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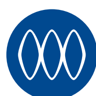

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New GASB Rules for OPEB (Other Postemployment Benefits) Finalized

by Glenn Bowen

Well, it finally happened. After a decade and a half on the Governmental Accounting Standards Board's (GASB) to do list, employers now have an accrual accounting standard for retiree welfare benefits, in the form of GASB Statement No. 45, "Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions." Governmental entities, auditors, taxpayers, and bond rating agencies will likely have many questions regarding the new standard. Let us start off with the basics:

WHO is affected by the standard? All public employers who follow GAAP and offer postemployment benefits other than pensions (see next paragraph) will be subject to the new accounting, reporting, and disclosure requirements. Note that even if retirees pay 100% of the premium for their insurance, in many cases the new rules will require reflecting an employer cost.

WHAT is OPEB? OPEB (other postemployment benefits) includes benefits other than pensions and termination incentives provided to former employees. Examples include medical, dental, and vision coverage, life insurance and long-term care. Note that some of these benefits may be provided by a pension plan. In that case, GASB 45 applies only to the healthcare benefits and GASB 27 applies to the rest.

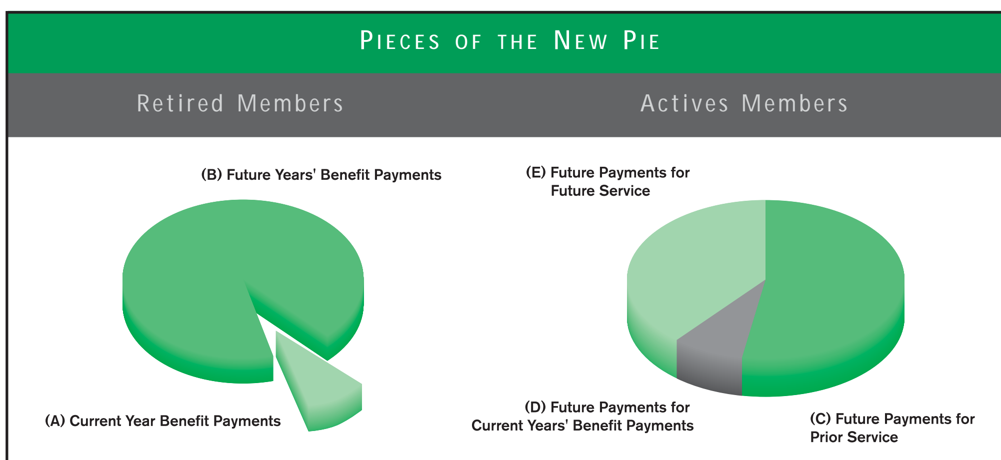
WHEN should we get started? Now would be just fine. Effective dates for GASB 45 are phased in for periods beginning after December 15 of 2006, 2007, or 2008, depending upon the size of the entity. This means that contracts resulting from upcoming union negotiations may extend beyond the effective date, thus you will want to determine the potential accounting impacts prior to bargaining. Since your first valuation can be performed based on census data collected up to 24 months prior to the effective date, many entities will soon be in a position to have calculations prepared that could be used for implementation.

WHERE do the numbers go? The Annual OPEB Cost will be reported on the income statement, and the Net OPEB Liability, if any, will appear on the balance sheet. See Figure 1,"The Pieces of the New Pie" for a discussion of how these numbers are developed.

WHY do we have to accrue for OPEB for active employees? Employees earn a right to postemployment benefits during their working years. The goal of accrual accounting is to match up the cost of an employee's services, including long term obligations such as OPEB, to that employee's period of active service. Thus GASB concluded that the current generation of users of governmental services should recognize the cost of government services as they accrue, even though the benefits are actually paid later. This is analogous to the treatment of pension benefits under GASB 27.

HOW often must we measure our liability? Plans with 200 or more members will require an actuarial valuation at least once every two years,

FIGURE 1



and plans with less than 200 members will require an actuarial valuation at least once every three years. Note that "members" includes all retirees and beneficiaries currently receiving benefits, as well as all current active employees and deferred vesteds who may ultimately earn a right to receive OPEB. (Plans with less than 100 members may choose to take advantage of a "simplified plan alternative" and forego an actuarial valuation. However, "simplified" in this case should not be confused with "simple.")

In Figure 1, pay-as-you-go accounting reflects slice (A) only, the current year's cash cost for OPEB actually paid to retirees. Accrual accounting under GASB 45 is designed to also reflect the value of future benefits for retirees and the portion of benefits for actives that have been earned but are not going to be paid in the current year. First, the present value in today's dollars of all future benefits expected to be received by each retired member and each active employee is calculated. An actuarial cost method is employed to allocate the active liability into the three pieces shown above in the Active Member pie. Slice (C) reflects the portion of the ultimate benefits allocated to prior service. Slice (D) is the portion allocated to the current year. Slice (E) is the portion allocated to future years. For retirees, all benefits to be paid this year (slice (A)) and in years to come (slice (B)) are also allocated to prior service. Actuaries call slice (D) the Normal Cost, and the combination of slices (A), (B), and (C) the Actuarial Accrued Liability (AAL).

The Annual OPEB Cost that will appear on the income statement comprises the Normal Cost and an amortization payment of the Unfunded Actuarial Accrued Liability (UAAL), plus some technical adjustments. The UAAL is the AAL less any assets that have been irrevocably set aside to fund future benefits.

The Net OPEB Liability that will appear on the balance sheet is the sum of all prior year's Annual OPEB Costs less the sum of all prior year's contributions, since the effective date of the standard.

Accrual Versus Pay-as-you-go Accounting in Real Life

To demonstrate the potential differences between accrual and pay-as-you-go accounting for OPEB, consider a study that Milliman recently performed for a municipal police and fire plan. The expected pay-as-you-go cost for retiree benefits in the effective year of the standard was roughly $300,000 (slice (A)). The expected Normal Cost (slice (D)) was roughly $800,000. The AAL (slices (A), (B), and (C)) was roughly $27,000,000. Since there were no plan assets to offset the AAL, the amortization payment of the UAAL was roughly $1,100,000. Thus, adding the Normal Cost and the UAAL amortization yields an expected Annual OPEB Cost of $1,900,000 under the new standard, over six times the pay-as-you-go or current cash cost that the municipality was used to thinking about when they considered the OPEB plan.

GASB 45 does not require advance funding for OPEB, just accrual accounting and reporting. Entities are free to continue pay-as-you-go funding. However, under the standard, the decision to advance fund would affect the allowable actuarial assumptions. More favorable investment return assumptions (discount rates) can generally be used only by entities that fund their liabilities as they accrue, which will produce significantly lower liabilities and accrual costs. Since funding, or the lack thereof, will influence the accounting results, there may be a strong incentive for governmental entities with available cash flow to commence funding their OPEB plans.

Does GASB 45 Really Matter?

If a sponsor's financial statements are used to assist in borrowing or are otherwise subject to scrutiny, the standard may have a significant impact. Ultimately, though, long-term plan costs are determined by plan provisions, not accounting treatments.

More Important Issues

Regardless of the details of the accounting standard, two significant issues looming on the horizon are certain to demand the attention of plan sponsors in years to come. The first is healthcare inflation, which has and likely will remain well in excess of wage inflation for the foreseeable future. The second is the pending wave of baby boomer retirements. Considering these two items in tandem, the resulting question is "How significant and sustainable are the benefit promises we are making?" Milliman was recently asked by a large statewide retirement system to project plan costs out for 10 years. We found that the annual pay-as-you-go cost, expressed as a percentage of annual payroll, was expected to nearly triple over that time. And, of course, that was just the start.

While many plan sponsors may find the new GASB 45 rules an added burden to the already complicated process of compiling financial statements, there is a silver lining to this new cloud. Many computer programs and methods used by actuaries to calculate the required disclosure amounts also produce projections of year-by-year future OPEB benefit payments. This information can help sponsors understand how pay-as-you-go costs will increase and plan for the retirement of baby boomers and medical cost increases.

It's Time to Act

The first item on a plan sponsor's to do list should be having an actuarial valuation performed to estimate accounting numbers, and project future pay-as-you-go costs. These estimates will help the plan sponsor understand how the accounting process works and prepare for the upcoming change. An analysis of the impact of funding these benefits on the accounting figures may be helpful for certain plan sponsors as well. While there is still some time until the effective date(s), it is advisable to start looking into the situation now, to allow as much reaction time as possible.

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This publication is intended to provide information and analysis of a general nature. Application to specific circumstances should rely on separate professional guidance. Inquiries may be directed to: Brent Banister, Editor; 1120 South 101st Street, Suite 400, Omaha, NE 68124-1088; (402) 393-9400; periscope@milliman.com

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