April 17, 2006

Director of Research
Project No. 25-15
Governmental Accounting Standards Board
401 Merritt 7, PO Box 5116
Norwalk, CT 06856-5116

Dear Sir/Madam:

On behalf of the American Academy of Actuaries'[1] Joint Committee on Retiree Health, we submit the following comments on the proposed GASB technical bulletin, *Accounting and Financial Reporting by Employers and OPEB Plans for Payments from the Federal Government Pursuant to the Provisions of Medicare Part D.*

The Joint Committee and many of its members have worked with the Board and its staff in recent years on matters related to GASB Statements 43 and 45. We appreciate the effort made on GASB's part to write meaningful accounting rules and would like to think we have been of some assistance in those efforts. We present these comments with respect and gratitude for your responsiveness to our comments in the past.

Our members have also spent much time in the last three years analyzing and implementing the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (Medicare Modernization Act or MMA). This involvement has included consultations with plan sponsors, accountants, and the staff of the Centers for Medicare and Medicaid Services (CMS), as well as performing actuarial valuations of the financial impact, short-term and long-term, of MMA. The proposed technical bulletin touches directly on such involvement. We are aware of MMA complexities that we do not see reflected in the technical bulletin. As such, we are concerned that this statement may be taking a step away from consistency and comparability.

Our awareness of these MMA complexities and GASB's stated goals of consistency and comparability lead us to disagree with the conclusion that other post-employment benefit (OPEB) liabilities should be determined without reduction for Medicare Part D payments and that such payments are characterized as voluntary nonexchange transactions. To explain our perspective, we have devoted much of this letter to outlining some background issues we recognize as pertinent to the technical bulletin. We begin by noting that the scope of the proposal may be narrower than its title implies.

SCOPE OF TECHNICAL BULLETIN

While the title of the proposed GASB technical bulletin and introduction to the four questions and responses implies the guidance should cover all types of payments from the federal government pursuant to the provisions of Medicare Part D, the "Introduction" to Appendix 1 (paragraph 11) only mentions one type of payment — the 28 percent retiree drug subsidy (RDS). The immediate question this raises is whether the Board will opine on types of federal payments other than RDS that employers might receive under Medicare Part D. There is nothing in the remainder of the technical bulletin that recognizes other federal payments. Nonetheless, some of these federal payment programs are already in effect. It is reasonable to expect many governmental entities to eventually seek

[1] The American Academy of Actuaries is a national organization formed in 1965 to bring together, in a single entity, actuaries of all specializations within the United States. A major purpose of the Academy is to act as a public information organization for the profession. Academy committees, task forces and work groups regularly prepare testimony and provide information to Congress and senior federal policy-makers, comment on proposed federal and state regulations, and work closely with the National Association of Insurance Commissioners and state officials on issues related to insurance, pensions and other forms of risk financing. The Academy establishes qualification standards for the actuarial profession in the United States and supports two independent boards. The Actuarial Standards Board promulgates standards of practice for the profession, and the Actuarial Board for Counseling and Discipline helps to ensure high standards of professional conduct are met. The Academy also supports the Joint Committee for the Code of Professional Conduct, which develops standards of conduct for the U.S. actuarial profession.

these other programs because they will reduce the cost to the sponsoring employer more than the retiree drug subsidy without affecting the cost to the retirees.

Background

The Medicare Modernization Act included several approaches for employers, including governmental employers, to receive payments from the federal government to offset part of the cost of providing prescription drug benefits to Medicare-eligible participants. Each approach encourages employers to maintain their prescription drug coverage. Some of these approaches result in direct payments to the employer, while other approaches result in payments to an intermediary that indirectly benefit the employer.

Below we have described four principal approaches an employer can use to provide prescription drug benefits to its retirees and have a portion of the cost funded, either directly or indirectly, by payments from the federal government. A short name is given to each of the prescription drug coverage alternatives open to employers, followed by a brief description:

1. 28 percent RDS — Primary coverage that satisfies the actuarial equivalency requirements for the retiree drug subsidy (i.e., the payment of 28 percent for certain eligible charges).

2. Wrap — Secondary (supplemental) coverage that wraps around Part D. The federal government subsidizes the primary coverage. The employer wrap approach could be similar to how medical benefit plans coordinate with Medicare Parts A and B and can be administered under several methods. Another wrap or supplemental approach that was adopted for 2006 provides coverage after a retiree has claims that reach the top of the initial coverage limit ($2,250 in the standard Part D design for 2006).

3. Commercial Prescription Drug Plan (PDP) — Primary coverage that is purchased from a qualified PDP (i.e. a commercial Part D plan). Under this approach, the qualified PDP would receive the payments directly from the federal government, but the price the commercial plan charges the plan sponsor would be lower than otherwise available, because it would take into account the federal payment.

4. Employer PDP — Primary coverage from a PDP owned by the employer. Under this approach the employer would contract with CMS and receive federal payments directly.

The following table provides numerical illustrations for how these coordination approaches could work in 2006.[2]

Table 1	Plan Payments	Reimbursement for Claims	Direct Federal Payment	Indirect Federal Payment	Net Plan Cost
Approach					
1. 28% RDS	$1,900	$550	--	--	$1,350
2. Wrap + Part D	$1,900	--	--	$720	$1,180
3. Commercial PDP	$1,900	--	--	$720	$1,180
4. Employer PDP	$1,900	--	$720	--	$1,180

Under approaches 2 and 3, the federal government payment is made to the commercial plan, whereas under approach 4, the federal government subsidy is paid directly to the employer. We believe these payments are not “grants” but are payments to the plans (whether the commercial plan or the employer plan) in compliance with Medicare Part D in recognition of the plans’ agreement to provide coverage that is equal to or better than the standard Part D coverage. As the cost to the employer is similar under these approaches, we believe the accounting should be the same. The cash cost under approach 3 is the net amount paid to the commercial plan, so to be consistent, we believe an employer that contracts directly with CMS should also account for the net plan cost.

[2] Note that in practice, the federal payment will vary within approaches 2, 3, and 4 because of slightly different calculation methods prescribed for each alternative by CMS.

Approach 2 can be administered using two commercial drug carriers or one. If it is administered by one carrier, then the payments by the carrier will be the same as under approach 3. If it is administered using two commercial plans, then the sum of the payments by the two commercial plans will equal the amount paid by the single carrier under 3. Both the single carrier and two carrier approaches therefore produce the same net cost to the employer and therefore we believe the accounting should be the same: that is, the employer should account for the net plan cost.

CONSISTENT ACCOUNTING TREATMENT

We believe one of the goals of implementing accrual accounting and disclosures under GASB Statements 43 and 45 was to improve the comparability and disclosure of the governmental employers' obligations for postretirement medical benefits. This objective can best be met by ensuring consistency in the accounting treatment of similarly situated employers. It would be inappropriate for an employer to account for payments that are paid to an intermediary. Therefore, to ensure consistent accounting treatment, we believe employers should account for their expected plan cost, net of any direct or indirect subsidy payments from CMS.

The objective for consistent accounting treatment applies both among similarly situated employers with similar benefit costs as well as for a single employer switching from one Medicare Part D approach in one year to another approach in the following year. Given the uncertainty about pharmacy claim coordination prior to Medicare Part D implementation, many employers elected a 'wait-and-see' attitude in 2005, electing to apply for the 28 percent RDS payment in 2006. Given that the other approaches yield a larger savings for a non-taxable entity, we envisage many governmental employers switching prescription drug approaches in the next few years while possibly maintaining the same substantive plan. Under the current proposal, we believe such plans would see a significant reduction in liability even though the retirees would be getting the same benefits and the sponsor's net cash outlay would be the same.

Recommendation:
We recommend that the technical bulletin be revised so that the accounting treatment for an employer is the same whether the employer buys coverage through a commercial plan or administers the coverage directly.

ISSUES WITH THE TECHNICAL BULLETIN REASONING

In contrast with the net plan approach we advocate, Paragraph 15 of the technical bulletin states the RDS payments do not reduce the OPEB commitment; rather they relieve Medicare of coverage responsibility. This implies that without RDS, drug coverage is a Medicare responsibility. The technical bulletin seems to want it both ways; if paying for a drug were a Medicare responsibility, then it is not an OPEB commitment. If a retiree signs up for a Part D plan, it is a Medicare responsibility and not an OPEB commitment, even if the plan qualifies for RDS. If the retiree does not sign up with a Part D plan, it is an OPEB responsibility, but one the government deems necessary to subsidize with financial assistance. Thus, the OPEB commitment should not be measured without reduction.

Also, the distinction between Part D and Parts A and B of Medicare made in Paragraph 14 of the technical bulletin does not hold for Part C of Medicare (Medicare Advantage). The federal government actively promotes Part C, where private insurers are the primary provider with a federal subsidy, as a substitute for the federal role as primary provider of Part A and Part B. The presumption in Paragraph 14 that Parts A and B are clearly separate from the OPEB exchange between employer and employee is not so evident when it comes to Part C. Yet it is possible for a retiree to be in Parts A and B one year, Part C the next, and then back to Part A and B again, and on into the future.

TIMING DIFFERENCES

Whether an employer becomes a PDP or purchases or arranges coverage through a commercial PDP, the payments from the federal government will be prospective, so there is no timing difference between the incurrence of the drug claim and the receipt of the federal subsidy payment. In contrast, the provisions of the 28 percent retiree drug subsidy require that the claims be incurred first, the claims information be collected and sent to CMS, and the RDS payments made retrospectively. Even for employers submitting claims data monthly, we would expect the timing delay to be at least two months on average and eight to 10 months for employers that file for annual or interim annual payments.

Recommendation:
We recommend that the technical bulletin include guidance on how the timing delay should be accounted for. In particular, the technical bulletin should state whether the payment should be treated as a short-term difference, as a receivable, or accounted for by some other mechanism.

DIFFERENCES BETWEEN EMPLOYER AND PLAN ACCOUNTING

In addition to addressing the GASB Statement 45 situations discussed above, we recommend that staff also consider how similar approaches used by a plan might affect GASB Statement 43 accounting. We believe there may be limited circumstances where the employer accounting and plan accounting will differ. For example, if a plan contracts with CMS to be a PDP, the cost of the benefits will be funded by two sources: the employer payment for the net plan cost and CMS payment of the direct subsidy.

VOLUNTARY NONEXCHANGE TRANSACTIONS

We note that in Paragraph 16 of the technical bulletin Medicare Part D payments from the federal government to the employer are classified as *voluntary nonexchange transactions* on the theory that "an employer that provides prescription drug benefits to Medicare-eligible retirees does not do so in exchange for Medicare D payments but is previously committed to provide the benefits as a part of the OPEB exchange with its employees."

We note the following from the House and Senate conference report for the Medicare Prescription Drug, Improvement, and Modernization Act of 2003:

> "About one-third of Medicare beneficiaries receive coverage for prescription drugs from their former employers. Retirees are generally happy with their coverage and want to keep it. But employer plans are under increasing pressure to drop or scale back coverage. In 1988, 66% of large employers provided health benefits. In 2002, that number slipped to just 34%. Costs for retiree health coverage rose 16.0% in 2002, while prescription drug expenditures increased by 11.8% last year, and most employers predict double-digit health inflation well into the future. Conferees believe the employer retiree subsidies included in the conference report will help employers retain and enhance their prescription drug coverage so that the current erosion in coverage would plateau or even improve. Absent this assistance, many more retirees will lose their employer sponsored coverage."

Clearly, MMA includes employer subsidies because the government feared employers would drop or scale back prescription drug coverage. Implicit in this fear stated by Congress, is a belief that the OPEB exchange cited in the technical bulletin is not enough to keep many employers from dropping the OPEB benefit. The "previous commitment…as a part of the OPEB exchange" cited in Paragraph 16 is not, in case after case, a reason for the sponsor to refrain from reducing coverage. Since the passage of MMA, the various approaches to federal assistance, outlined above, have been incentives for providing continuing prescription drug coverage.

We believe Paragraphs 14, 15, and 16 of the technical bulletin misapprehend the reality reflected with the passage of MMA in regards to the long-term viability of OPEB programs. The RDS program is in reality an exchange transaction by which government support reduces the financial burden of OPEB programs in exchange for continuation of elements of those programs. At the least, we do not believe the RDS payments fit into any of the four categories for voluntary nonexchange transactions under GASB Statement 33.

CONCLUSION

We recommend that GASB staff substantially amend the proposed technical bulletin. As indicated in Table 1, the amount of the 28 percent RDS can reasonably be expected to be lower than the direct subsidy under each of the other approaches. While many governmental employers may have selected the RDS approach for 2006, we expect the number of governmental employers using this approach to drop significantly over the next few years as the feasibility of the other approaches is proven. Changing the Part D approach from RDS to the wrap, commercial PDP, or employer PDP may help reduce the employer cost without changes to the benefit structure. Accordingly, we strongly believe that a technical bulletin setting out accounting treatment for this RDS approach needs to recognize the other approaches and that such recognition will show the appropriate liability measure to be the net plan cost. Without substantial amendment in this direction, we recommend that GASB staff consider withdrawing the proposed technical bulletin.

We appreciate the opportunity to submit these comments, and would welcome the opportunity to work with you to address the concerns outlined in this letter. Please contact Heather Jerbi, the Academy's senior pension policy analyst (202.785.7869; Jerbi@actuary.org), if you have any questions or we can be of further assistance.

Sincerely,

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