

GASB Statement 45

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Overview



International Association of Fire Fighters

Online Jobaid: United States Governmental Accounting Standards Board: GASB Statement 45

Introduction

Public employers will soon be required to account for and report on the cost of providing health and other non-pension benefits of their current and future retirees.

In 2004, the Governmental Accounting Standards Board (GASB) released Statement 45 (GASB 45) concerning health and other non-pension benefits for retired public employees. These benefits may also be called “other post-employment benefits” and retiree healthcare programs, which are by far the most costly. GASB 45 strongly encourages public sector employers to set aside funds for non-pension benefits. Instead of a “pay-as-you-go,” employers are strongly encouraged to fully fund retirement plans in order to show a more favorable financial statement.

The intent of GASB 45 was to bring governmental accounting standards more in line with private company standards. Though GASB has no power to change ‘how’ governments fund retiree health, pension and other benefits, it does govern the rules that auditors must follow in providing opinions on the reliability of governmental financial statements. Audited financial statements prepared according to GASB are scrutinized by investors in state and local bonds and rating agencies that make judgments on the likelihood those bonds will be paid off is required.

Key Facts to Know

- GASB 45 is not a law, it's an accounting standard. However, failure to follow GASB 45 could be harmful to the financial health of public employers.
- GASB 45 does not require advance funding, but it encourages public employers to set aside money for their employees' retirement in order to fund future liabilities.
- Employers will then be able to use higher investment return assumptions in determining the discount for calculating liabilities, which could help lower benefit costs.
- For city and state governments that do not have a plan for funding their retiree benefits, the bond rating could be negatively affected, in addition to negative credit ratings, investment returns, borrowing costs, all of which affect negotiations.

Compliance with GASB 45

The new accounting rule dramatically increases the amount of quality information included in government financial reports particularly in regard to retiree healthcare and other retiree benefits. State and local governments must take a series of steps that include quantifying the unfunded liabilities association with retiree health benefits. Results of these assessments must be reported in governmental audits and updated regularly. Government financial statements will then list an actuarially determined amount known as an annual required contribution. In regard to healthcare this contribution includes 1) the 'normal costs – the amount that needs to be set aside in order to fund future retiree health benefits earned in the current year and 2) unfunded liability costs- the amount needed to pay off existing unfunded retiree health liabilities over a period of no longer than 30 years.

GASB 45 Compared to Pension Requirements

Retiree health benefits, like pensions are a form of deferred compensation. In other words, the employee earns the compensation during their working years but is paid after they retire. Pension systems typically are funded by governments paying normal costs each year as employees earn the compensation and the funds are invested to generate returns and grow until required to be paid to the employees following retirement. This practice is known as 'pre-funding'. Pension accounting standards focus on how well retirement systems are pre-funded. To the extent the funds set aside each year for pensions are insufficient to cover the projected benefit costs, the system is said to have an 'unfunded liability'. Retiree health benefit programs under GASB 45 standards are very similar and will result in the calculation of an unfunded liability similar to that of pension systems.

For governments that fund retiree health benefits on a pay-as-you-go basis, 100 percent of the liability will be considered 'unfunded'. Unfunded liabilities, like those for pension systems will be determined by actuaries and accountants based on certain assumptions regarding future health care costs, inflation, retiree age vs. mortality tables, and investment returns.

Retiree Health Benefits: Potential Ramifications of GASB 45

Private corporations began to account for retiree liabilities in 1990 due to a change in the applicable accounting standard. Since that time, investors have pressured companies to either fund the liabilities or drop the benefits altogether. The percentage of large firms offering health benefits to retirees has dropped from about 66 percent in 1988 to 33 percent in 2005.

Today all 50 states offer health benefits to their retirees in some or all age groups. The range of benefits differs from 100 percent coverage to minimal coverage as a supplement to Medicare. Many states have already begun pre-funding benefits. For example, the state of Ohio is addressing retiree healthcare through the pension system. A portion of public employers' retirement contributions is set aside for funding of retiree health care. The Ohio system has already set aside \$10 billion to fund these benefits which significantly reduces the \$19 billion unfunded portion of the liability (2002 actuarial report) that will eventually be reported under GASB 45.

Addressing Retiree Health Costs: Recommendations and Options

Prefunding retiree health benefits to begin addressing unfunded liabilities

- If starting from scratch, states and/or local governments could begin paying the estimated amount needed to be set aside and invested each year to pay for health care post retirement. However, since these benefits have been offered for decades and typically no funds set aside, the start –up amount would be considerably more to begin prefunding. This program however could be started with new employees.
- Partial prefunding retiree health benefits is an option. As most state and local governments liabilities in this area will likely be exorbitant, most will not be able to pay given today's budget situations. Therefore another option is funding part of the GASB 45 annual contribution. Any amount of prefunding reduces the exposure of the state to future increases in health costs. Investment earnings from funds set aside today will reduce future budget pressures.
- Prefunding results in a reduction in costs over time as investment earnings would supplement employer and employee contributions for retiree health costs.
- Prefunding also helps secure expected benefits for employees by creating a pool of assets strengthening the ability to continue to offer benefits over time.

Printed Documentation

- Prefunding contributes to higher bond rating as bond rating agencies monitor the funding status of the retiree health program, and help determine the interest rates paid on debt. Although there is no indication that bond investors or rating agencies will rush to downgrade ratings once GASB 45 reveal large liabilities, these liabilities are considered debt and rating agencies may use them for comparison to governments that have acted to resolve the liability and those that have not.

Legislative action

- Actuarial valuation information should be made available to legislators to enable them to appropriately address the magnitude of state and local government unfunded liability
- Creation of a working group to address
 - retiree health care costs
 - types of pre-funding vehicles
 - investment guidelines
 - viability of issuing bonds to reduce liability
 - increasing funding from Federal government

Retiree Medical Trust

- Retiree medical trusts (RMT) are an option for mitigating the escalating costs of retiree health care benefits. An RMT is a hybrid health plan with features similar to defined benefit and defined contribution plans. In an RMT, the employee and employer make fixed contributions during the employees' active working years. These contributions are then pooled and held in a trust as a legally separate entity from the employee or the employer. The trust is administered by a board of trustees composed of representatives of both employer and employees. The board is responsible for decisions regarding investment vehicles and distribution plans and would have the fiduciary responsibility to administer the RMT for the exclusive benefit of participating employees. Once participating employees retire, regular benefits would be paid for healthcare expenses in a manner similar to defined benefit pension plans. Both employer and employee contributions are permissible on a pre-tax basis as long as the RMT is mandated to the entire bargaining unit or employee classification and not a selection on individual option (cafeteria) plans.
- According to NCPERS, a government may implement an RMT that does not create liabilities for Government Accounting Standards Board (GASB) reporting. When established through consultation with the plan's accountants and attorney and carefully defining the contribution to the plan, the employer may avoid reporting liability for benefits under GASB 45. Even when such reporting may be advisable, the effect on financial statements can be minimized with an explanation that the benefits are not vested, and can be reduced when necessary for financial soundness of the plan.

*Other options NOT RECOMMENDED but addressed for information purposes. Governments are likely to seek one of the following.

Cost Reduction Options

- Employee pay or Reduce benefits- the ability of governments to cut retiree health benefits for current and past workers is an evolving area of law. To the extent that

state and/or local governments have promised employees in statute, in collective bargaining agreements, or elsewhere that it will pay a portion or all of their health care during retirement as deferred compensation, these benefits may be a vested contractual right of the employee as are pensions.

- Reduce or alter future employee post retirement benefits – within the law there are options to reduce or alter retiree health benefits for employees who begin service in the future. (See Chesterfield VA memo/case study below)
 - Change the current contribution formula for the retiree and family benefits
 - Increase the share of retiree health benefits costs paid by employees during their working years.
 - Raise the number of years required to vest in retiree health benefits.
 - Establish a defined contribution program to which state and/or local governments would agree to contribute a set amount of money thus shifting the financial risk to the employee.

The city of Chesterfield, Virginia assisted in the change of their future post retirement benefits. Learn how they did it. Read more in the Case Study page or download:

Chesterfield, Virginia Memo
 Chesterfield, Virginia News Article

Implementation of GASB 45 Statement

The effective dates of the GASB 45 requirements will be phased in over three years based on state/local government annual revenues in fiscal year 1998-99.

Effective Date Annual Revenue

12/15/06 \$100 million or more
 12/15/07 \$10 million or more but less than \$100 million
 12/15/08 less than \$10 million

In addition to current active employees, jurisdictions will be required to report liability for terminated employees with benefits not yet received, and retired employees and beneficiaries currently receiving benefits.

FAQs

Who is affected by GASB Standard 45?

In general, all public sector employers offering post-employment benefits, other than pensions, will be required to reflect the costs of those benefits in their financial statements.

Today, most public sector OPEB are funded on a 'pay-as-you-go' basis, does GASB Standard 45 require advance funding?

GASB 45 DOES NOT REQUIRE advanced funding. The decision whether to fund the benefits has no impact on the actual cash costs eventually paid out as plan benefits.

The impact of this decision will however have a significant impact on the accounting process. The standard creates a strong incentive to fund. (See question on Standard requirements above) Employers who fund these benefits will generally be able to use more favorable accounting methods, which result in significantly lower OPEB costs.

Furthermore, bond rating agencies may look unfavorably on governmental employers that do not have a plan for funding their OPEB obligations.

Do the standards require an actuarial valuation?

The short answer is YES. The purpose(s) of a valuation is to:

- (a) Determine the potential monetary liability of the retiree health plan;
- (b) Budget for GASB costs and to properly distribute costs among employee classifications;
- (c) Aid in developing strategies for managing costs through funding or managing plan costs; and
- (d) Employers may use data contained within these actuarial valuations to "aid" them in union negotiations.

Printed Documentation

The valuation required by GASB 45 is similar to pension valuations which have been required for years under GASB 25: Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans and GASB 27: Accounting for Pensions by State and Local Governmental Employers. However, the valuation under GASB 45 requires health care assumptions that are not present in pension valuations, such as premium rates and claim cost assumptions, health care trends (inflation) and levels of participation.

How frequently are valuations required?

Every 2 years if 200 or more members

Every 3 years if less than 200 members

A member is defined as an active employee, a former employee with vested benefits, a retiree, a spouse or a widow(er).

What do employers need to do?

Public sector employers need to develop a course of action to:

- (a) Meet the reporting requirements under the accounting standards and
- (b) Manage their financial and political impact.
- (a) Understand whether the accounting standards apply and if so, to understand the legal and benefit design aspects of the plan;

In order to develop a course of action public employers need to:

- (b) Conduct a preliminary actuarial analysis to:
 - Determine whether the liabilities and annual expense require any action;
 - Budget for OPEB costs
 - Properly allocate costs among employee classifications
 - Forecast for the future and aid in strategy development
 - Assist in contract negotiations
 - Quantify the potential liability of the retiree health plans
- (c) All employers will need to understand the impact on their bond ratings and decide on a funding strategy. Some employers will rely solely on funding strategies to manage the expense, while others will develop strategies to manage costs through benefit plan changes or cost management. All employers will want to anticipate questions from bond rating agencies, taxpayers, and retirees.

How will the financial impact of OPEB expenses be documented?

OPEB expenses will be shown in the Statement of Activities on jurisdictional financial statements. Actuarial accrued liability will be disclosed on a Schedule of Funding progress report, typically presented as “required supplementary information.”

Unfunded plans will be required to show the unfunded liability on the Statement of Net Assets.

What is the potential investment impact of GASB Standard 45?

Municipal bond and credit ratings will be affected by the results of GASB valuations and related decisions on whether to fund the liabilities.

The cost of borrowing may increase and bond ratings may be affected if liabilities are unfunded or strategies are not developed to manage costs.

How will GASB 45 impact OPEB benefits received by IAFF members?

GASB Standard 45 creates challenges for IAFF affiliates. Affiliates will most likely be faced with employer proposals to reduce OPEB liabilities by:

- Lowering the level of retiree health care benefits granted;
- Offering new employees (or new retirees) a reduced benefit level; or
- Placing a cap on total OPEB employer provided benefits.

Affiliate leaders should insist on labor-management discussions to develop alternative solutions to these proposals. For example, leaders should be prepared to consider options like establishing a Retiree Medical Trust (RMT). RMTs give future retirees a lifetime of benefit payments for medical costs and insurance premiums, similar to a defined benefit pension. RMT Insurance includes medical, hospital, vision, dental and long-term care policies. The benefit payment can be used on individual or group medical policies (for example, the spouse’s group coverage). A government may implement an RMT that does not create liabilities for Government Accounting Standards Board (GASB) reporting. When established through consultation with the plan’s accountants and attorney and carefully defining the contribution to the plan, employers may avoid reporting liability for benefits under GASB 45. Even when such reporting may be advisable, the effect on financial statements can be minimized with an explanation that the benefits are not vested, and can be reduced when necessary for financial soundness of the plan.

Appendix

Resources



[International Association of Fire Fighters Department of Technical Assistance and Information Resources](#)

[Association of Public Pension Fund Auditors](#)

[Employee Benefit Research Institute](#)

[International Foundation of Employee Benefit Plans](#)

[National Association of Public Pension Attorneys](#)

[National Association of State Retirement Administrators](#)

[Pension Benefit Guaranty Corporation](#)

[Public Retirement Information Systems Management](#)