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What Governments Should Know About the GASB Postemployment Benefit Standards

The Governmental Accounting Standards Board has finally released its new financial statements governing financial reporting for postemployment benefit plans other than pension plans ("OPEB"). The project, initially launched in 1990 then put on hold for several years, will require public employers to make a variety of important decisions and take a series of important steps prior to the effective dates of the new rules.

In general, Statement 43 requires disclosures that include a description of the plan, summary of significant accounting policies, contributions and reserves. Most significantly, the statement requires disclosure of the funded status (actuarial liabilities vs. assets) and statement of funding progress, along with the methods and assumptions used for those disclosures.

Statement 45, meanwhile, requires the plan sponsor to book the actuarial cost (net of employee and retiree contributions) of the plan as an expense on its financial statements, and then accrue a liability to the extent actual contributions were less than this expense.

The rationale for the GASB's new accounting standards is that postemployment benefits are offered to attract and retain qualified employees today. Therefore, entities should recognize, and the taxpayers should pay for, those costs while the employees are active and the taxpayers are receiving the benefits of those employees' services. The predominant accounting approach currently in use is "pay-as-you-go," where the cost is recognized after employment. The effect of that approach is to shift the costs between taxpaying generations.

GASB had begun work on this project soon after its private sector counterpart, the Financial Accounting Standards Board, released its equivalent rule for corporations – FAS 106. However, the GASB project was put on hold in the mid-1990s. GASB then released an exposure draft in February 2003, with a revised draft in January 2004. The final statements were released in May (Statement 43) and July (Statement 45) of this year.

The GASB standards apply to benefits paid by employers but received after employment if they are not part of a pension plan. (Pension benefits are covered by Statements 25 and 27.) The GASB statement is most significant for postretirement healthcare benefits, but will also cover postretirement life insurance, disability (if not through a pension plan), group legal, and potentially long-term care benefits. Employee leave programs, COBRA healthcare coverage, and early retirement incentives are not part of this statement.

The effective dates for Statements 43 and 45 are based on the implementation phase for Statement 34 and are shown in the chart below. As an example, a large jurisdiction with a July 1 fiscal year would have an effective date for Statement 43 of the fiscal year ending June 30, 2007 and for Statement 45, the fiscal year ending June 30, 2008. Although this may seem like the distant future, many jurisdictions recognize the need to evaluate these plans now so they can implement changes before the Statements take effect.

Effective Dates of GASB Statements
(applies to the first fiscal year beginning after the date shown)

Revenue for the First Fiscal Year Ending after 6/15/1999	Statement No. 43	Statement No. 45
More than $100 million	12/15/2005	12/15/2006
Between $10 and $100 million	12/15/2006	12/15/2007
Less than $10 million	12/15/2007	12/15/2008

Plans with over 100 members will have to engage a qualified actuary to meet the valuation requirements imbedded in Statements 43 and 45. Plans with 200 or more members will need a valuation done at least every other year, with those under 200 members at least every third year. Plans with under 100 members can use an alternative calculation method provided in the statements instead of engaging an actuary. GASB's new requirements differ from the private sector's FASB 106 in that they allow actuaries to choose one of six actuarial cost methods (ways of attributing the cost of the benefits to a year of service) rather than prescribing a single method. In addition, the unfunded liability is amortized

over a maximum of 30 years, rather than 20, and there is greater flexibility on the amortization methods. For example, using a level percentage of pay is allowed.

Another key difference is in the assumption used to discount future payments to the valuation date. FASB ties the discount rate to high quality corporate bonds, resulting in liabilities that vary from year to year depending upon bond market yields. GASB is tying the discount rate to "the expected long-term investment yield on the investments that are used to finance the payment of benefits."

According to GASB, if the plan is actuarially funded the discount rate should be the expected investment on the plan's assets. However, for an unfunded plan the discount rate should be the return on the assets of the employer, which is generally much lower than a dedicated fund. This means that for identical benefits, an unfunded plan will have higher costs and liabilities than an actuarially funded plan – and this cost could be significant. Our estimates for clients have shown that, should the plan take an unfunded approach, the liabilities and actuarial costs under Statements 43 and 45 could be more than 50% higher than a funded approach.

Currently, most of our public sector clients are trying to assess the impact the new GASB standards will have on their financial statements and are determining ways to deal with them. Some have also started to set aside funds in addition to the pay-as-you-go cost to offset somewhat the impact of this new standard, including taking advantage of the lower discount rates. Some have begun to examine their post-employment benefit package to see if it is indeed both affordable and competitive.

When the FASB statement was implemented in the early 1990s, many private sector employers reduced (or eliminated) their post-employment benefits. It is too early to tell what the impact will be in the public sector, but we can be sure this will raise awareness of both the cost of this benefit to employers and the value of this benefit to retirees.

We recommend that employers consider the following:

- Identify the plans and benefits that are subject to the new OPEB Statements. Entities may also want to review what authority is available to make changes in the plans and benefits.
- If you haven't already started, track the pay-as-you go costs for these plans separately for retirees and other terminated participants. Many plans lump active employee and retiree costs together (for example, in health care). Tracking experience separately will help improve the accuracy of the calculations.
- Estimate the financial impact of these new Statements, including understanding how sensitive the financial impact is to key assumptions made in the valuation.
- Consider funding these plans on an actuarial basis. Although it will likely mean an increase in the contributions initially, it will lower the liabilities and the annual expense and prevent a liability from accruing on the balance sheet.

Your CHEIRON consultant will be happy to review your situation to help you determine a more specific plan of action.

Cheiron is a full-service actuarial consulting firm assisting corporations, public employers and Taft-Hartley plans manage their benefit plans proactively to achieve strategic objectives and safeguard the interests of plan participants and beneficiaries.