

The Anticipated Impact of Government Accounting Standards Board (GASB) Standard 45

Q: 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.

Q: What does the Standard require?

The GASB accounting standard 45 requires an employer to accrue the costs of other post-employment benefits (OPEB)¹ over the career of an employee and to disclose the amount of any unfunded liability.

For employers who choose to fully fund their OPEB liabilities, the annual expense is called the Annual Required Contribution (ARC). ARC is the sum of the annual costs for benefits earned during the year plus an amortization, or costing out, of expenses for benefits earned before the adoption of GASB 45.

For employers who do not fully fund the costs of these benefits, the annual expense also includes further adjustments because there are no investment earnings to offset the liability. Under this scenario, the reportable annual expense for an **unfunded** benefit plan could be as much as twice the annual expense for a **funded** plan. These increased costs are the primary reason that GASB 45 is so significant to public sector employees, since most OPEB are not fully funded for the anticipated liability.

Q: 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

¹ Post retirement benefits OTHER than pension

unfavorably on governmental employers that do not have a plan for funding their OPEB obligations.

Q: 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.

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.

Q: 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).

Q: 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.

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

- (a) Understand whether the accounting standards apply and if so, to understand the legal and benefit design aspects of the plan;

- (b) Conduct a preliminary actuarial analysis to determine whether the liabilities and annual expense require any action; and
- (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.

Q: 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*.

Q: 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.

Q: How does OPEB/GASB 45 fit into the rating process?

Investor services, such as Standard and Poor’s, will assess a) management, b) finances and c) debt factors by asking specific questions.

- (a) Investor services will use a series of questions to review **management** criteria. For example:
 - Is the jurisdiction actively pursuing alternatives to soften the impact of OPEB obligations incurred under GASB 45?
 - Where does the OPEB problem rank in relation to other planning priorities?
 - How conservative (or aggressive) are the methods and assumptions being used to determine OPEB liabilities and plan for the future?

- (b) Investor services will ask questions to review **financial** criteria:
- Are there other areas in the budget to cut to make room for increasing OPEB costs?
 - Will total carrying charges of bond debt service, pension contributions, plus OPEB contributions be sustainable given existing (or projected) resources?
- (c) Investor services will ask questions to review the **debt** criteria:
- What is the legal obligation of the employer to meet retiree health care obligations and to pay benefits?
 - How does OPEB alter the long-term liability landscape for the employer?
 - Does OPEB put the employer at a comparative disadvantage in relation to its peers from the standpoint of total long-term liabilities?

Q: 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.