

# Valuable Insights for Evaluating GASB Statements No. 43 and 45

December 6, 2005

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## Today's Agenda

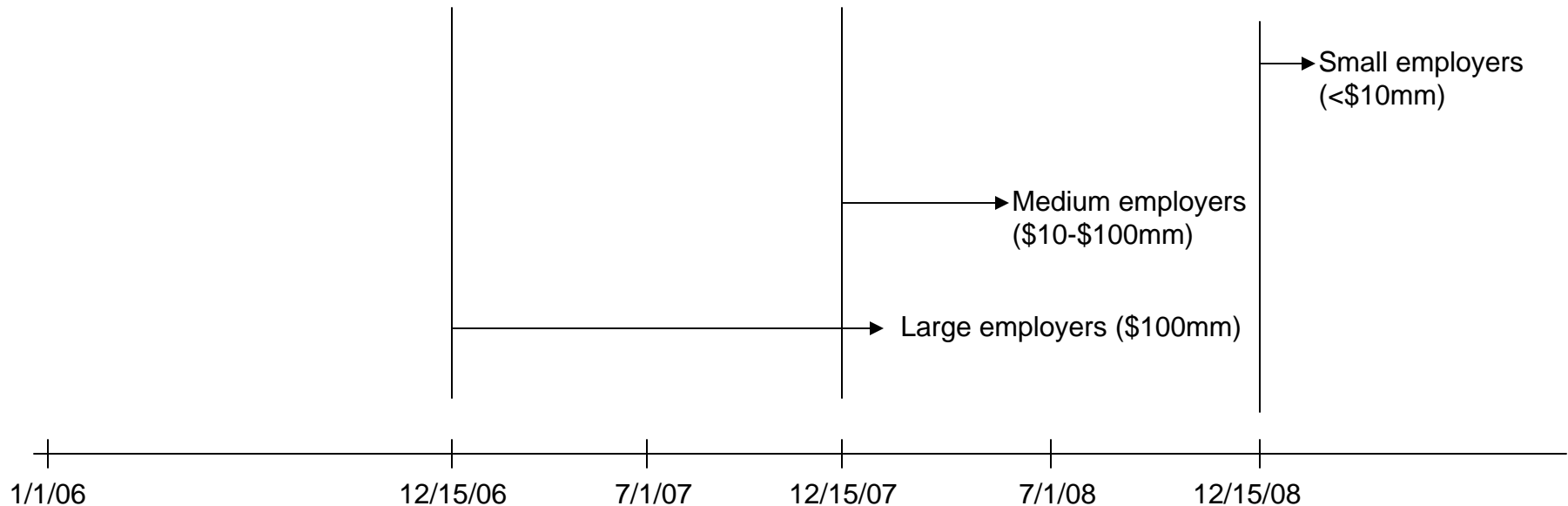
- GASB 43/45 basics
- Addressing the new Standards – A tour through the employer process
  - Understanding your plan
  - Measuring the accounting costs
  - Reviewing the resulting liabilities & annual costs
  - Considering plan design and funding alternatives
  - Developing an action plan
- Next steps

## Here Are the GASB 43/45 Basics

- Accounting and financial reporting for postemployment benefits other than pensions (OPEB)
  - GASB 43 applies to plans with OPEB assets
  - GASB 45 applies to employers
  - Mandates uniform accrual-based accounting
- Objectives of GASB 43 and 45
  - Report OPEB the same way pensions are currently reported
  - Recognize cost of OPEB systematically over employees' years of service

# GASB 43/45 is Almost Here!

- GASB 43 and 45 have staggered effective dates depending on size – GASB 43 is effective one year before GASB 45 dates shown below:



**Not a lot of time!**  
**Need to start the process now!!**

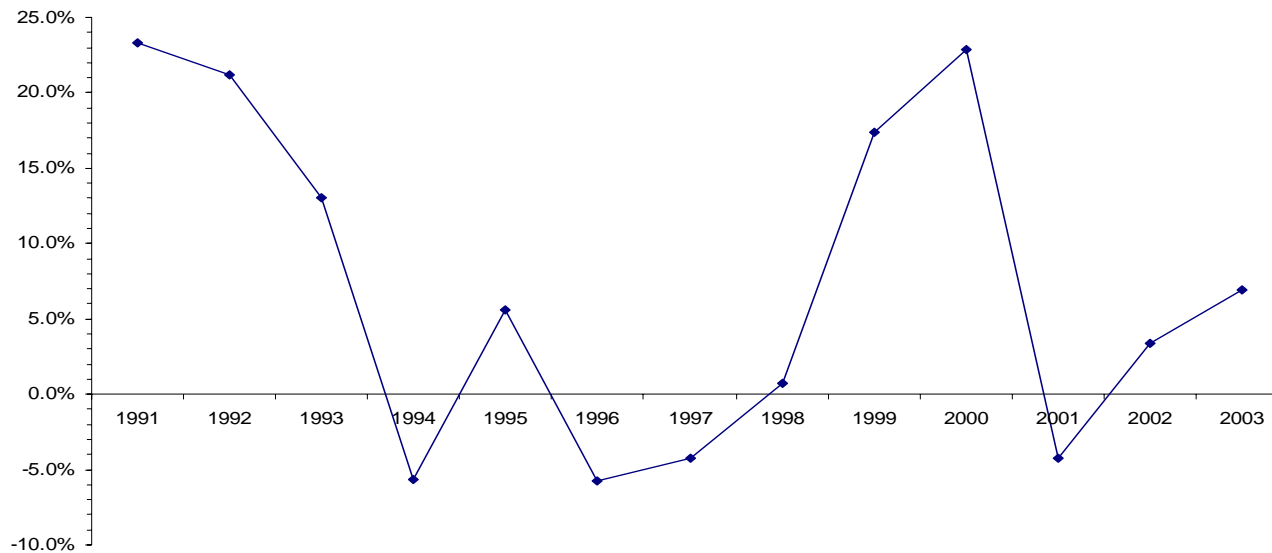
# What is an OPEB?

- OPEB stands for Other Postemployment Benefits
  - These are all benefits other than pension benefits
- OPEB include:
  - Postemployment healthcare benefits
    - Medical
    - Prescription drugs
    - Dental
    - Vision
    - Hearing
    - Medicare Part B or Part D premiums
  - Other forms of postemployment benefits when provided separately from a pension plan
    - Life insurance
    - Long-term care
    - Long-term disability

## What OPEB Are Not

- Postemployment healthcare benefits generally are:
  - NOT like defined pensions – therefore costs are subject to significant volatility

Percentage Change in Retiree Composite Per Capita Medical Cost



- NOT necessarily vested – therefore can be subject to change
- NOT pay-related – rather the benefit increases with medical inflation

## How Are OPEB Costs Currently Reported?

- Most governmental employers use a pay-as-you-go method
- Financial statements only report the OPEB benefits being paid in the current year as the expense
- Since OPEB is reported in this manner, there has been little or no prefunding of OPEB benefits

## Why is GASB Requiring This Reporting?

- OPEB benefits are part of the compensation for services rendered by employees
- Benefits are “earned,” and obligations accrue or accumulate, during employment
- Entities are not properly accounting for the future benefits that are promised and/or expected by employees
- Analysts will be able to evaluate OPEB obligations in the same way it currently evaluates pension obligations

## Who Does GASB Affect?

- Applies to all state and local government entities that provide or participate in OPEB
- Includes public benefit corporations and authorities, utilities, hospitals, colleges and universities, and public employee retirement systems that are employers
- Applies whether the employer issues separate financial statements or is included in another entity's statements
  - Cities, counties or school districts that participate in a statewide plan must follow GASB on an individual basis

## What Are the Credit Implications?

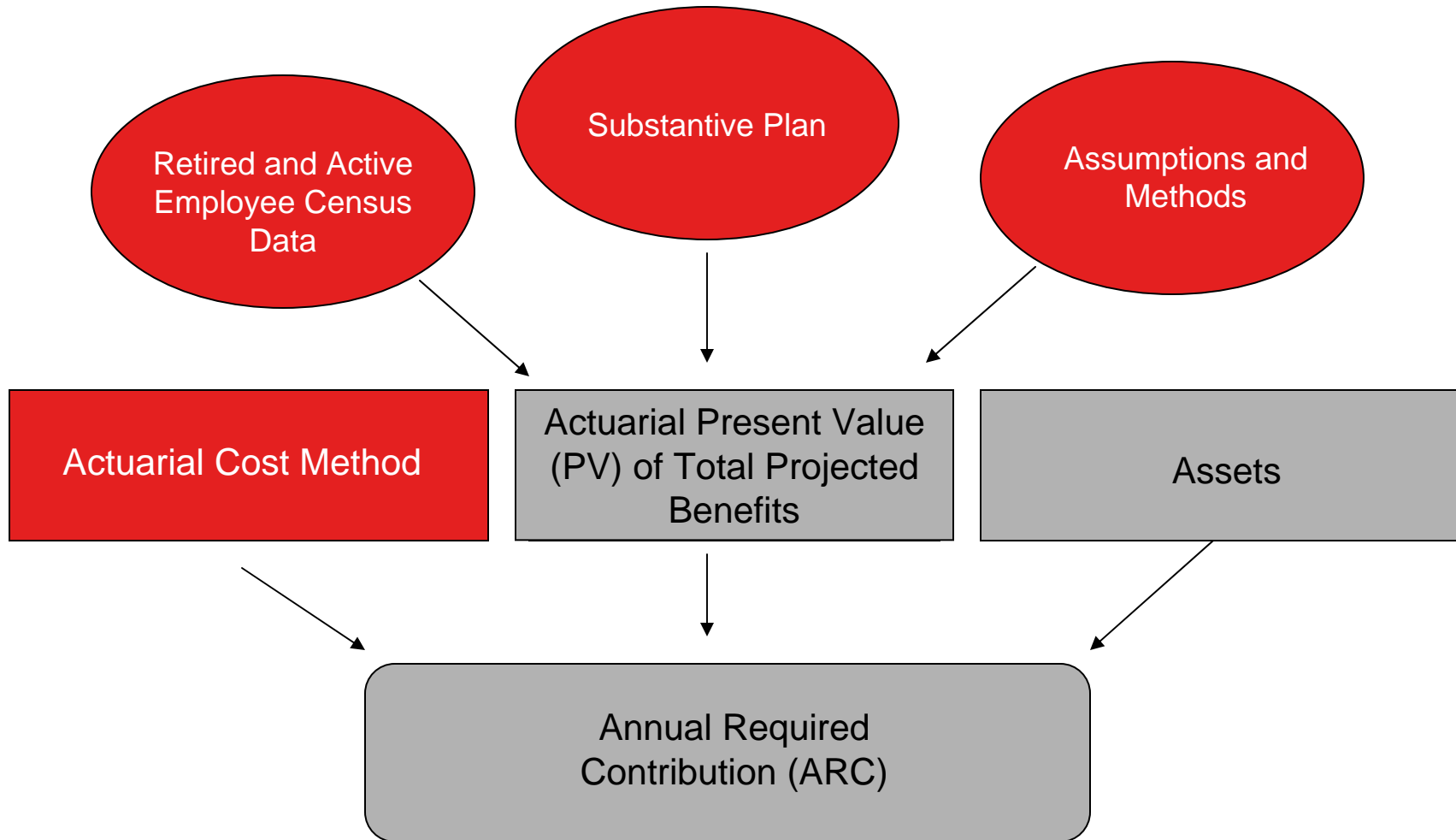
- OPEB promises primarily result from employment contracts with governmental entities
- Lack of funding along with recent rapid health-care cost increases will result in OPEB obligations (primarily health care) are significant
- These obligations likely will and adverse impact credit
- Reporting OPEB could reveal:
  - Funding could strain operation
  - Employers may be unable to fulfill obligation
- Unfunded liabilities will be considered in rating process

# Understanding Your Plan – It May Not Be as Easy as You Think!

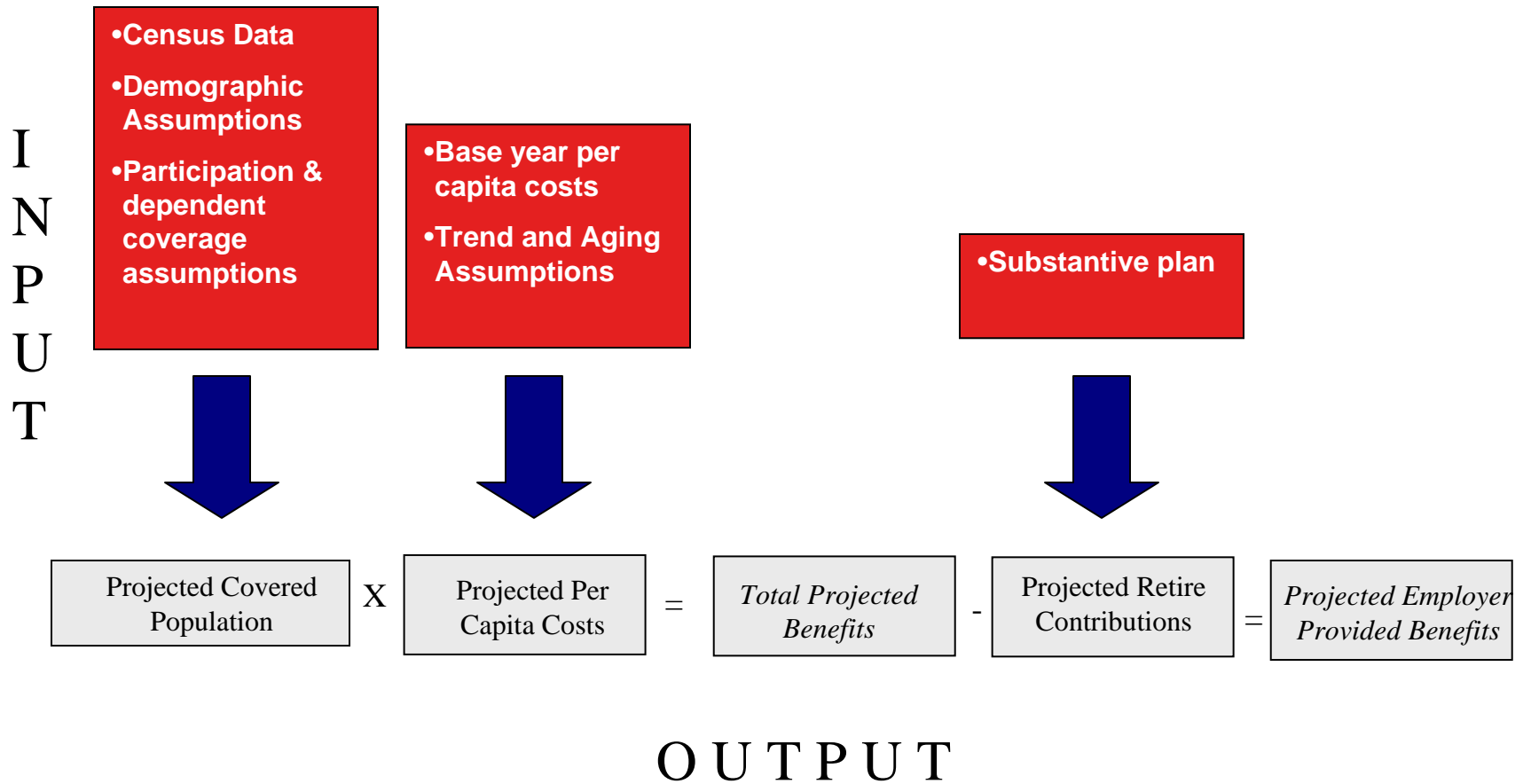
- Substantive Plan – The plan as understood by the employer and plan members
- Need to consider:
  - Eligibility, underlying benefits and cost sharing arrangements
  - Historical patterns of changes
  - Written documents and communications to participants
- Other plan features
  - Caps on Employer's share of benefits
  - Potential implicit rate subsidies
  - Medicare Part B or Part D premium reimbursement

**Action Item: Define current plan and document historical patterns of change**

# Measuring the OPEB Costs



# Selecting Assumptions and Methods – Projected Benefit Payments



# Selecting Assumptions and Methods – Total PV of Benefits

Total PV of Benefits is discounted value of projected benefit payments

Year	Projected Employer Provided Benefits	Total Present Value of Benefits
2007	\$30,000,000	
2008	\$33,000,000	
2009	\$36,000,000	
2010	\$39,000,000	
2011	\$43,000,000	

The diagram illustrates the calculation of the Total Present Value of Benefits. It features a table with three columns: Year, Projected Employer Provided Benefits, and Total Present Value of Benefits. The years 2007 through 2011 are listed, with corresponding projected benefit amounts: \$30,000,000, \$33,000,000, \$36,000,000, \$39,000,000, and \$43,000,000. A red box labeled 'Discount Rate' is positioned below the table. A blue arrow points from the 'Discount Rate' box up to the 'Total Present Value of Benefits' column. Another blue arrow points from the 'Discount Rate' box left to the 'Projected Employer Provided Benefits' column. A third blue arrow points from the 'Discount Rate' box down to the 'Year' column.

## Selecting Assumptions and Methods – Discount Rate

- Discount rate – Expected long-term investment yield on investments expected to be used to finance payment of benefits. Investments could include:
  - Plan assets — for a funded plan (where assets are accumulated in a trust)
  - Employer assets — for an unfunded plan
  - A combination of plan and employer assets — for a partially funded plan

**Action Item: Examine current funding policy & explore funding alternatives**

## Selecting Assumptions and Methods – Trend Assumption

- Trend assumption – The rate of change in the per capita costs over time
  - Based primarily on “core” trend components – medical inflation, utilization and intensity of services (excluding the impact of aging)
  - Typically a select and ultimate assumption with short-term rates typically decreasing until an ultimate rate is reached
  - For example: 12% in 2006 grading down to an ultimate of 5% over a ten year period

**Action Item: Collect historical cost and enrollment information in order to establish appropriate assumptions**

## Selecting Assumptions and Methods – Per Capita Claims Costs (PCCCs)

- Base year per capita claims costs
  - Often established based on average of multiple experience periods
  - Separate rates developed based on Medicare eligibility and/or plan
  - Separate rates could be established by type of service (e.g., medical vs. prescription drugs)

**Action Item: Ensure that historical detailed claims and enrollment experience by plan is available & ensure PCCCs used for accounting are consistent with rates used for determining retiree contributions**

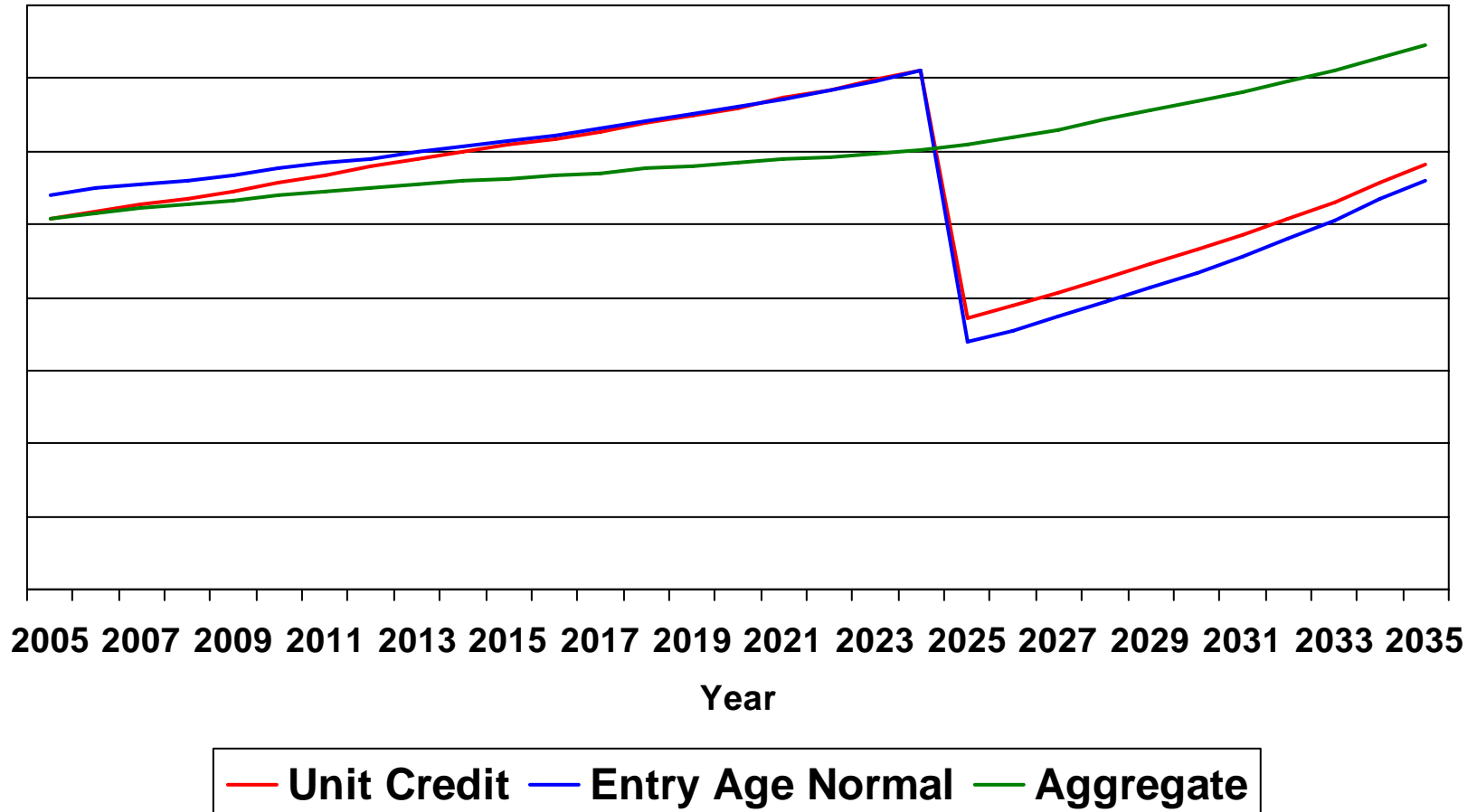
## Allocating the Present Value of Projected Benefits to Periods of Employment

- Six acceptable actuarial cost methods — entry age, attained age, unit credit, frozen entry age, frozen attained age, and aggregate
- Pattern of funding will vary by method (see following graphs)
- Measurement of an employer's annual OPEB cost based on the annual required contribution (the ARC), an amount including:
  - Normal cost
  - Amortization of the unfunded actuarial accrued liability (UAAL) over a maximum of 30 years
  - 10-year minimum for method change gains
  - Level dollar or % funding

**Action Item: Determine appropriate funding method for OPEB accounting**

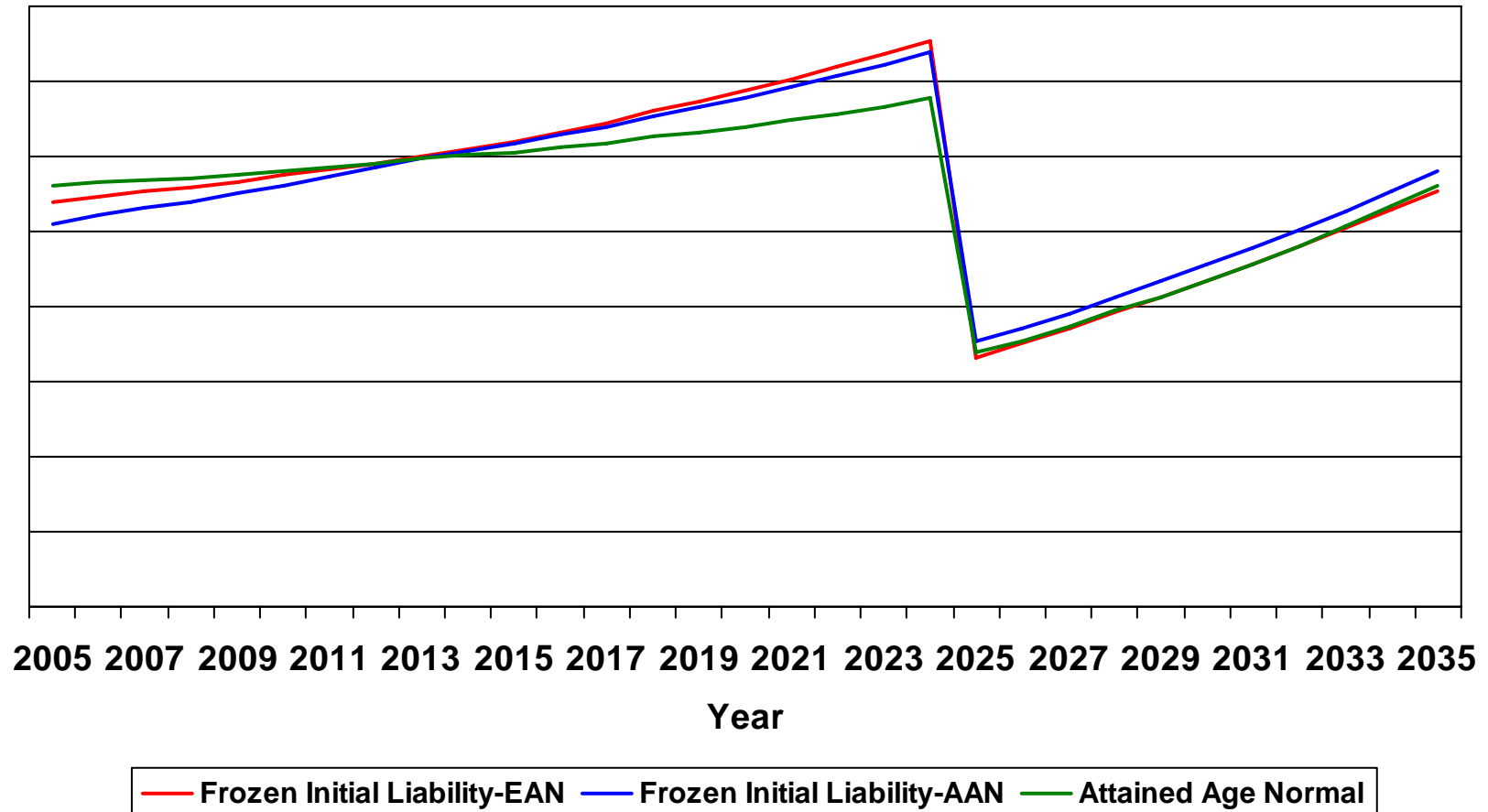
# How Acceptable Methods Allocate Costs

## Employer Contribution



# How Acceptable Methods Allocate Costs

## Employer Contribution



## Resulting Liabilities & Annual Costs – What Does This Mean to Employers and Plan Sponsors?

- Obligations will be significant
- Could have a profound effect on coverage provided to retirees
- As magnitude of obligations is discovered, employers may:
  - Restrict eligibility
  - Change the level of coverage
  - Eliminate or reduce spouse and dependent coverage
  - Ask for increased contributions from membership
  - Explore revenue sources for pre-funding

# Resulting Liabilities and Annual Costs – Case Study

## The Promise

- 55,000 actives, 30,000 retirees
- Service-based contributions (100% employer paid for retiree only at 20+ years)
- Underlying Plans
  - Pre-age 65: Same as active coverage
  - Post-age 65: 80% medical + Rx coverage

## The Price Tag

- Current cash payments: \$100 million
- Total PV: \$4 billion
- ARC: \$250 million
  - Health: 11% of pay
  - Pension: 13% of pay

# Strategic Plan Design Considerations

## Healthcare marketplace

- Comprehensive coverage is available through Medicare with the introduction of Medicare Part D Rx benefits
- Significant individual plan offering choices for Medicare-eligible retirees and dependents
- Individual insurance marketplace is not mature for expensive pre-age 65 retirees

## Legal considerations

- Need to consider legal & bargaining implications of changes

# Strategic Plan Design Considerations (Continued)

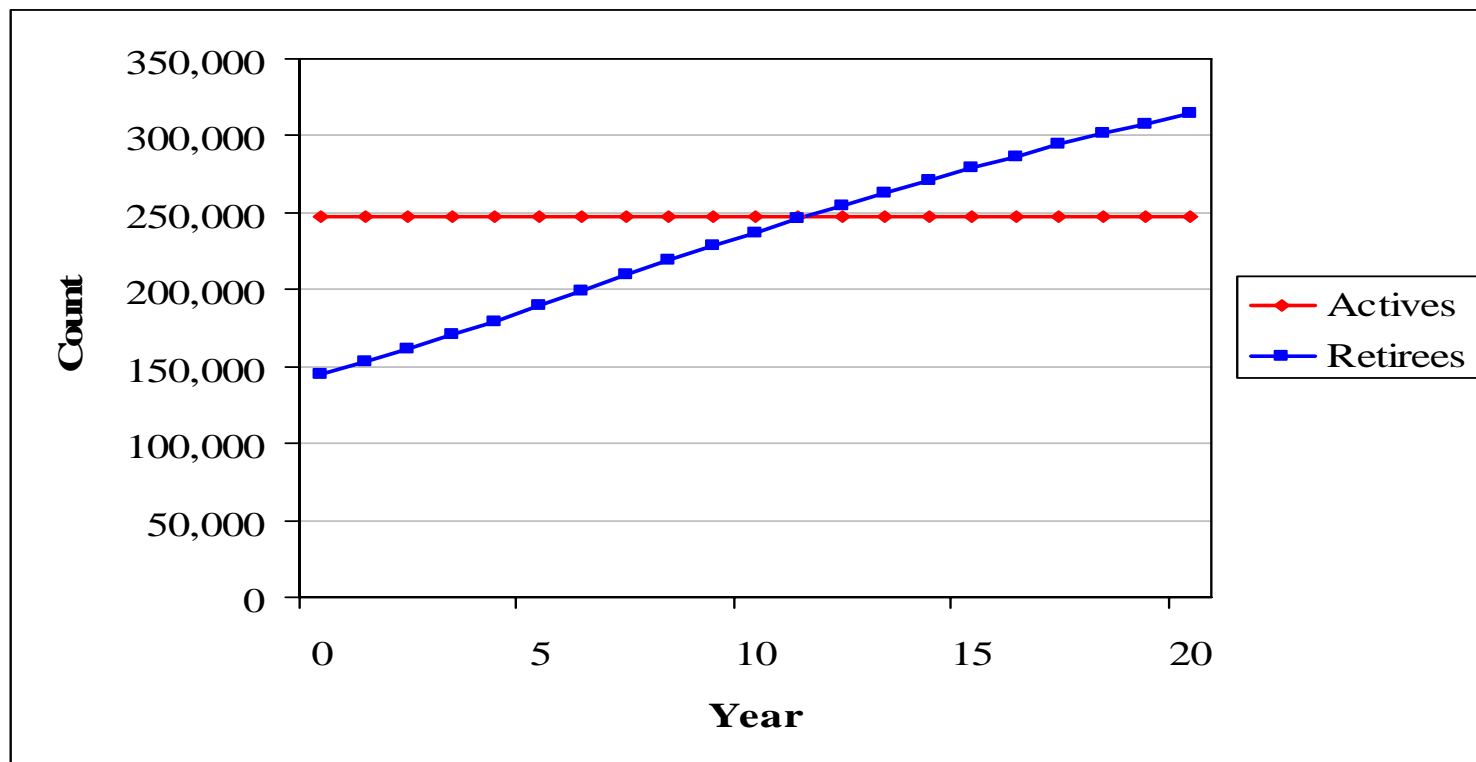
## Overall HR strategy considerations

- Must consider HR impact of future changes in benefits
  - Need to examine characteristics of future covered population and workforce (i.e., relationship between inactive and active participants)
  - May want to provide incentive for employees to work longer given possible future labor shortage as baby boomers retire
  - Need to evaluate whether OPEB benefits are considered valuable and understood by all workforce segments

**Action Item: Create a inter-disciplined team to address the financial & HR issues that will arise**

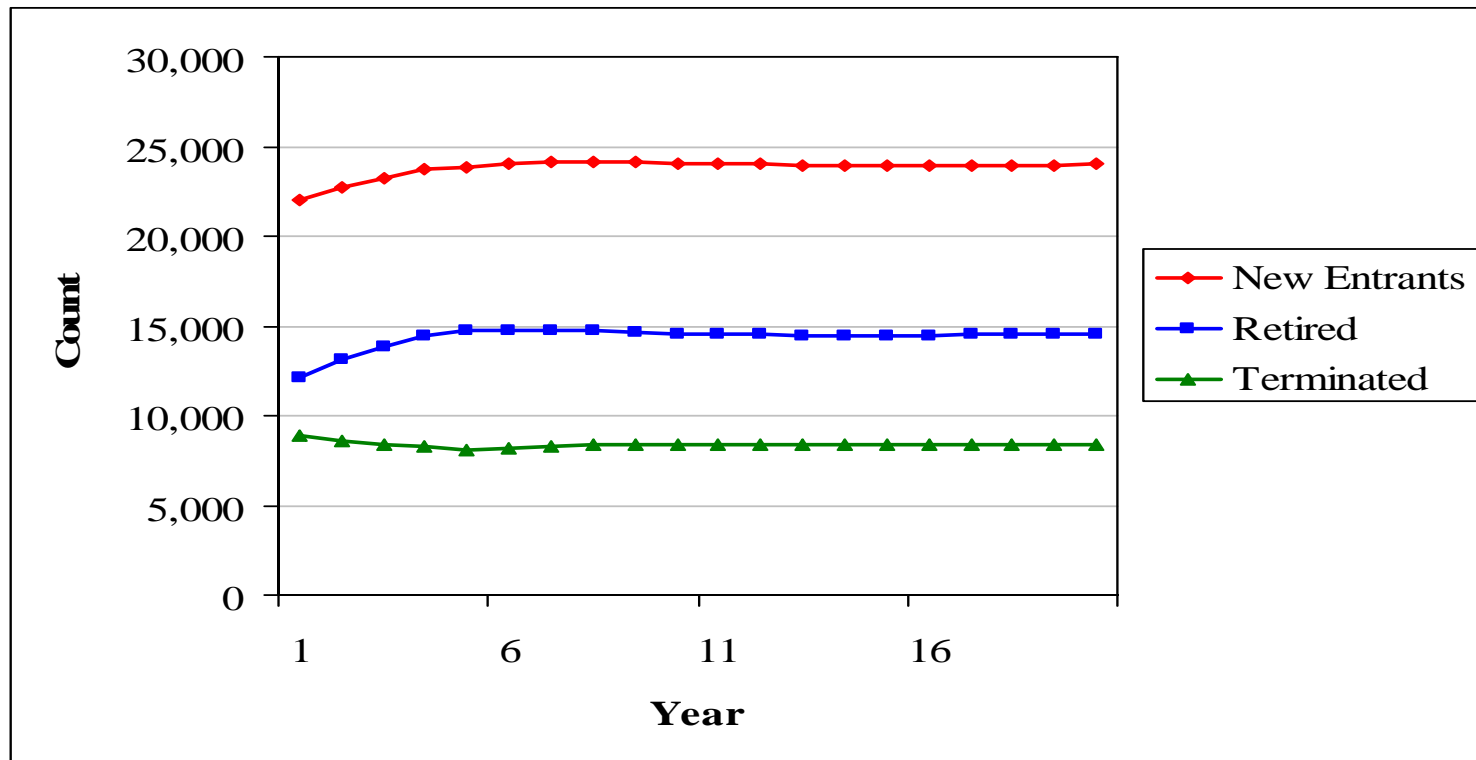
# Actual State System / Demographer™ Projections

## Member Count by Year – Active and Terminated



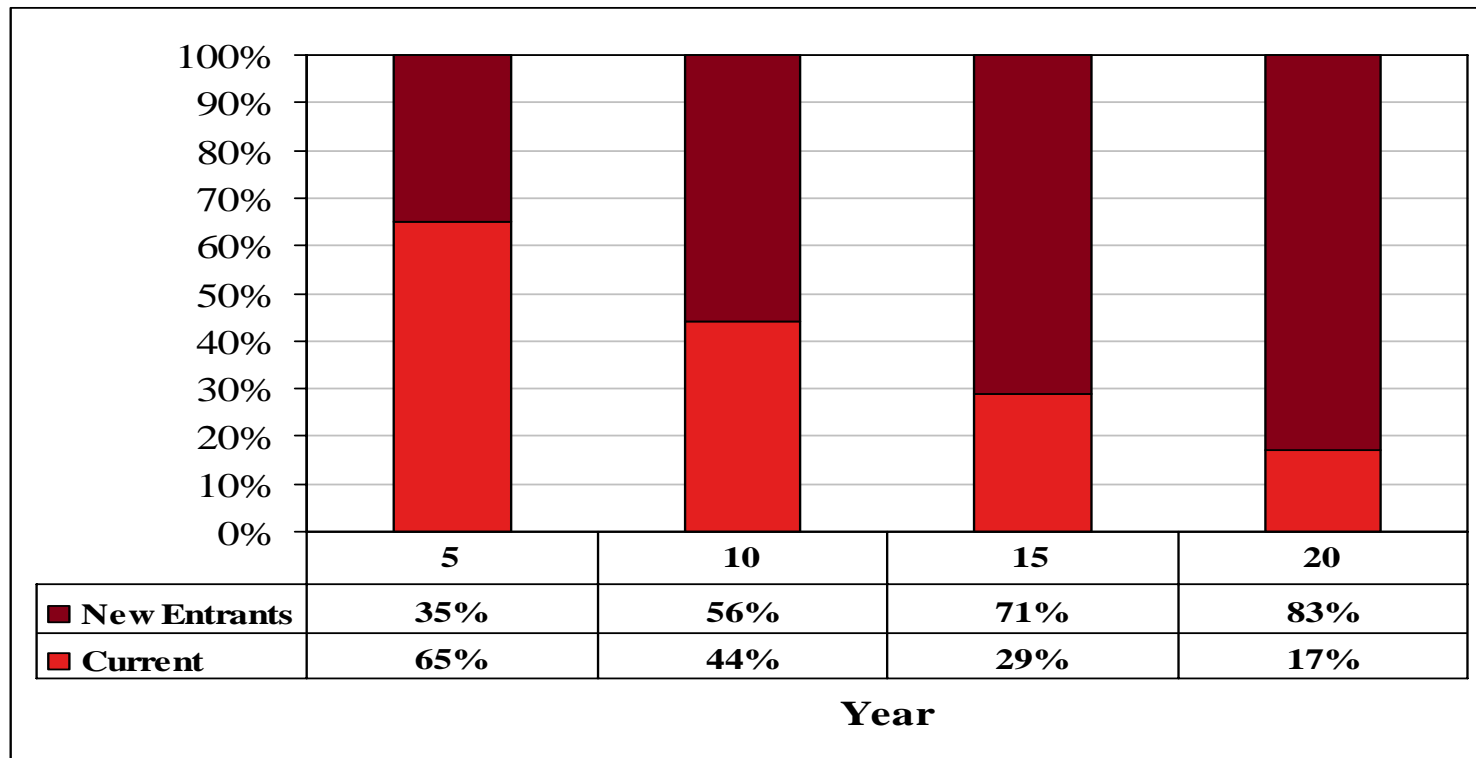
# Actual State System / Demographer™ Projections

## New Members and New Terminees

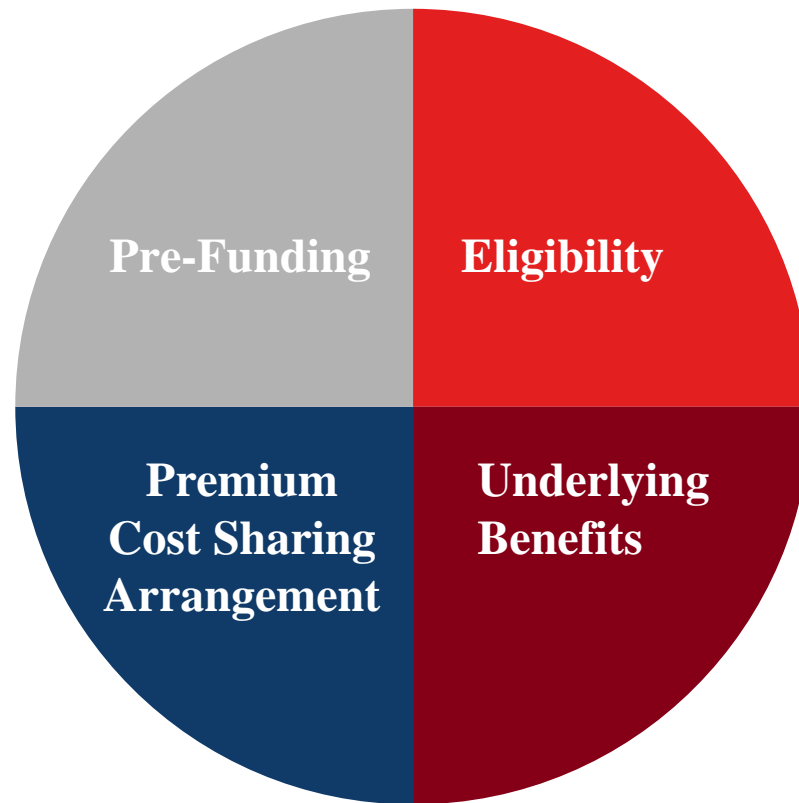


# Actual State System / Demographer™ Projections

## Current Members Remaining Active



# Plan Design Considerations to Manage Costs



## Funding Considerations

- Change funding policy
  - Pre-fund through retirement system or general assets
  - Use a Voluntary Employee Benefit Association (VEBA) Trust
  - Provide for employee after-tax contributions to a special 401(a) account
  - Move to a DC approach with HSA or Retirement Medical Benefit Account (RMBA)

## Next Steps

- Recognize GASB 43/45 is here and will have substantial impact
- Measure liabilities and annual costs under GASB
- Educate all constituencies
- Explore alternative benefit, contribution, eligibility, and funding design strategies as necessary
- Develop an action plan and create an inter-disciplined team to address the financial & HR issues that will arise

# Thank You!

## Questions

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