PUBLIC SECTOR LABOR & EMPLOYMENT
LAW REPORT

Volume VI, No. 1 May 2005

New GASB Financial Reporting Requirements Will Make it More Difficult for Public Employers to Continue Generous Retiree Health Benefits

Many state and local governments have struggled to find ways to pay annual double-digit increases in health premiums and prescription drug costs. To make matters worse, Statement Nos. 45 and 43, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* ("GASB No. 45") and *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans* ("GASB No. 43"), by the Governmental Accounting Standards Board ("GASB") were issued last year. GASB No. 45 applies to state and local governmental entities that provide or participate in plans that provides retiree benefits other than pensions (e.g., health benefits).

These new financial reporting rules will require public employers to measure and report the long-term costs of retiree health benefits of current employees. Up until now public employers have only reported these costs on a pay-as-you-go basis, which understates the real cost of providing these benefits. GASB No. 45 requires employers to report these costs on an accrual basis.

What Does GASB No. 45 Cover?

GASB No. 45 covers all postemployment benefits other than pensions (hereafter referred to as "OPEB"). Thus, aside from health benefits, GASB No. 45 covers dental and vision coverage, life insurance, and long-term care. GASB No. 45 does not cover termination offers and benefits that are regarded as incentives to terminate employment, unless the inducement to retire early increases an employer's obligation to provide health benefits/OPEB under an existing defined benefit plan.

GASB No. 45's Requirements

The following is a summary of some of the financial reporting changes GASB No. 45 will usher in:

- The long-term cost of OPEBs must be measured and reported on an accrual basis (over an employee's working lifetime) using actuarial methods and assumptions, not unlike what public employers currently do with respect to reporting the long-term cost of an employee's pension benefit.
- Actuarial valuations must be done to calculate the employer's annual required contribution associated with the benefit promise, the actuarial accrued liability (for its unfunded portion), and the actuarial value of its plan assets.
- Actuarial assumptions must be based on the experience of the covered group and reflect long-term future trends.
- For plans with 200 or more total members (includes active employees, terminated vested employee and retirees), valuations must be completed at least every two years. For plans with fewer that 200 total members, valuations need only be done at least every three years.
- For plans with fewer than 100 total members, employers may use an alternate method for measuring annual required contributions and related OPED liabilities that does not require employing the services of an actuary to calculate the valuations noted above. Appendices in the GASB statements illustrate the calculations and assumptions to be used under this alternative method.

When Does GASB No. 45 Go Into Effect?

The new GASB standards will be phased in over a period of three years. Which phase an employer will quali-

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fy for depends on its total annual revenues as of its first fiscal year ending after June 15, 1999:[1]

- Phase I: first fiscal year after 12/15/06 (employers with revenues of $100 million or more);
- Phase II: first fiscal year after 12/15/07 (participating employers with revenues of $10 million but less than $100 million); and
- Phase III: first fiscal years after 12/15/08 (participating employers with revenues of less than $10 million).

Although the new standards do not take effect immediately, employers need to start calculating their actuarial valuations now.

How Should Employers Respond To GASB No. 45?

Public employers can no longer ignore or hide the size of their unfunded retiree health liability in the face of the new GASB guidelines, which has grown in recent years due to a number of factors: 1) unprecedented increases in health care and prescription drug costs; 2) due to the prevalence of early retirement programs, public employers have a larger share of retirees who are not Medicare eligible and whose benefits are much more costly to provide than 65+ retiree benefits; and 3) public employers have historically paid a greater portion of the cost of retiree health benefits than private employees.

If recent legislative changes in Alabama are an indication of how public employers plan to respond to GASB No. 45, retirees can expect to pay a greater and greater share of the cost of their health care benefits. At the end of 2004, the Alabama legislature passed five laws that will make it easier for the state to shift health premium costs onto state employees and retirees.

Other cost-containment measures public employers should consider utilizing:

- Shift a greater portion of the cost onto retirees (premium costs, spousal coverage, deductibles, co-payments, out-of-pocket limits);
- Reconsider eligibility rules (e.g., do away with early retirement option, raise retirement age, if not barred by statute);
- Review coordination between 65+ retiree health benefits and Medicare (e.g., shift a greater portion of unpaid medical expenses to retiree);
- Determine whether participation in Medicare's prescription drug program (goes into effect 01/01/06) would be less costly than continuing to provide a prescription drug plan to 65+ retirees;
- Reintroduce some of the more successful managed care features (e.g., prior authorization for costly procedures, reduce provider choice, limit number of plan choices);
- Participate in statewide prescription drug buying coalitions to lower vendor fees and margins; and
- Consider setting a cap on annual contributions.

The new GASB guidelines will force public employers to make fiscally responsible decisions regarding what kinds of retiree benefits they can afford to provide now and in the future. Since many of these decisions will entail shifting more of the cost of retiree health benefits onto retirees, it is essential that employers take the time to communicate the reasons why retirees will foot a greater share of their health care costs.

Maybe the new guidelines will redouble efforts by our state and federal legislatures to find a solution to the health care crisis, since no one — employer, employee or retiree — can to pay for health premium increases that are outstripping the general inflation rate. Until such a solution can be found, however, public employers will have to bite the bullet.

Mark Casciari

Minimum Salary Requirements For Exempt Employees

On August 23, 2004, federal law implemented a new minimum salary of $455 for all exempt employees. What some public employers may not know, however, is that while the federal wage laws were pending, Illinois state law implemented a minimum salary of $425 for all exempt employees. Initially, the $425 standard was part of the proposed federal regulations, which did not become effective and was replaced by the higher $455 weekly standard in the final federal regulations. However, according to the Illinois Department of Labor, the federal proposed $425 standard went into effect on April 1, 2004 in Illinois under H.B. 1645, which brought the public sector within the overtime coverage of Illinois law. As an enforcement position, IDOL is expecting that all exempt employees in Illinois were paid a minimum of $425 per week between April 1, 2004 and August 23, 2004. This is an area of possible exposure that most public sector employers have not anticipated. In the case of an IDOL audit or other wage and hour matters that may arise, please keep this issue in mind.

Edward W. Bergmann

Hiring Applicants Based on Test Score Cut-Offs is Risky

In *Lewis v. City of Chicago*, No. 98 C 5596, 2005 WL 693618 (N.D. Ill. Mar. 22, 2005), the court found that the City's decision to hire only those applicants who scored 89 and above on a hiring test had a discriminatory impact and was therefore impermissible. *Lewis* involved the City's firefighter hiring test which was administered in 1995. The City established that applicants who scored 89 or higher on the test were "well-qualified" and could move on to the next stage of the process. This meant that approximately 12.6% of white applicants, as compared to 2.2% of African-American appli-

cants, moved on to the next stage. After about 5 years, the City ran out of applicants who had scored 89 or above. The City then selected applicants who scored between 65 and 88 on the test who were classified as "qualified."

The parties stipulated that the test had a disparate impact on African-American applicants. Therefore, the case centered on whether the City could prove that the 89 cut-off score was a business necessity. First, the court found that the 89 cut-off score was not a reliable measure of the cognitive skills that the City intended to measure. The primary portion of the test consisted of a video demonstration that tested note-taking skills — a duty that was not important to the position of firefighter. Second, the court found that the 89 cut-off score was not statistically meaningful and that the City established it for "administrative convenience." Third, the court found that the 89 cut-off score did not distinguish between qualified and unqualified firefighters, as evidenced by the fact that the City has hired hundreds of employees who scored below 89 on the test. The court also emphasized that in prior litigation, the City had admitted that the test results could not be used to predict firefighters' overall performance. For these reasons, the court concluded that the City could not establish that the test was a business necessity.

The court further noted that even if the City could establish a business necessity, the plaintiffs would still win because they could show a less discriminatory method for the City to choose firefighters, such as random selection from those applicants who passed the test.

Therefore, if a public employer uses a hiring test that has a disparate impact on the hiring rate of any protected group of applicants, the employer should re-evaluate its test to ensure that the test accurately measures important job skills, links test performance to job performance, distinguishes between qualified and unqualified applicants, and provides statistically meaningful cut-off points.

Dina Kapernekas and Molly Eastman

Schools: Supreme Court Allows Title IX Retaliation Claim

In *Jackson v. Birmingham Board of Education,*[2] the United States Supreme Court allowed a teacher to proceed with a retaliation claim which was brought under Title IX. Roderick Jackson, a teacher in the Birmingham, Alabama public schools, brought suit against the Birmingham Board of Education alleging that the Board retaliated against him because he had complained about sex discrimination in the high school's athletic program. Specifically, Jackson complained to his supervisors that the girls' basketball team, which he coached, was not receiving equal funding and equal access to athletic equipment and facilities. After Jackson complained, he began to receive negative work evaluations and ultimately was removed as the girls' coach.

This case was the first case before the United States that involved allegations of retaliation in a school setting. The plain language of Title IX does not include a cause of action for retaliation. The Court did, however, interpret Title IX to include a cause of action for retaliation, reasoning that "[r]eporting incidents of discrimination is integral to Title IX enforcement and would be discouraged if retaliation against those who report went unpunished. Indeed, if retaliation were not prohibited, Title IX's enforcement scheme would unravel." Thus, the court concluded that if the school board had retaliated against the teacher because he complained of sex discrimination, this would have constituted intentional discrimination on the basis of sex in violation of Title IX.

Dina Kapernekas and Molly Eastman

Recent Public Sector Activities of Seyfarth Shaw Attorneys

Dina Kapernekas presented two speeches for the Council on Education in Management in Oak Brook, Illinois, in December, 2004, entitled *Keeping In Compliance With The Latest FMLA And State Leave Law Developments*, and an *Update On The ADA And State Disability Laws.*

On January 14, 2005, Jim Baird addressed the WPELRA, at its Annual Conference in Madison, Wisconsin,on: *Is This Job Likely To Get Even Tougher In The Future?*

On February 12, 2005, Jill Leka spoke on *Trends in Collective Bargaining* and Bob Smith spoke on *Interest Arbitration Developments* in Oak Brook to the Northern Alliance of Fire Districts.

Bob Smith presented a report to the American Bar Association Committee on State and Local Government and Employment Law regarding interest arbitration trends and developments across the nation at the Committee's annual meeting in February.

Seyfarth Shaw presented its full-day Public Sector Collective Bargaining and Employment Law Update on February 24, 2005, in OakBrook.

Mary Kay Klimesh chaired the Illinois State Bar Association's Education Law Section Council's program *Legal Issues in Education* on February 25, 2005.

Jill Leka spoke on *The Do's and Don'ts of Collective Bargaining Process* in Bloomingdale to the Public Works Association on March 3, 2005.

Jim Powers and Jill Leka moderated labor and employment law seminars on recent legislative changes sponsored by the Illinois State Bar Association on March 4 & 11 in Chicago.

On March 17, 2005, Seyfarth Shaw presented a full-day seminar entitled the *Disabled Worker's Program.* The Seyfarth Shaw attorneys included Ron Lipinski, Ronald Kramer, Jill Leka, Patti Hubbard, and Abigail Rogers.

Seyfarth Shaw staff, in partnership with the IML, Illinois Park District Association, Township Officials of Illinois, and the Illinois Association of Chiefs of Police, hosted five seminars for public sector employers likely affected by the recent jurisdictional amendments to the Illinois Public

Labor Relations Act on March 7, 14, 16, 21 & 23. The attorney presenters included: Jill Leka, Lee Kutzke, Ron Kramer, Jim Powers, Bob Smith, Karen Osgood, and Marty Marta.

Jill Leka also gave numerous recent speeches on *New Legislation* to various municipalities and to the IML Home Rule attorneys in programs sponsored with the Illinois Municipal League and the ISBA, in Bloomington, Peoria and Carbondale on March 11, 18 & 28, 2005.

Mary Kay Klimesh addressed *Limitations on Tenure* at the National Association of Schools of Theatre's 40th Annual Meeting for Administrators of Theatre Program in Higher Education in Louisville, Kentucky on April 2, 2005.

Jim Baird gave a presentation on April 11, 2005 to the NPELRA entitled *The Battle in Bargaining Over Money: Tips From The Trenches.*

On May 18, 2005 Marc Jacobs spoke on a national audio conference sponsored by Human Capital Magazine on *Personnel Record Management - What to Keep, Purging Files and Avoiding Employment Litigation.*

Upcoming Activities

May 27, 2005: Jim Baird will be participating in a panel presentation entitled: Pubic Sector: *A Case Study in How the Courts Affect Arbitrators and Arbitration in the Public Sector; Illinois and the Public Policy Exceptio*n at the National Academy of Arbitrators' 2005 Annual Meeting, in Chicago, Illinois.

June 16 & 22, 2005: Mary Kay Klimesh will be hosting two workshops on *Preparing for the 2005-06 School Year Implementing the Requirements of THE NEW IDEA 2004*. The first workshop will be held in Joliet and the second workshop will be held in Lake Forest. Both workshops will focus on evaluation, eligibility, and the IEP process under IDEA 2004 as well as student discipline, manifestation reviews and 45 day placements.

July 22, 2005: Bob Smith, Dr. Lew Bender and Linda Kica will be presenting an IPELRA program for Human Resource professionals, Department Heads and Managers on helping their employees make the transition from co-worker to coach.

July 27, 2005: Bob Smith will be presenting a legal update on employment law to attendees of the Rocky Mountain Public Labor Relations Association in Durango, Colorado.

July 28, 2005: Elaine Fox and Marc Jacobs will be presenting a full-day program on *Employee Discharge and Documentation in Illinois* through Lorman Education Services.

Endnotes

1 GASB No. 43 goes into effect one year earlier for each of the three phases. For example, for participating employers with revenues of $100 million or more, GASB No. 43 goes into effect as of the first fiscal year beginning after 12/15/05, and so on.

2 No. 02-1672, 2005 U.S. LEXIS 2928 (Mar. 29, 2005).

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