, who shall be a member of the American Academy of Actuaries, shall perform an actuarial valuation of the town's OPEB liabilities and funding schedule, as of June 30, 2012, and no less frequently than every second year thereafter. The determinations shall be made in accordance with generally accepted actuarial standards and shall conform to the requirements of GASB 43 and 45 and the actuary shall make a report of the determinations to the town. The report shall, without limitation, detail the demographic and economic actuarial assumptions used in making the determinations and each report after the first report shall also include an explanation of the changes, if any, in the demographic and economic actuarial assumptions employed and the reasons for the changes.

(b) Beginning in fiscal year 2013, all payments for the purposes of meeting the town's costs of OPEB pursuant to this act shall be made from the OPEB Trust Fund. Disbursements from the fund, including any earnings or interest accruing from the investment of these amounts, shall only be in accordance with this act.

SECTION 4. This act shall take effect upon its passage.

Approved, December 30, 2013.

Governmental Accounting Standards Board

Other Postemployment Benefits: A Plain-Language Summary of GASB Statements No. 43 and No. 45

Please note: This document, prepared by the GASB staff, has not been reviewed or approved by the GASB Board and is not an authoritative document in the hierarchy of generally accepted accounting principles.

Governmental Accounting Standards Board

Other Postemployment Benefits: A Plain-Language Summary of GASB Statements No. 43 and No. 45

CONTENTS

Page Number

What Are Other Postemployment Benefits, and Why Are They Important? 1
Why Has the GASB Issued New Standards for OPEB? 1
What Types of OPEB Plans Do Governments Use? 1
How Do Governments Currently Finance Postemployment Benefits? 2
How Should Governments Participating in Defined Benefit Plans Account for OPEB? 2
How Should Governments Determine the Cost of OPEB? 3
The OPEB liability 4
OPEB assets 4
The unfunded liability 4
OPEB contributions 4
OPEB expenses, expenditures, and the net obligations 5
Implicit Rate Subsidies for Retirees 5
Provisions for Small Plans 6
What Additional OPEB Information Should a Government Employer Present in Its Financial Report? 6
Notes to the Financial Statements 6
Plan description 6
Funding policy 6
Members and types of benefits 7
Costs and obligations, methods and assumptions 7
Required Supplementary Information 8
What Information Should an OPEB Plan Present in Its Financial Report? 9
Financial Statements 9
Notes to the Financial Statements 9
Plan description 9
Accounting policies 10
Contributions and reserves 10
Investment concentrations 10
Funded status and funding progress 11
Required Supplementary Information 11

When Should Governments Implement These New Standards? 11
What Is the GASB? 12
How Does the GASB Set Standards? 12
Illustrations 14
Illustration 1. Notes to the Financial Statements for an Employer Contributing to a Single-Employer Defined Benefit Healthcare Plan 14
Illustration 2. Notes to the Financial Statements and Schedule of Funding Progress for an Employer Contributing to an Agent Multiple-Employer Defined Benefit Healthcare Plan 16
Illustration 3. Notes to the Financial Statements for an Employer Contributing to a Cost-Sharing Multiple-Employer Defined Benefit Healthcare Plan 18
Illustration 4. Defined Benefit Healthcare Plan Financial Reports 20

WHAT ARE OTHER POSTEMPLOYMENT BENEFITS, AND WHY ARE THEY IMPORTANT?

Employees of state and local governments may be compensated in a variety of forms in exchange for their services. In addition to a salary, many employees earn benefits over their years of service that will not be received until after their employment with the government ends through retirement or other reason for separation. The most common type of these postemployment benefits is a pension. As the name suggests, *other postemployment benefits* (OPEB) are postemployment benefits *other than pensions.* OPEB generally takes the form of health insurance and dental, vision, prescription, or other healthcare benefits provided to eligible retirees, including in some cases their beneficiaries. It may also include some types of life insurance, legal services, and other benefits.

Why Has the GASB Issued New Standards for OPEB?

The GASB established standards in 1994 for how public employee pension plans and governmental employers participating in pension plans should account for and report on pension benefits, but similar provisions did not exist for OPEB. Although the OPEB may not have the same legal standing as pensions in some jurisdictions, the GASB believes that pension benefits (as a legal obligation) and OPEB (as a constructive obligation in some cases) are a part of the compensation that employees earn each year, even though these benefits are not received until after employment has ended. Therefore, the cost of these future benefits is a part of the cost of providing public services *today.* However, most governments report their *cash outlays* for OPEB in a given year, rather than the *cost to the employer of OPEB earned by employees* in that year; these two amounts may be vastly different. In the absence of standards similar to those the GASB enacted for pensions, *most governments do not report the full cost of the OPEB earned by their employees each year.*

Furthermore, most governments do not report information about the nature and size of their long-term financial obligations and commitments related to OPEB. Consequently, the readers of financial statements, including the public, have incomplete information with which to assess the cost of public services and to analyze the financial position and long-run financial health of a government. The purpose of the new standards—GASB Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans,* and GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*—is to address these shortcomings.

What Types of OPEB Plans Do Governments Use?

There are two basic forms of postemployment benefit plans. *Defined benefit* plans are those that specify the *amount of benefits to be provided* to the employees after the end of their employment. *Defined contribution* plans stipulate only the *amounts to be contributed by a government employer* to a plan member's account each year of active employment, and do not specify the amount of benefits employees will receive after the end of their employment.

Plans may also be distinguished by how many employers participate in them. As their name indicates, *single-employer* plans involve only one government, whereas *multiple-employer* plans include more than one government. In a *cost-sharing multiple-employer* plan, governments *pool or share* the costs of financing benefits and administering the plan and the assets, if any, accumulated to pay benefits. Generally, a single actuarial valuation is conducted for all of the employees of the participating governments *combined.*

In *agent multiple-employer* plans, there is no pooling of benefit costs. Separate actuarial calculations are made for each participating government in the plan, and separate accounts are maintained to ensure that each employer's contributions are used to provide benefits only for the employees of that government. The cost of administering the plan, however, is shared by the participating governments.

How Do Governments Currently Finance Postemployment Benefits?

In general, postemployment benefits are financed in one of two ways. Some governments follow an *actuarial* approach, which entails paying to a pension or OPEB plan an amount that is expected to be sufficient, if invested now, to finance the benefits of employees after they are no longer working for the government. This approach is commonly followed for determining pension contributions.

For OPEB, however, most governments currently follow a *pay-as-you-go* approach, paying an amount each year equal to the benefits distributed or claimed in that year. The new OPEB standards do not mandate the funding of OPEB benefits (in other words, to set aside assets in advance to pay benefits in the future). As noted above, they address accounting and financial reporting issues only.

HOW SHOULD GOVERNMENTS PARTICIPATING IN DEFINED BENEFIT PLANS ACCOUNT FOR OPEB?

In general, governments should account for and report the annual cost of OPEB and the outstanding obligations and commitments related to OPEB in the same manner as they currently do for pensions. These amounts should be produced by actuarial valuations performed in accordance with parameters established by the GASB. The valuations should be conducted at least every two years for plans that administer OPEB for 200 or more plan members (both active employees and retirees) or at least every three years for plans with fewer than 200. Actuarial valuations generally should follow accepted actuarial practices as set forth by the Actuarial Standards Board.

How Should Governments Determine the Cost of OPEB?

The process of determining how much should be set aside now in order to provide for future benefits in a defined benefit plan utilizes actuarial methods and assumptions. An actuary's estimate or "valuation" is the product of many assumptions, based on historical experience, regarding the factors that determine the level of resources that will be needed in the future to finance benefits. These factors may include, but are not limited to:

- How many employees a government is expected to have that will receive benefits
- How long employees are expected to work for the government
- How long employees are expected to live after retiring (and, hence, how many years they will receive benefits)
- How much healthcare costs are expected to increase
- How large a return a government is expected to receive on its investments.

The actuary calculates *how much should be contributed now* to ensure that an adequate level of resources is available in the future. The future cash outlays for OPEB should be projected based on economic and demographic assumptions such as those mentioned above. These cash outflows would then be discounted to their *actuarial present value*—their estimated value if paid today—using a discount rate equal to an assumed long-term rate of return on investments. The actuarial present value generally would be spread over a period that approximates the anticipated years of an average worker's employment with the government, utilizing any one of six acceptable actuarial cost methods. The portion of the actuarial present value allocated to a particular year is called the *normal cost.* The portions allocated to the remaining years of employment are future normal costs.

The Board's decision to allow a choice among six methods reflects the fact that actuaries have developed a variety of methods to help determine how to fund pension and OPEB plans. The selection of a particular method generally is based on a recommendation from the actuary based on demographics, benefits offered, and the funding status of the plan. The Board believes it is most appropriate and useful to the users of financial statements if a government uses the same actuarial cost method for both funding and financial reporting, as long as the government's funding method is consistent with the principles of accrual-based accounting. If its funding method is not consistent, then a government should select from the six allowable actuarial cost methods for the purposes of financial reporting.

The OPEB Liability. The actuarial calculations are required to take into account not only benefits *expected to be earned* by employees in the future (future normal costs), but also those benefits the employees *have already earned.* One reason for this is that governments had been granting pension and OPEB benefits for many years before the accounting standards required their costs and obligations to be actuarially determined. Second, governments sometimes *retroactively* improve the benefits they provide to their employees. The portion of the actuarial present value allocated to prior years of employment—and thus not provided for by future normal costs—is called the *actuarial accrued liability* (AAL).

OPEB Assets. If an OPEB plan has cash, investments, and other resources, these may be applied to fund the actuarial accrued liability. The value of these resources is referred to as the *actuarial value of assets.* The actuarial value of assets is not the same as fair value, which is used to report a government's investments in its statements of net assets and balance sheet. Fair values can be volatile in the short term, with gains one year and losses the next. Postemployment benefits, however, are long-term transactions—assets are being set aside today to pay for benefits well into the future. Although there may be sharp changes in asset value in the short run, over the long run the change in asset value tends to be steadier. For financial reporting purposes, gains or losses in plan assets are averaged over several years (usually three to five), producing an actuarial value of assets that is more stable over time than fair value.

The Unfunded Liability. The excess of the AAL over the actuarial value of assets is the *unfunded actuarial accrued liability* (UAAL or unfunded liability). The unfunded liability would be amortized (spread) over a period of up to thirty years (approximately equal to a typical public employee's term of employment), either in *level dollar* amounts or as a *level percentage of projected payroll.* Like a home mortgage, the level dollar method divides the liability into equal dollar amounts over the selected number of years; each payment is part interest, part principal. The level percentage method calculates payments so that they equal a constant percentage of payroll over time as payroll increases; most governments currently use this method when reporting their pension benefits.

OPEB Contributions. The normal cost and the portion of the UAAL to be amortized in the current period together make up the *annual required contribution* (ARC) of the employer for the period. The ARC is an amount that is actuarially determined in accordance with the requirements of Statements 43 and 45 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. Employer contributions consist of payments directly to or on behalf of a retiree or beneficiary, premium payments to insurers, or irrevocably transferred assets to a trust (or equivalent arrangement) in which plan assets are dedicated to providing benefits to retirees and beneficiaries in accordance with the terms of the plan and are legally protected from creditors of the employer and plan administrator.

OPEB Expenses, Expenditures, and the Net Obligations. For a government in a single-employer or agent multiple-employer plan, the *annual OPEB cost* equals the ARC plus or minus certain adjustments if the employer's actual contributions in prior years differed from the ARC. The annual OPEB cost is the OPEB *expense* that a government would report in its accrual-based financial statements—the government-wide statements and the proprietary fund statements. Generally, the cumulative sum of differences between an employer's annual OPEB cost and the amounts *actually contributed* to the plan since the effective date of the standards makes up a liability (or asset) called the *net OPEB obligation.*

By contrast, for an employer government participating in a cost-sharing multiple-employer plan, the annual OPEB expense is equal to the employer's *contractually required contribution* to the plan—the amount assessed by the plan for the period—which may or may not equal the ARC.

In the financial statements that use accrual accounting a government is not required to place an initial liability on the statement of net assets when this standard is first implemented. Governments *may* report as a liability the accumulated differences between their actual contributions and the ARC for prior years, to the extent they have the necessary information to do so.

Under modified accrual in the governmental fund financial statements, an employer would report OPEB *expenditures* equal to *the amount contributed to the plan or expected to be liquidated with expendable available financial resources.* Because the governmental fund financial statements focus on current financial resources, they would not include the net OPEB obligation or any other long-term liability.

Implicit Rate Subsidies for Retirees

In health insurance plans where a government's retirees and current employees are insured together as a group, the premiums paid by the retirees may be lower than they would have been if the retirees were insured separately—this is called an *implicit rate subsidy.* Some believe that if the retirees pay 100 percent of their premiums without a specific contribution from the employer, then the employer should not be required to treat the implicit rate subsidy as an OPEB. The standards that were first proposed for public review were consistent with that point of view.

However, based on the comments received regarding those proposed standards, the GASB ultimately concluded in Statements 43 and 45 that exempting governments from including an implicit rate subsidy in their OPEB calculations would result in the annual cost and long-term obligations of their OPEB being significantly understated. Implicit rate subsidies should therefore be included by governments as OPEB.

Provisions for Small Plans

As mentioned above, actuarial valuations are required at least every two or three years, depending on the size of the OPEB plan. In recognition of the potential cost of hiring consultants to perform these valuations, the standards allow the smallest single-employer plans—those with fewer than one hundred members—and the employers that participate in them to estimate the AAL and the ARC using simplified methods and assumptions. (The method also is available to certain employers in agent multiple-employer plans.) The specifics of this *alternative measurement method* are described fully in Statements 43 and 45.

WHAT ADDITIONAL OPEB INFORMATION SHOULD A GOVERNMENT EMPLOYER PRESENT IN ITS FINANCIAL REPORT?

Notes to the Financial Statements

To assist users in understanding the nature of a government's OPEB and its efforts to finance its OPEB, the GASB's standards require governments to prepare note disclosures to accompany the expense, expenditure, and liability information reported in the financial statements.

Plan Description. Disclosures describing the plan contain the following basic information about the types of OPEB offered and how they are administered. (See Illustrations 1–3 at the end of this document.)

a. Name of the plan, identification of the public employee retirement system or other entity that administers the plan, and identification of the plan as a single-employer, agent multiple-employer, or cost-sharing multiple-employer defined benefit OPEB plan.
b. Brief description of the types of benefits and the authority under which benefit provisions are established or may be amended. For example, the disclosure might reveal that a plan provides retirement, disability, and death benefits to plan members and their beneficiaries, and that a specific section of state law regulates the changing of benefit provisions.
c. Whether the OPEB plan issues a *stand-alone financial report* or is included in the report of a public employee retirement system or another entity and, if so, how to obtain the report.

Funding Policy. Governments should disclose the following funding policy information about how contributions are made toward financing OPEB:

a. Authority (for example, state statute) under which the obligations of the plan members, employer(s), and other contributing entities (for example, state contributions to local government plans) to contribute to the plan are established or may be amended.
b. Required contribution rate(s) of active plan members.
c. Required contribution rate(s) of the employer in accordance with the funding policy, in dollars or as a percentage of current-year covered payroll. If the plan is a single-employer or agent plan and the rate differs significantly from the ARC, a government should disclose how the rate is determined. If the plan is a cost-sharing plan, a government should disclose the required contributions in dollars, the percentage of that amount contributed for the current year and each of the two preceding years, and how the required contribution rate is determined. Governments should also disclose any legal or contractual limitations on the maximum amount of their contributions.
d. A brief description of the terms of any long-term contracts for contributions to the plan and the amount still outstanding; for example, a government that is not able to make its full contribution in a given year might agree with the plan to make up the shortfall with interest in annual installments over a three-year period.

Members and Types of Benefits. If an employer government includes an OPEB plan in its financial statements as a trust or agency fund and the plan does not issue its own financial statements separate from those of the employer government, the employer also discloses the following information *about the plan as a whole:*

a. The types of employees covered (such as general employees, police officers, legislators) and, for multiple-employer plans, the participating governments
b. The number of members, sorted by (1) retirees and beneficiaries currently receiving benefits, (2) members no longer working for the government and entitled to benefits, but not yet receiving them, and (3) current employees
c. A brief description of (1) the types of benefits provided and (2) provisions for cost-of-living adjustments or other future increases in benefits
d. The balances remaining as of the date of the financial report in the plan's legally required reserves, a description of the purpose of the reserves, and whether the reserves are fully funded.

Costs and Obligations, Methods and Assumptions. Because governments participating in single-employer or agent multiple-employer plans are individually responsible for financing the OPEB cost of their own employees and retirees, these governments are required to provide additional information in their notes. The following additional disclosures are intended to help users assess whether the governments are keeping pace with actuarially required contribution amounts, the extent to which the resources set aside for paying

OPEB are sufficient or insufficient, and the methods and assumptions employed to conduct the actuarial calculations:

a. For the current year, annual OPEB cost and the dollar amount of contributions actually made. If the employer has a net OPEB obligation, it should also disclose the components of annual OPEB cost, the increase or decrease in the net OPEB obligation, and the net OPEB obligation at the end of the year.
b. For the current year and each of the two preceding years, annual OPEB cost, percentage of annual OPEB cost contributed that year, and net OPEB obligation at the end of each year.
c. The funded status of the plan; this is the same information governments would be required to disclose in a schedule of funding progress (see below), but only for the most recent valuation date.
d. Information about actuarial methods and assumptions used in the valuations that the information reported about the ARC, annual OPEB cost, and the funded status and funding progress of OPEB plans is based upon. (More details regarding this information can be found in Statement 45.)

Required Supplementary Information

Governments generally should present RSI related to defined benefit OPEB plans covering *the last three actuarial valuations.* A government participating in a cost-sharing multiple-employer plan, however, does not have to present RSI for OPEB as long as the plan issues its own separate financial report or is included in the financial report of another governmental entity.

Three types of RSI about defined benefit OPEB plans might be presented in a government's financial report:

a. Schedule of funding progress
b. Schedule of employer contributions
c. Notes to the RSI schedules.

The schedule of funding progress provides information that is useful for judging how well funded a pension plan is. (See page 18 for an illustrative example.) The first column shows the date as of which the information in the following columns was applicable. The next three columns show the actuarial value of assets, the AAL, and the UAAL. The fifth column divides asset value by the AAL—the *funded ratio.* A funded ratio can be as low as zero (for a pay-as-you-go system with no assets) and as high as 100 percent or even higher (for a fully funded system, or one that actually has assets that exceed the AAL, respectively). The second-to-last column in the schedule includes the covered payroll—the total payroll of the current employees covered by the plan. The last column then calculates a ratio of unfunded liability-to-payroll—dividing the UAAL by the covered payroll.

The schedule of employer contributions compares a government's actual contributions to its OPEB plan with its ARC. (See the illustration on page 26.) If a government is aware of any factors that have a significant effect on the trend information in the two RSI schedules, such as improvements or reductions in OPEB benefit provisions, expansion or reduction of the eligible population, or changes in the actuarial methods, it adds an explanatory note to the schedules.

Governments in single-employer and agent multiple-employer plans present funding progress information pertinent to the government's own members. If a government includes the OPEB plan in its financial statements as a trust fund and a separate report is not issued by the OPEB plan, then the government generally would present additional RSI:

a. A government in a single-employer plan would add a schedule of employer contributions.
b. A government in an agent plan would present a schedule of funding progress and a schedule of employer contributions *for the agent plan as a whole* (in addition to the schedule of funding progress the government is already presenting for just its own employees and retirees).
c. A government in a cost-sharing plan would present a schedule of funding progress and a schedule of employer contributions *for the cost-sharing plan as a whole.*

WHAT INFORMATION SHOULD AN OPEB PLAN PRESENT IN ITS FINANCIAL REPORT?

Financial Statements

The financial report of a defined benefit OPEB plan includes two financial statements. The *statement of plan net assets* includes information about the plan's assets, liabilities, and net assets as of the end of the fiscal year. (See Illustration 4.) The *statement of changes in plan net assets* provides information about additions to, deductions from, and net increases or decreases in plan net assets during the fiscal year. Additions generally include employer and member contributions and investment income. Deductions typically are benefits and administrative expenses.

Notes to the Financial Statements

Defined benefit OPEB plans should prepare note disclosures to give users information about plan description, accounting policies, contributions and reserves, and funded status and funding progress. (See Illustration 4.)

Plan Description. The following information is intended to inform the user about the nature of the plan, its members, and the OPEB it provides:

a. Identification of the plan as a single-employer, agent multiple-employer, or cost-sharing multiple-employer defined benefit OPEB plan and disclosure of the number of participating employers and other contributing entities
b. Classes of employees covered (for example, general employees and public safety employees) and information on the current members, including the number of retirees and beneficiaries currently receiving benefits, terminated members entitled to but not yet receiving benefits, and current active members
c. Brief description of benefit provisions.

Accounting Policies. In its summary of significant accounting policies, a plan should disclose the accounting choices it has made relative to OPEB:

a. Basis of accounting, including the policy with respect to recognition in the financial statements of contributions, benefits paid, and refunds paid
b. Brief description of how the fair value of investments is determined.

Contributions and Reserves. The following information should be disclosed to help users understand how contributions are made to the plan and the amounts and purposes of the plan's reserves:

a. Authority under which the obligations of the plan members, employer(s), and other contributing entities to contribute to the plan are established or may be amended
b. Funding policy, including a brief description of how the contributions of the plan members, employer(s), and other contributing entities are determined, how the costs of administering the plan are financed, and any legal or contractual maximum contribution rates
c. Required contribution rates of active plan members, in accordance with the funding policy
d. Brief description of the terms of any long-term contracts for contributions to the plan and disclosure of the amounts outstanding at the reporting date
e. The balances in the plan's legally required reserves at the reporting date, as well as a brief description of the purpose of each reserve and designation disclosed and whether the reserve is fully funded.

Funded Status and Funding Progress. Finally, plans should prepare a note disclosure containing the most recent information about their funded status and funding progress:

a. The funded status of the plan as of the most recent valuation date
b. Disclosure of information about actuarial methods and assumptions used in the valuations on which the information reported about the ARC, annual OPEB cost, and the funded status and funding progress of OPEB plans is based. (More details regarding this information can be found in Statement 43.)

Required Supplementary Information

Following the notes, plans should present two schedules as required supplementary information. (See Illustration 4.) The *schedule of funding progress* shows historical trend information for the past three actuarial valuations about the funded status of the plan and efforts to accumulate sufficient resources to pay benefits when they come due. (This trend should cover a period as short as three fiscal years, if the valuation is conducted annually, or as long as nine years if the valuation is performed every three years.) The disclosure should include the actuarial valuation date, the actuarial value of plan assets, the actuarial accrued liability, the total unfunded actuarial accrued liability, the actuarial value of assets as a percentage of the actuarial accrued liability (funded ratio), the annual covered payroll, and the ratio of the unfunded actuarial accrued liability to annual covered payroll.

To help users understand whether government contributions are keeping pace with amounts required by the actuarial calculations, the *schedule of employer contributions* should present historical trend information comparing the ARC with actual employer contributions for the fiscal years covered by the three most recent actuarial valuations. This should include the dollar amount of the ARC applicable to each year and the percentage of that ARC that was recognized in the plan's statement of changes in plan net assets for each year as contributions from the employer(s).

WHEN SHOULD GOVERNMENTS IMPLEMENT THESE NEW STANDARDS?

The new standards should be implemented by *employers* in three phases based on a government's total annual revenues in the first fiscal year ending after June 15, 1999:

- Phase 1—governments with total annual revenues of $100 million or more—periods beginning after December 15, 2006
- Phase 2—governments with total annual revenues of $10 million or more, but less than $100 million—periods beginning after December 15, 2007
- Phase 3—governments with total annual revenues of less than $10 million—periods beginning after December 15, 2008.

The standards for OPEB plans are effective one year prior to the implementation date for the employer (in a single-employer plan) or for the largest participating employer in the plan (for multiple-employer plans).

WHAT IS THE GASB?

The 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. The GASB was founded in 1984 under the auspices of the Financial Accounting Foundation (the Foundation), which appoints the GASB's board, raises its funds, and oversees its activities. The Foundation also oversees the GASB's counterpart for the private companies and not-for-profit organizations, the Financial Accounting Standards Board.

The mission of the GASB is to establish and improve standards of state and local governmental accounting and financial reporting that will:

- Result in useful information for users of financial reports, and
- Guide and educate the public, including issuers, auditors, and users of those financial reports.

Although the GASB does not have the power to enforce compliance with the standards it promulgates, the authority for its standards is recognized under the Code of Professional Conduct of the American Institute of Certified Public Accountants (AICPA). The Code requires auditors to note any departures from GASB standards when they express an opinion on financial reports that are presented in conformity with generally accepted accounting principles. Also, legislation in many states requires compliance with GASB standards, and governments usually are expected to prepare financial statements in accordance with those standards when they issue bonds or notes or otherwise borrow from public credit markets.

The GASB is composed of a full-time chair and six part-time members drawn from various parts of the GASB's constituency—state and local government finance officers, auditors, the accounting profession, academia, and persons who use financial statement information. The GASB has a professional staff drawn from similar constituencies as the Board. The staff works directly with the Board and its task forces, conducts research, analyzes oral and written comments received from the public, and drafts documents for consideration by the Board.

HOW DOES THE GASB SET STANDARDS?

The GASB follows the set of "due process" activities enumerated in its published rules of procedure before issuing its standards. Due process is stringent and is designed to permit timely, thorough, and open study of financial accounting and reporting issues by the preparers, attestors, and users of financial reports in order to encourage broad public participation in the standards-setting process.

For many issues it addresses, the GASB:

- Appoints an advisory task force of outside experts
- Studies existing literature on the subject and conducts or commissions additional research if necessary
- Publishes for public comment a discussion document setting forth the issues and possible solutions
- Conducts public hearings
- Broadly distributes an Exposure Draft of a proposed standard for public comment.

Significant steps in the process are announced publicly. The GASB's meetings are open to public observation and a public record is maintained. The GASB also is advised by the Governmental Accounting Standards Advisory Council, a 29-member group appointed by the Foundation and representing a wide range of the GASB's constituents.

Additional information about the GASB and its activities may be found at www.gasb.org.

Illustration 1—Notes to the Financial Statements for an Employer Contributing to a Single-Employer Defined Benefit Healthcare Plan

[Note: This example assumes that the plan is included as an other employee benefit trust fund in the employer's financial reporting entity. Only those disclosures required by Statement 45 are illustrated. In accordance with footnote 21 of Statement 45, the requirement to present a schedule of funding progress covering at least three actuarial valuations would be met by complying with paragraphs 31 through 35 of Statement 43. That schedule is not illustrated here. Information required by Statement 43 because the plan is reported as an other employee benefit trust fund would be shown in addition to the information illustrated below. If the plan was not included in the employer's financial reporting entity, the employer would be required to present a schedule of funding progress similar to that included in Illustration 2.]

State of Grande

Notes to the Financial Statements
for the Year Ended June 30, 20X2

Note X. Postemployment Healthcare Plan

Plan Description. State Retired Employees Healthcare Plan (SREHP) is a single-employer defined benefit healthcare plan administered by the Grande Retirement System. SREHP provides medical and dental insurance benefits to eligible retirees and their spouses. Article 37 of the Statutes of the State of Grande assigns the authority to establish and amend benefit provisions to the state legislature. The Grande Retirement System issues a publicly available financial report that includes financial statements and required supplementary information for SREHP. That report may be obtained by writing to Grande Retirement System, State Government Lane, Latte, GR 01000, or by calling 1-800-555-PLAN.

Funding Policy. The contribution requirements of plan members and the state are established and may be amended by the state legislature. The required contribution is based on projected pay-as-you-go financing requirements, with an additional amount to prefund benefits as determined annually by the legislature. For fiscal year 20X2, the state contributed $357.7 million to the plan, including $190.7 million for current premiums (approximately 84 percent of total premiums) and an additional $167.0 million to prefund benefits. Plan members receiving benefits contributed $35.4 million, or approximately 16 percent of the total premiums, through their required contribution of $50 per month for retiree-only coverage and $105 for retiree and spouse coverage.

Annual OPEB Cost and Net OPEB Obligation. The state's annual other postemployment benefit (OPEB) cost (expense) is calculated based on the *annual required contribution of the employer (ARC),* an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years. The following table shows the components of the state's annual OPEB cost for the year, the amount actually contributed to the plan, and changes in the state's net OPEB obligation to SREHP (dollar amounts in thousands):

Annual required contribution	$577,180
Interest on net OPEB obligation	90,437
Adjustment to annual required contribution	(95,258)
Annual OPEB cost (expense)	572,359
Contributions made	(357,682)
Increase in net OPEB obligation	214,677
Net OPEB obligation—beginning of year	1,349,811
Net OPEB obligation—end of year	$1,564,488

The state's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for 20X2 and the two preceding years were as follows (dollar amounts in thousands):

Fiscal Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
6/30/X0	$497,538	67.4%	$1,160,171
6/30/X1	538,668	64.8	1,349,811
6/30/X2	572,359	62.5	1,564,488

Funded Status and Funding Progress. As of December 31, 20X1, the most recent actuarial valuation date, the plan was 58.1 percent funded. The actuarial accrued liability for benefits was $8.8 billion, and the actuarial value of assets was $5.1 billion, resulting in an unfunded actuarial accrued liability (UAAL) of $3.7 billion. The covered payroll (annual payroll of active employees covered by the plan) was $2.2 billion, and the ratio of the UAAL to the covered payroll was 165 percent.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Actuarial Methods and Assumptions. Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

In the December 31, 20X1, actuarial valuation, the entry age actuarial cost method was used. The actuarial assumptions included a 6.7 percent investment rate of return (net of administrative expenses), which is a blended rate of the expected long-term investment returns on plan assets and on the employer's own investments calculated based on the funded level of the plan at the valuation date, and an annual healthcare cost trend rate of 12 percent initially, reduced by decrements to an ultimate rate of 5 percent after ten years. Both rates included a 4.5 percent inflation assumption. The actuarial value of assets was determined using techniques that spread the effects of short-term volatility in the market value of investments over a five-year period. The UAAL is being amortized as a level percentage of projected payroll on an open basis. The remaining amortization period at December 31, 20X1, was seventeen years.

Illustration 2—Notes to the Financial Statements and Schedule of Funding Progress for an Employer Contributing to an Agent Multiple-Employer Defined Benefit Healthcare Plan

City of Mocha

Notes to the Financial Statements for the Year Ended June 30, 20X2

Note X. Postemployment Healthcare Plan

Plan Description. The city's defined benefit postemployment healthcare plan, Mocha Postemployment Healthcare Plan (MPHP), provides medical benefits to eligible retired city employees and their beneficiaries. MPHP is affiliated with the Municipal Retired Employees Health Plan (MREHP), an agent multiple-employer postemployment healthcare plan administered by the Robusta Retirement System. Article 39 of the Statutes of the State of Robusta assigns the authority to establish and amend the benefit provisions of the plans that participate in MREHP to the respective employer entities; for MPHP, that authority rests with the city of Mocha. The Robusta Retirement System issues a publicly available financial report that includes financial statements and required supplementary information for MREHP. That report may be obtained by writing to Robusta Retirement System, 399 Grocer Aisle, Caffe, RO 02000, or by calling 1-877-555-PLAN.

Funding Policy. The contribution requirements of plan members and the city are established and may be amended by the MREHP board of trustees. MPHP members receiving benefits contribute $75 per month for retiree-only coverage and $150 per month for retiree and spouse coverage to age 65, and $40 and $80 per month, respectively, thereafter.

The city of Mocha is required to contribute the *annual required contribution of the employer (ARC),* an amount actuarially determined in accordance with the parameters of

GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years. The current ARC rate is 13.75 percent of annual covered payroll.

Annual OPEB Cost. For 20X2, the city's annual OPEB cost (expense) of $870,517 for MPHP was equal to the ARC. The city's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for 20X2 and the two preceding years were as follows:

Fiscal Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
6/30/X0	$929,401	100%	$0
6/30/X1	910,042	100	0
6/30/X2	870,517	100	0

Funded Status and Funding Progress. The funded status of the plan as of December 31, 20X1, was as follows:

Actuarial accrued liability (AAL)	$19,490,482
Actuarial value of plan assets	15,107,180
Unfunded actuarial accrued liability (UAAL)	$ 4,383,302
Funded ratio (actuarial value of plan assets/AAL)	77.5%
Covered payroll (active plan members)	$6,331,031
UAAL as a percentage of covered payroll	69.2%

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information that shows whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Actuarial Methods and Assumptions. Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

In the December 31, 20X1, actuarial valuation, the entry age actuarial cost method was used. The actuarial assumptions included a 7.5 percent investment rate of return (net of administrative expenses) and an annual healthcare cost trend rate of 12 percent initially, reduced by decrements to an ultimate rate of 5 percent after ten years. Both rates include a 4.5 percent inflation assumption. The actuarial value of MPHP assets was determined using techniques that spread the effects of short-term volatility in the market value of investments over a three-year period. MPHP's unfunded actuarial accrued liability is being amortized as a level percentage of projected payroll on a closed basis. The remaining amortization period at December 31, 20X1, was twenty-two years.

REQUIRED SUPPLEMENTARY INFORMATION
Schedule of Funding Progress for MPHP

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL)— Entry Age (b)	Unfunded AAL (UAAL) (b – a)	Funded Ratio (a / b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b – a) / c)
12/31/W9	$10,138,007	$16,867,561	$6,729,554	60.1%	$5,984,554	112.4%
12/31/X0	12,093,839	17,572,474	5,478,635	68.8	6,182,351	88.6
12/31/X1	15,107,180	19,490,482	4,383,302	77.5	6,331,031	69.2

Illustration 3—Notes to the Financial Statements for an Employer Contributing to a Cost-Sharing Multiple-Employer Defined Benefit Healthcare Plan

Brewer State University

Notes to the Financial Statements
for the Year Ended June 30, 20X2

Note X. University Retiree Health Plan

Plan Description. Brewer State University contributes to the State University Retiree Health Plan (SURHP), a cost-sharing multiple-employer defined benefit postemployment healthcare plan administered by the Grande Retirement System. SURHP provides medical benefits to retired employees of participating universities. Article 38 of the Statutes of the State of Grande assigns the authority to establish and amend benefit provisions to the SURHP board of trustees. The Grande Retirement System issues a publicly available financial report that includes financial statements and required supplementary information for SURHP. That report may be obtained by writing to

Grande Retirement System, State Government Lane, Latte, GR 01000, or by calling 1-800-555-PLAN.

Funding Policy. Article 38 provides that contribution requirements of the plan members and the participating employers are established and may be amended by the SURHP board of trustees. Plan members or beneficiaries receiving benefits contribute $65 per month for retiree-only coverage and $135 for retiree and spouse coverage to age 65, and $35 and $75 per month, respectively, thereafter.

Participating universities are contractually required to contribute at a rate assessed each year by SURHP, currently 8.75 percent of annual covered payroll. The SURHP board of trustees sets the employer contribution rate based on the *annual required contribution of the employers (ARC),* an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) of the plan over a period not to exceed thirty years. The university's contributions to SURHP for the years ended June 30, 20X2, 20X1, and 20X0, were $58,717, $49,886, and $47,375, respectively, which equaled the required contributions each year.

Illustration 4—Defined Benefit Healthcare Plan Financial Reports

GRANDE RETIREMENT SYSTEM

STATEMENTS OF PLAN NET ASSETS
as of June 30, 20X2

(Dollar amounts in thousands)

	State Retired Employees Healthcare Plan	State University Retiree Health Plan	20X2 Total
Assets			
Cash and short-term investments	$ 250	$ 13,532	$ 13,782
Receivables			
Employer	1,182	2,101	3,283
Employer—long-term	—	4,064	4,064
Employee	1,010	1,562	2,572
Interest and dividends	836	31,193	32,029
Total receivables	3,028	38,920	41,948
Investments, at fair value			
U.S. Treasuries	723,487	194,807	918,294
Federal government agencies	1,216,282	308,764	1,525,046
Corporate bonds	1,790,676	378,783	2,169,459
Corporate stocks	3,271,662	615,773	3,887,435
Total investments	7,002,107	1,498,127	8,500,234
Properties, at cost, net of accumulated depreciation of $5,164 and $323, respectively	6,177	434	6,611
Total assets	7,011,562	1,551,013	8,562,575
Liabilities			
Accounts payable and other	7	51,828	51,835
Net assets held in trust for other postemployment benefits	$7,011,555	$1,499,185	$8,510,740

GRANDE RETIREMENT SYSTEM

STATEMENTS OF CHANGES IN PLAN NET ASSETS
for the Year Ended June 30, 20X2

(Dollar amounts in thousands)

	State Retired Employees Healthcare Plan	State University Retiree Health Plan	20X2 Total
Additions			
Contributions			
Employer	$ 357,682	$ 33,639	$ 391,321
Plan member	35,409	4,479	39,888
Total contributions	393,091	38,118	431,209
Investment income			
Net appreciation in fair value of investments	475,914	65,845	541,759
Interest	261,540	55,939	317,479
Dividends	127,853	22,079	149,932
	865,307	143,863	1,009,170
Less investment expense	44,996	9,177	54,173
Net investment income	820,311	134,686	954,997
Employer interest on long-term contracts	—	365	365
Total additions	1,213,402	173,169	1,386,571
Deductions			
Benefits	226,108	25,568	251,676
Administrative expense	2,350	662	3,012
Total deductions	228,458	26,230	254,688
Net increase	984,944	146,939	1,131,883
Net assets held in trust for other postemployment benefits			
Beginning of year	6,026,611	1,352,246	7,378,857
End of year	$7,011,555	$1,499,185	$8,510,740

Grande Retirement System

Notes to the Financial Statements
for the Fiscal Year Ended June 30, 20X2

The Grande Retirement System (GRS) administers two defined benefit postemployment healthcare plans—State Retired Employees Healthcare Plan (SREHP) and State University Retiree Health Plan (SURHP). Although the assets of the plans are commingled for investment purposes, each plan's assets may be used only for the payment of benefits to the members of that plan, in accordance with the terms of the plan.

A. Summary of Significant Accounting Policies

Basis of Accounting. GRS's financial statements are prepared using the accrual basis of accounting. Plan member contributions are recognized in the period in which the contributions are due. Employer contributions to each plan are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of each plan.

Method Used to Value Investments. Investments are reported at fair value, which for SREHP and SURHP is determined by the mean of the most recent bid and asked prices as obtained from dealers that make markets in such securities. Securities for which market quotations are not readily available are valued at their fair value as determined in good faith by the custodian under the direction of the GRS board of trustees. A valuation service may be engaged to assist in the determination of fair value.

B. Plan Descriptions and Contribution Information

Membership of each plan consisted of the following at December 31, 20X1, the date of the latest actuarial valuation:

	SREHP	SURHP
Retirees and beneficiaries receiving benefits	31,642	4,876
Terminated plan members entitled to but not yet receiving benefits	743	2,289
Active plan members	50,601	8,861
Total	82,986	16,026
Number of participating employers	1	15

State Retired Employees Healthcare Plan

Plan Description. SREHP is a single-employer defined benefit postemployment healthcare plan that covers retired employees of the state including all departments and agencies. SREHP provides health and dental insurance benefits to eligible retirees and their spouses. Article 37 of the Statutes of the State of Grande assigns the authority to establish and amend the benefit provisions of the plan to the state legislature.

Contributions. Article 37 also assigns to the state legislature the authority to establish and amend contribution requirements of the plan members and the state. Retired plan members and beneficiaries currently receiving benefits are required to contribute specified amounts monthly toward the cost of health insurance premiums. For the year ended June 30, 20X2, plan members contributed $35.4 million, or approximately 16 percent of total premiums, through their required contributions of $50 per month for retiree-only coverage and $105 per month for retiree and spouse coverage. The state is required to contribute the balance of the current premium cost ($190.7 million, or about 84 percent of total premiums for 20X2) and may contribute an additional amount to prefund benefits as determined annually by the legislature ($167.0 million for 20X2). Administrative costs of SREHP are financed through investment earnings.

State University Retiree Health Plan

Plan Description. SURHP is a cost-sharing multiple-employer defined benefit postemployment healthcare plan that covers retired employees of participating universities. SURHP provides medical benefits to plan members. Article 38 of the Statutes of the State of Grande assigns the authority to establish and amend benefit provisions to the SURHP board of trustees.

Contributions. Article 38 also assigns to the SURHP board of trustees the authority to establish and amend contribution requirements of the plan members and the participating employers. For the year ended June 30, 20X2, plan members or beneficiaries receiving benefits contributed $4.5 million, or approximately 18 percent of total premiums, through their required contributions of $65 per month for retiree-only coverage and $135 for retiree and spouse coverage to age 65, and $35 and $75 per month, respectively, thereafter. Participating universities were required to contribute at a rate equivalent to the annually required contribution of the employers (ARC) (8.75 percent of covered payroll, or $33.6 million). Administrative costs of SURHP are financed through investment earnings.

Long-Term Receivables. In addition to actuarially determined contributions, certain employers also make semiannual installment payments, including interest at 7.5 percent per year, for the cost of service credit granted retroactively to employees when the employers initially joined SURHP. As of June 30, 20X2, the outstanding balance was $4.1 million. These payments are due over various time periods not exceeding five years at June 30, 20X2.

C. Funded Status and Funding Progress—OPEB Plans

The funded status of each plan as of the most recent actuarial valuation date is as follows (dollar amounts in thousands):

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL)—Entry Age (b)	Unfunded AAL (UAAL) (b – a)	Funded Ratio (a / b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b – a) / c)
SREHP						
12/31/X1	$5,131,017	$8,833,219	$3,702,202	58.1%	$2,243,759	165.0%
SURHP						
12/31/X1	1,301,663	1,575,136	273,473	82.6	371,168	73.7

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Actuarially determined amounts are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedules of funding progress, presented as required supplementary information following the notes to the financial statements, present multiyear trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

The accompanying schedules of employer contributions present trend information about the amounts contributed to the plan by employers in comparison to the ARC, an amount that is actuarially determined in accordance with the parameters of GASB Statement 43. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost for each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years.

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations. Additional information as of the latest actuarial valuation follows:

	SREHP	SURHP
Valuation date	12/31/X1	12/31/X1
Actuarial cost method	Entry age	Entry age
Amortization method	Level percentage of pay, open	Level percentage of pay, open
Remaining amortization period	17 years	15 years
Asset valuation method	5-year smoothed market	5-year smoothed market
Actuarial assumptions:		
Investment rate of return*	6.7%†	7.5%
Healthcare cost trend rate*	12% initial 5% ultimate	12% initial 5% ultimate

*Includes an inflation assumption of 4.5%.

†Determined as a blended rate of the expected long-term investment returns on plan assets and on the state's investments, based on the funded level of the plan at the valuation date.

REQUIRED SUPPLEMENTARY INFORMATION
(Dollar amounts in thousands)

SCHEDULES OF FUNDING PROGRESS

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL)— Entry Age (b)	Unfunded AAL (UAAL) (b – a)	Funded Ratio (a / b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b – a) / c)
SREHP						
12/31/W7	$3,696,201	$7,189,703	$3,493,502	51.4%	$2,144,804	162.9%
12/31/W9	4,209,207	7,838,210	3,629,003	53.7	2,325,810	156.0
12/31/X1	5,131,017	8,833,219	3,702,202	58.1	2,243,759	165.0
SURHP						
12/31/W7	697,274	1,001,851	304,577	69.6	297,926	102.2
12/31/W9	935,184	1,168,147	232,963	80.1	329,473	70.7
12/31/X1	1,301,663	1,575,136	273,473	82.6	371,168	73.7

SCHEDULES OF EMPLOYER CONTRIBUTIONS

	Employer Contributions			
	SREHP		SURHP	
Year Ended June 30	Annual Required Contribution	Percentage Contributed	Annual Required Contribution	Percentage Contributed
19W9	$535,307	54.3%	$29,047	100%
20X0	501,102	66.9	31,056	100
20X1	542,812	64.3	32,123	100
20X2	577,180	62.0	33,639	100