



**OTHER POST
EMPLOYMENT BENEFITS**

**GASB STATEMENTS NO. 43 and 45
REPORTING GUIDELINES FOR GOVERNMENT
FINANCIAL STATEMENTS**

A Civic Federation Issue Brief

**Prepared By
The Civic Federation
February 9, 2006**

TABLE OF CONTENTS

OVERVIEW	3
Rationale for the New OPEB Reporting Guidelines.....	3
THE SIGNIFICANCE OF THE NEW OPEB REPORTING REQUIREMENTS	3
Rating Agency Response to Date on GASB Statements 43 and 45	4
Recent Government Approaches to Address OPEB Cost Growth	5
SUMMARY OF GASB STATEMENTS 43 and 45	6
GASB Statements 43 and 45 Implementation Schedules	6
DETAILS OF THE NEW REPORTING GUIDELINES.....	7
Financial Statements	7
<i>Statement of Plan Net Assets</i>	8
<i>Statement of Changes in Plan Net Assets</i>	9
Note Disclosure.....	10
<i>Plan Description</i>	10
<i>Accounting Policies</i>	10
<i>Contributions and Reserves</i>	10
<i>Funded Status and Funding Progress</i>	10
Requirement Supplemental Information Schedules.....	10
<i>Schedule of Funding Progress</i>	11
<i>Schedule of Employer Contributions</i>	11

OVERVIEW

Detailed financial information about public employee non-pension benefits is not currently required in governmental audited financial statements. To address this issue, the Governmental Accounting Standards Board (GASB) issued two statements in June 2004 providing reporting guidelines for these types of benefits, GASB Statements 43 and 45. These requirements will be phased in from 2005-2008 depending on the size of individual governments.

Non-pension benefits provided to employees after employment ends are referred to as Other Post Employment Benefits or OPEB. OPEB includes health insurance coverage for retirees and their families, dental insurance, life insurance and term care coverage. It does not include termination benefits such as accrued sick leave and vacation.

Most governments currently fund OPEB on a pay-as-you-go basis, paying an amount annually equal to the benefits distributed or claimed that year. They do not pre-fund obligations as is the case with pension obligations.

Rationale for the New OPEB Reporting Guidelines

Other Post Employment Benefits usually do not have the same legal standing as pension benefits. In Illinois, for example, public pension benefits are guaranteed by the State Constitution.¹ However, other post employment benefits are a part of the compensation package employees earn each year, even though the benefits are not received until employment has ended. The cost of these future benefits is a part of the cost of providing public services today.

Even though OPEB represents future obligations of a government, most governments typically report only their *cash outlays* for OPEB in a given year rather than the cost to the employer of OPEB *earned* in that year by employees. These two amounts are usually very different.

In the absence of any reporting requirements, most governments do not report the full cost of OPEB earned by their employees in a given year. In addition, most governments do not report financial information about the size of the long-term commitments associated with OPEB nor do they provide information about the structure of those commitments. Therefore, the public has incomplete information with which to assess the full cost of public services as well as the financial position and long-term fiscal health of a government. GASB Statements 43 and 45 will fill this void in much the same way GASB Statement 34 helped provide users of financial statements with information about the full cost of capital assets.

THE SIGNIFICANCE OF THE NEW OPEB REPORTING REQUIREMENTS

GASB Statements 43 and 45 will have a significant fiscal and policy ramifications for American state and local governments. The implementation of these new OPEB reporting standards will

¹ Article XIII, Section 5 of the Illinois State Constitution states, "Membership in any pension or retirement system of the State, any unit of local government or school district, or any agency or instrumentality thereof, shall be an enforceable contractual relationship, the benefits of which shall not be diminished or impaired."

likely lead to a vigorous public discussion about non-pension benefits as the costs and long-term liabilities of these benefits are made publicly available for the first time for most governments.

There is no comprehensive information available to date regarding either the total amount of assets or unfunded liabilities for other post employment benefits for governments across the United States. However, Standard and Poor's notes that unfunded OPEB may in some cases be as high as 50% of an employer's total pension liability.²

Also, some information about unfunded OPEB liabilities has been published in various news accounts for certain jurisdictions and is provided in the exhibit below. All of the information provided below is not actuarially determined; rather it reflects very preliminary estimates and thus should be considered as no more than initial "back of the envelope" calculations. But it does provide a snapshot of the size of liabilities for certain governments.

ESTIMATES OF UNFUNDED LIABILITIES: SELECTED JURISDICTIONS	
JURISDICTIONS	ESTIMATES OF UNFUNDED LIABILITIES
STATES	
Alabama	\$11 billion
California	\$40 billion
Delaware	\$2.7 billion
Maryland	\$20 billion
Michigan	\$30 billion
New Jersey	\$20 billion
North Carolina	\$14 billion
MUNICIPALITIES	
Dallas	\$500 million
Duluth	\$280 million
Forth Worth	\$772 million
San Diego	\$500 million
SCHOOL DISTRICTS	
Fresno Unified School District	\$1.1 billion
Los Angeles Unified School District	\$4.9 billion

**Source: Governmental Research Association Reporter,
4th Quarter 2005**

Rating Agency Response to Date on GASB Statements 43 and 45

The rating agencies have stated that they will consider OPEB funding status in their evaluations of government financial condition. It is possible that bond ratings may suffer for those governments with large and/or mounting liabilities and no defined way to pay for these future costs. However, Moody's has stated that the OPEB liability disclosures will not necessarily

² Standard and Poor's. "Reporting and Credit Implications of GASB 45 Statement on Other Post Employment Benefits," December 1, 2004.

cause immediate rating adjustments on a broad scale.³ The extent to which a government's OPEB funded status affects its overall credit rating depends on the issuer's current rating and a comprehensive review of the issuer's finances. Fitch essentially concurs with Moody's assessment, noting that an adverse credit rating could be issued if governments fail to show substantive progress over time in funding OPEB liabilities or do not produce a reasonable plan to meet annual OPEB contributions.⁴ Standard and Poor's cautions that the likelihood of adverse ratings increases in situations in which the actuarial funding of OPEB liabilities would seriously impact operations and/or if employers are unable or unwilling to fulfill such obligations.⁵

According to Moody's, the ultimate credit impact of the OPEB disclosures will depend on several factors, including:

- The absolute size of the unfunded actuarial accrued liability (UAAL) in relation to the size of budget, payroll and the tax base;
- Plans for UAAL amortization as well as funding of new OPEB costs as incurred on an accrual basis;
- Actuarial assumptions used to determine the values of liability and pledged assets, including discount and medical cost inflation rates;
- Retirement benefits promised to current and workers and retirees;
- The impact that full funding of OPEB obligations would have on the issuer's overall financial condition; and
- The current credit assessment of the issuer.⁶

Recent Government Approaches to Address OPEB Cost Growth

The possibility of an adverse effect on bond ratings has led to greater consideration by many governments of controlling or reducing the rate of growth in benefit levels and/or pre-funding their OPEB obligations in much the same manner as they pre-fund pension obligations. Mayor Michael Bloomberg of New York City recently proposed creating a trust fund to pay for retiree health care. The Mayor proposes to use half of the City's FY2007 budget surplus of \$3.4 billion for this fund.⁷

Strategies for reducing OPEB costs include requiring higher health insurance co-payments, reducing levels of coverage, aligning benefits with years of service and providing reduced benefits for new hires. Some governments are also exploring the possibility of shifting to Defined Contribution-based OPEB (as well as pension) plans. Some recent OPEB plan changes cited by Moody's include:

³ Moody's Investors Service. "Other Post Employment Benefits: New Accounting Requirements to Shed Light on Cost of State and Local Retiree Health Benefits; Funding Pressures Expected to Vary Widely," July 2005.

⁴ Fitch Ratings. "The Not So Golden Years: Credit Implications of GASB 45," June 22, 2005.

⁵ Standard and Poor's. "Reporting and Credit Implications of GASB 45 Statement on Other Post Employment Benefits," December 1, 2004.

⁶ Moody's Investors Service. "Other Post Employment Benefits: New Accounting Requirements to Shed Light on Cost of State and Local Retiree Health Benefits; Funding Pressures Expected to Vary Widely," July 2005.

⁷ *New York Times*. "Bloomberg Wants to Use Surplus to Pay Down City's Obligations," January 31, 2006.

- The cities of Orlando, Florida and Arlington, Texas have cut back on retirement healthcare benefits for new employees.
- The State of Alabama has increased the premium payment obligation for certain types of employees, including smokers and those who retire after a short term of service.
- The State of Georgia enacted a law in 2005 creating the Georgia Retiree Health Benefit Fund to receive annual contributions based on the State's Actuarial Required Contribution (ARC).
- In 2003, trustees of the Ohio Public Employees Retirement System (OPERS) concluded that the retiree health benefits fund will be depleted in 12 years. The following year, OPERS decided to reduce OPEB costs by cutting the portion of insurance premium coverage available to retirees with only 10 years of service to 50% for workers hired in 2002 or 25% for those hired later (workers with 30 years or more of service would retain 100% of coverage). In addition, the reductions were also applied to dependents and increased contributions from active workers and employers were mandated. These actions are projected to extend the solvency of the health benefits fund for 18 years.⁸

SUMMARY OF GASB STATEMENTS 43 and 45

GASB Statement Number 43: *Financial Reporting for Postemployment Benefits Other Than Pensions*, establishes uniform financial reporting standards for other post employment benefit plans. GASB Statement Number 45: *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* addresses standards for the measurement, recognition, and display of employers' other post employment benefit expense/expenditures and related liabilities (assets), note disclosures, and required supplementary information (RSI) if applicable.

The measurement and disclosure requirements of the two Statements are related, and disclosure requirements are coordinated to avoid duplication when an OPEB plan is included as a trust or agency fund in an employer's financial report. As with all GASB statements, Statements 43 and 45 are financial statement reporting standards, not funding mandates. They do not **require** governments to pre-fund or establish minimum funding levels for OPEB plans.

GASB Statements 43 and 45 Implementation Schedules

GASB Statements 43 and 45 will be implemented according to a staggered schedule based on the size of the government as measured by annual revenues. Governments with total annual revenues in FY2000 that exceed \$100 million must begin reporting information in their FY2005 audited financial statements. In Northeastern Illinois, this includes governments such as the Chicago Public Schools, Cook County, the City of Chicago, the Chicago Park District and the Metropolitan Water Reclamation District.

⁸ Ibid.

The standards for OPEB plans are effective one year prior to the implementation date for the employer in a single employer plan or for the largest participating employer in the plan for a multi-employer plan.

IMPLEMENTATION SCHEDULE FOR GASB 43 & 45			
	Total Annual Revenues (as of FY00)	GASB 43 applies for periods beginning after:	GASB 45 applies for periods beginning after:
Phase 1	\$100 million or more	12/15/2005	12/15/2006
Phase 2	\$10 million to \$100 million	12/15/2006	12/15/2007
Phase 3	Less than \$10 million	12/15/2007	12/15/2008

DETAILS OF THE NEW REPORTING GUIDELINES

The new Other Post Employment Benefit guidelines will ask governments to account for and report the annual cost of OPEB and all outstanding obligations and commitments related to OPEB in the same way they report financial information for pensions.

Currently, OPEB expenses are included a government's general fund expenditures and spelled out in an audit note as the cost is expensed in the current year, reflecting the pay as you go nature of these expenses.⁹ Under the new guidelines, OPEB financial information will be produced using actuarial valuations performed in accordance with GASB standards. The actuarial valuations should be performed at least every two years for plans that administer OPEB for 200 or more plan members (active and retired) or every three years for plans with fewer than 200 members. The specific types of financial information that must be reported include:

- Other post employment benefit assets and liabilities.
- Unfunded accrued actuarial liabilities (UAAL). This is the excess of the unfunded actuarial liability over the actuarial value of assets.
- Annual Required Contributions (ARC). This is the normal cost and the portion of the unfunded actuarial accrued liability of the employer for the period being reported.
- Expenses, expenditures and net obligations of the appropriate fund or funds.
- Implicit rate subsidies for retirees. In health insurance plans where retirees and current employees are insured together as a group, premiums for retirees are lower than what they would be if retirees were insured separately. This is an implicit rate subsidy and the new reporting standards will require that the amount of that subsidy be disclosed.

The new reporting guidelines will require OPEB plans to present two financial statements as well as accompanying notes and two required supplemental information (RSI) schedules.

Financial Statements

Two financial statements, the Statement of Plan Net Assets and the Statement of Changes in Plan Net Assets, will be included in OPEB financial statements. Illustrations are provided for each of

⁹ Standard and Poor's. "Reporting and Credit Implications of GASB 45 Statement on Other Post Employment Benefits," December 1, 2004.

these features. They are derived from GASB’s report entitled “Other Post Employment Benefits: A Plain-Language Summary of GASB Statements No. 43 and No. 45.”

Statement of Plan Net Assets

The Statement of Plan Net Assets will include information about the OPEB plan’s assets, liabilities and net assets at the end of the fiscal year. The exhibit that follows provides a hypothetical example of the Statement for a fictional state government.

STATEMENTS OF PLAN NET ASSETS			
as of June 30, 20X2			
(Dollar amounts in thousands)			
	State Retired Employees Healthcare Plan	State University Retiree Healthcare Plan	20X2 Total
Assets			
Cash and short-term investments	\$ 250	\$ 13,532	\$ 13,782
Receivables			
Employer	\$ 1,182	\$ 2,101	\$ 3,283
Employer - long-term	\$ -	\$ 4,064	\$ 4,064
Employee	\$ 1,010	\$ 1,562	\$ 2,572
Interest and Dividends	\$ 836	\$ 31,193	\$ 32,029
Total Receivables	\$ 3,028	\$ 38,920	\$ 41,948
Investments, at fair value			
U.S. Treasuries	\$ 723,487	\$ 194,807	\$ 918,294
Federal government agencies	\$ 1,216,282	\$ 308,764	\$ 1,525,046
Corporate bonds	\$ 1,790,676	\$ 378,783	\$ 2,169,459
Corporate stocks	\$ 3,271,662	\$ 615,773	\$ 3,887,435
Total Investments	\$ 7,002,107	\$ 1,498,127	\$ 8,500,234
Properties, at cost, net of accumulated depreciation of \$5,164 and \$323, respectively	\$ 6,177	\$ 434	\$ 6,611
Total assets	\$ 7,011,562	\$ 1,551,013	\$ 8,562,575
Liabilities			
Accounts payable and other	\$ 7	\$ 51,284	\$ 51,283
Net assets held in trust for other postemployment benefits	<u>\$ 7,011,555</u>	<u>\$ 1,499,185</u>	<u>\$ 8,510,740</u>

Source: GASB. Other Post Employment Benefits: A Plain Language Summary of GASB Statements No. 43 and No. 45, p. 20.

Statement of Changes in Plan Net Assets

The Statement of Changes in Net Plan Assets will provide information about additions to, deductions from, and net increases or decreases in an OPEB plan's net assets during the fiscal year. The exhibit below provides a hypothetical example of the Statement of Changes in Plan Net Assets for a fictional state government.

STATEMENTS OF CHANGES IN PLAN NET ASSETS
as of June 30, 20X2

(Dollar amounts in thousands)

	State Retired Employees Healthcare Plan	State University Retiree Healthcare Plan	20X2 Total
Additions			
Contributions			
Employer	\$ 357,682	\$ 33,639	\$ 391,321
Plan Member	\$ 35,409	\$ 4,479	\$ 39,888
Total Contributions	<u>\$ 393,091</u>	<u>\$ 38,118</u>	<u>\$ 431,209</u>
Investment income			
Net appreciation in fair value of investments	\$ 475,914	\$ 65,845	\$ 541,759
Interest	\$ 261,540	\$ 55,939	\$ 317,479
Dividends	\$ 127,853	\$ 22,079	\$ 149,932
	\$ 865,307	\$ 143,863	\$ 1,009,170
Less investment expense	\$ 44,996	\$ 9,177	\$ 54,173
Net investment income	\$ 820,311	\$ 134,686	\$ 954,997
Employer interest on long-term contracts	<u>\$ -</u>	<u>\$ 365</u>	<u>\$ 665</u>
Total additions	<u>\$ 1,213,402</u>	<u>\$ 173,169</u>	<u>\$ 1,386,571</u>
Deductions			
Benefits	\$ 226,108	\$ 25,568	\$ 251,676
Administrative expense	<u>\$ 2,350</u>	<u>\$ 662</u>	<u>\$ 3,012</u>
Net increase	\$ 984,944	\$ 146,939	\$ 1,131,883
Net assets held in trust for other post employment benefits			
Beginning of year	<u>\$ 6,026,611</u>	<u>\$ 1,352,246</u>	<u>\$ 7,378,857</u>
End of year	<u>\$ 7,011,555</u>	<u>\$ 1,499,185</u>	<u>\$ 8,510,740</u>

Source: GASB. Other Post Employment Benefits: A Plain Language Summary of GASB Statements No. 43 and No. 45, p. 21.

Note Disclosure

Notes accompanying the financial statements will describe the features of the OPEB plan, and provide information about the accounting policies used, contributions and reserves, funded status and funding progress. More specifically, the notes will include the following types of information.

Plan Description

- Identification of the plan as a single-employer, agent multi-employer or cost-sharing multi-employer defined benefit plan.
- Disclosure of the number of participating employees and contributing entities.
- Information about the classes of employees covered (e.g., general employees or public safety employees).
- A brief description of benefit provisions.

Accounting Policies

- Disclosure of the basis of accounting, including the plan's policy with respect to recognition in the financial statements of contributions, benefits paid and refunds paid.
- A brief description of how the fair value of investments is determined.

Contributions and Reserves

- Disclosure of the authority under which the obligations of plan members, employers and other contributing entities to contribute to the plan may be changed.
- A description of the OPEB plan's funding policy, including a description of how contributions are determined, how the costs of administering the plan are financed and any legal or contractual maximum contribution rates.
- Reporting of the required contribution rates of active plan members.
- A brief description of the terms for any long-term contracts for contributions to the plan as well as disclosure of the amounts outstanding at the report date.
- Information about the balances in the OPEB plan's legally required reserves at the reporting date, a description of the purpose of each reserve and disclosure of whether or not the reserve is fully funded.

Funded Status and Funding Progress

- Information regarding the funded status of the OPEB plan as of the most recent valuation date.
- Disclosure of information about the actuarial method and the assumptions upon which the actuarially required contribution (ARC), annual OPEB cost, and the funded status and funding progress of the plan are based.

Requirement Supplemental Information Schedules

The new OPEB financial statements will include two Required Supplementary Information (RSI) schedules: the schedule of funding progress and the schedule of employer contributions. These schedules will follow the Notes.

Schedule of Funding Progress

The Schedule of Funding Progress will show historical trend information for at least the past three actuarial valuations about the OPEB plan’s funded status and efforts to accumulate resources to pay benefits as they come due. The schedule should include:

- The actuarial valuation date;
- The actuarial value of plan assets;
- The actuarial accrued liability;
- The total unfunded actuarial accrued liability;
- The actuarial value of assets as a percentage of the actuarial accrued liability (funded ratio);
- The annual covered payroll; and
- The ratio of the unfunded actuarial accrue liability to annual covered payroll.

The exhibit below provides an illustration of a Schedule of Funding Progress for both the State Employees and State University Healthcare Plans of a fictional state government.

SCHEDULES OF FUNDING PROGRESS						
Actuarial Valuation Date	Actuarial Value of Assets a	Actuarial Accrued Liability (AAL)- Entry Age b	Unfunded AAL (UAAL) b-a	Funded Ratio a/b	Covered Payroll c	UAAL as a Percentage of Covered Payroll (b-a)/c
SREHP*						
12/31/W7	\$ 3,696,201	\$ 7,189,703	\$ 3,493,502	51.4%	\$ 2,144,804	162.9%
12/31/W9	\$ 4,209,207	\$ 7,838,210	\$ 3,629,003	53.7%	\$ 2,325,810	156.0%
12.31/X1	\$ 5,131,017	\$ 8,833,219	\$ 3,702,202	58.1%	\$ 2,243,759	165.0%
SURHP**						
12/31/W7	\$ 697,274	\$ 1,001,851	\$ 304,577	69.6%	\$ 297,926	102.2%
12/31/W9	\$ 935,184	\$ 1,168,147	\$ 232,963	80.1%	\$ 329,473	70.7%
12.31/X1	\$ 1,301,663	\$ 1,575,136	\$ 273,473	82.6%	\$ 371,168	73.7%

* State Retired Employees Healthcare Plan

** State University Retiree Healthcare Plan

Source: GASB. Other Post Employment Benefits: A Plain Language Summary of GASB Statements No. 43 and No. 45, p. 25.

Schedule of Employer Contributions

The Schedule of Employer Contributions will present historical trend information that compares the actuarially required contribution (ARC) with actual employer contributions for the last three fiscal years. The information should report the dollar amount of the ARC applicable to each year and the percentage of the ARC recognized in the OPEB plan’s Statement of Changes in Plan Net Assets for each year as contributions from the employer. The exhibit below provides an example

of a Schedule of Employer Contributions for both the State Employees and State University Healthcare Plans of a fictional state government.

SCHEDULES OF EMPLOYER CONTRIBUTIONS				
Employer Contributions				
Year Ended June 30	SREHP*		SURHP**	
	Annual Required Contribution	Percentage Contributed	Annual Required Contribution	Percentage Contributed
19W9	\$ 535,307	54.3%	\$ 29,047	100.0%
20X0	\$ 501,102	66.9%	\$ 31,056	100.0%
20X1	\$ 542,812	64.3%	\$ 32,123	100.0%
20X2	\$ 577,180	62.0%	\$ 33,639	100.0%

* State Retired Employees Healthcare Plan

** State University Retiree Healthcare Plan

Source: GASB. Other Post Employment Benefits: A Plain Language Summary of GASB Statements No. 43 and No. 45, p. 26.