GASB 45 - Concepts and Issues

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Overview of presentation

- General GASB 45 Concepts
- Conducting a GASB 45 Valuation
- Accounting Concepts
- Consulting Considerations

General GASB 45 Concepts

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Important terms

GASB = **G**overnmental
Accounting
Standards
Board

OPEB = **O**ther
Post
Employment
Benefits

WHAT are OPEBs?

- Medical
- Dental
- Vision
- Hearing
- Disability
- Life Insurance
- Long-term Care

WHY the new GASB 45 Standard?

- OPEBs “earned” over working career
- OPEBs considered part of compensation
- “True cost” of OPEBs should be reflected on financial statements

WHO is affected

All public employers who offer OPEBs to retired employees

WHEN – effective dates

Fiscal years starting after:

- 12/15/06 for Phase 1 governments - $100M+
- 12/15/07 for Phase 2 governments - $10M to $100M
- 12/15/08 for Phase 3 governments – less than $10M

Dollar amounts refer to tax revenue

Other general points

- GASB 43 applies to plan level reporting; GASB 45 applies to employer level reporting (similar to GASB 25/27)
- Currently, most governments are not funding for OPEB in advance – typical funding arrangement is pay-as-you-go
- The magnitude of the GASB 45 accrued liability is surprising to most employers

Conducting a GASB 45 Valuation

Key considerations

- Census data
- Plan provisions
- Actuarial assumptions
- Claims cost and trend

Census data

Required census data will depend on specific characteristics of the plan, but in general includes:

- ID
- DOB
- DOH
- Sex code
- SDOB (for retirees)
- Retiree contributions

Plan provisions

Plan provisions can be difficult to ascertain and may require legal analysis. In general, you need to know:

- Eligibility requirements
- Type and level of benefits
- Coordination with Medicare
- Employee/retiree contributions and/or cost sharing provisions
- Dependant/spouse coverage

Actuarial assumptions and methods

Economic assumptions

- Discount rate
- Medical inflation

Demographic assumptions

- Retirement
- Withdrawal rates
- Mortality
- Disability
- Percent of employees and spouses electing coverage

Actuarial cost method

Claims and trend

In determining per capita claims cost and trend, it is important to understand the employer's actual cost structure and consider the following:

- Claim experience
- Nature of the arrangement: insured vs. self-insured
- Implicit subsidy issues
- Differences in medical and drug costs and inflation
- Pre and post Medicare benefits and trend
- Provider discounts

Illustration of valuation methodology

Simplified example for retired employee*

Age at hire – N/A
Current age – 65
Assumed retirement age – N/A
Assumed age at death – 81
Assumed pre-65 annual claims – N/A
Assumed post-65 annual claims – $3,750

- Total pre-65 payments – $0
- Total post-65 payments – 16 x $3,750 = $60,000
- Total value of future benefits – $60,000
- Actuarial accrued liability – $60,000

* To simplify this example, we have ignored, among other things, interest discounting AND medical inflation. In general, those two items have opposing effects on actuarial accrued liability.

Illustration of valuation methodology

Simplified example for active employee*

Age at hire – 27
Current age – 42
Assumed retirement age – 52
Assumed age at death – 81
Assumed pre-65 annual claims – $5,000
Assumed post-65 annual claims – $3,500

- Total pre-65 payments – 13 x $5,000 = $65,000
- Total post-65 payments – 16 x $3,750 = $60,000
- Total value of future benefits – $125,000
- Actuarial accrued liability – $125,000 x 15/25 = $75,000

* To simplify this example, we have ignored, among other things, interest discounting AND medical inflation. In general, those two items have opposing effects on actuarial accrued liability.

Accounting Concepts

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Key terms

- Annual required contribution (ARC) - Normal cost + amortization
- Net OPEB obligation - Difference between:

  (1) the sum of all OPEB costs, and

  (2) the sum of all contributions

Accounting example

Consulting Considerations

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Funding

- No requirement to fund
- Funding vehicle must be acceptable under applicable law. Alternatives may include: VEBAs, 401(h) accounts or section 115 trusts.
- Consequences of not funding:
  - Lower discount rate
  - Larger unfunded liability
  - Larger net OPEB obligation on balance sheet
  - Impact on credit rating
  - No benefit security for participants

Changes to benefit structure

Some alternatives that could reduce liability:

- Reduce benefits for new employees
- Increase employee cost sharing
- Move to defined contribution approach
- Place dollar caps on employee contributions
- Modify eligibility criteria
- Limit employer cost growth to a fixed percentage

Client action items

- Understand the magnitude and sensitivity of the liabilities
- Understand the accounting impact
- Review the current plan design and consider the impact of plan changes
- Consider the advantages and disadvantages of funding

Thank you

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