NAGDCA NOTES

GASB 45: New Standards in Reporting OPEB

The Governmental Accounting Standards Board's new standard, GASB 45, relates to Other Post Employment Benefits (OPEB) provided to retirees and other former employees. The pronouncement applies to every state, city and county government, as well as specialized public organizations such as school districts, hospitals, colleges and universities. Examples of OPEBs are medical, dental, vision, hearing, prescription drugs, life insurance, long-term care, long-term disability and death benefits.

Typically, government employers have reported the cost of healthcare and other non-pension benefits on a "pay as you go" basis. The annual cash paid for benefits has been the annual expense with no other liabilities or funding requirements identified in the entity's financial statements. GASB 45 states that the current "pay as you go" method doesn't accurately reflect the true liabilities that governments are accumulating for future benefits of current employees; the promise of future benefit is an expense that must be recorded rather than deferred as a liability to a future generation.

Under the new standards, state and local government employers must account for, and report, the annual cost of OPEB in the same way they report pensions. As a result, the annual OPEB costs for most employers will be based on actuarially determined amounts. Governments must use actuarial-life expectancy evaluations to determine the final accounting and reporting amounts expected in the future. OPEB costs must also be reported over the working lifetime of employees, and the information provided in financial statements must include the funding status, costs – including the annual required contribution, and provisions of the OPEB plan.

The difficulty for most entities in reporting this information accurately varies by size and plan offerings. It is extremely important that entities properly assess the impact of any unfunded liabilities on their current and future finances so that steps can be taken to ease the impact of GASB 45.

Things to consider:

- If your entity currently provides benefits for retired employees other than pension benefits, or if it is being considered by your entity, GASB 45 should be reviewed thoroughly. This GASB pronouncement applies only to employers that offer OPEB plans.
- Know the current method used by your entity during the accounting procedure for health and welfare benefits for retired employees. If the entity has been using a "pay as you go" method of expensing retiree benefits, the administrator needs to be aware that this method will no longer be allowed once GASB 45 goes into effect.
- Know your entity's current unfunded liability, as well as it's percentage of current-year revenues. Under GASB 45, an actuarial evaluation must be performed in order to estimate the future liability of the accrued benefits. Depending on the number of individuals covered by the benefit plan, the actuarial valuation must be performed every two or three years.
- Based on GASB 45 guidelines, you must be prepared to provide the entity's annual expense and how it will be reported on financial statements. The actuarial valuation will estimate the Unfunded Accrued Actuarial Liability (UAAL) of the benefits plan. This will

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include an amortization schedule (normally 20 to 30 years) and an annual required contribution (ARC) to meet the UAAL. The ARC is comprised of two values: the current annual expense incurred by normal plan activity (the "normal cost") and any additional amount required to meet the ARC. Reporting the amount of the ARC, while subject to certain flexibilities inherent in GASB 45, is not optional.

- Analyze all options that the entity has for revising the benefit plan to comply with GASB 45. Strategies for reducing the liability exposure include: reducing the number of retirees entitled to these benefits; discontinue offering OPEBs to retirees once they reach eligibility for Medicare; provide graduated levels of benefits based on tenure or other similar conditions. If retiree benefits are negotiated through a collective bargaining agreement, the entity would need to renegotiate these provisions in order to affect its future obligation for these benefits.
- Review all options for setting aside money to cover the future costs of retiree benefits. Entities generally have three options for funding the liability. The first option is to pay the full ARC each year. This allows the entity to use the higher discount rate in the actuarial valuation, which will translate into a lower liability. A second option is to continue using the pay as you go approach, which requires using the lower discount rate from the actuarial valuation. This approach, however, will translate into a higher liability for the entity. A third option is to pre-fund the OPEB liability, most likely through debt issues similar to pension obligation bonds that many governmental entities have issued in the past several years to meet the liabilities under their defined benefit plans. It should be noted that GASB 45 requires that in order to meet the funding requirements, the entity must direct the payments to an insurer, irrevocable trust, or other third party. This is to protect the plan beneficiaries from the entity's creditors, and to provide funding for the exclusive benefit of the plan participants.

Implementation Timeline *(figures based on 1999 fiscal year revenue)*:
- 2007-2008 FY: Entities with total revenue of $100 million or more must comply in the fiscal year beginning after December 15, 2006.
- 2008-2009 FY: Entities with total revenue between $10 million and $100 million must comply in the fiscal year beginning after December 15, 2007.
- 2009-2010 FY: Entities with total revenue less than $10 million must comply in the fiscal year beginning after December 15, 2008.

Conclusion:
Governmental entities have a number of responsibilities and various options, to comply with GASB 45. The first item on an entity's "to do" list should be having an actuarial evaluation performed to estimate the unfunded liability, and project future required contributions. These estimates will help the entity understand its future obligations to plan participants and enable them to prepare to meet the liability. The entity should also consider funding options as the different options will have varying effects on the government's financial statements. Finally, the entity should consider strategies to reduce their liabilities, as the amounts are highly likely to grow as health care costs continue to rise.

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Governmental Accounting Standards Board (GASB); www.GASB.org.

Government Finance Officers Association: www.gfoa.org

GASB 45 Solutions; California School Boards Association; http://www.csba.org/ds/gasb45.htm.

Government Employee Forum on GASB Statement 45; http://www.iaff.org/gasb/webcast.htm.

Hogue, J. Richard; Summary of GASB 43 and 45; http://www.hoguejr.com/gasb.php.