



THE GASB'S ACCOUNTING STANDARDS FOR OTHER POSTEMPLOYMENT BENEFITS

In June 2004, the Governmental Accounting Standards Board (GASB) approved the final set of accounting standards applicable to "other postemployment benefits" (OPEBs), which are non-pension benefits provided after a person leaves employment, such as retiree health care. The final standards are explained in two statements:¹

- *Statement No. 43, Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans, and*
- *Statement No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions.*

The GASB is a seven member Board selected from individuals knowledgeable about state and local governmental accounting issues. The Board establishes standards for measuring and reporting information presented in the financial reports of state and local governments, in essence setting generally accepted accounting principles. If a state or local government does not follow the GASB's standards, this will be noted in the audit letter that accompanies the government's annual financial report and may affect the government's credit rating.

Statements Nos. 43 and 45 provided detailed descriptions of the approved standards for the "measurement, recognition and display" of OPEB-related expenses/expenditures¹ (see Endnotes), liabilities, assets, note disclosures, and other financial information published in the government's annual financial report. Statement No. 45 applies

to governmental employers or other sponsors of OPEB benefits. Statement No. 43 applies to OPEB plans through which the benefits are provided. Although the statements do not require that the benefits be pre-funded, they do define a financial framework for assessing the costs, design, and sustainability of OPEBs offered by state and local governments.

The GASB's standards apply to all forms of other postemployment benefits, but apply differently depending on whether the benefit is provided through a defined benefit OPEB plan or a defined contribution OPEB plan. In a defined benefit OPEB plan, the plan pays specific benefits to members after employment in a manner that does not depend solely on assets held in individual accounts. For example, the plan may pay 50 percent of the retiree's monthly health insurance premiums over the life of the retiree. In a defined contribution OPEB plan, the benefits are based solely on amounts held in individual accounts.

For benefits provided through defined benefit OPEB plans, the GASB's primary requirement is that the long-term cost of retiree health care and other OPEBs be measured and reported on an accrual basis using actuarial methods and assumptions applied in essentially the same way they are applied to state and local government pension plans. Most of the OPEB standards are written for this form of OPEB benefit.

For benefits provided through defined contribution OPEB plans, the GASB requires the cost of the benefits be measured and reported as the employer's required contributions to the individual accounts. In essence, the accounting and reporting rules that apply to defined contribution OPEB plans are the same as apply to defined contribution retirement plans, as presented in GASB Statements Nos. 25 and 27.

¹ This briefing paper summarizes accounting standards published by the Governmental Accounting Standards Board. While it offers information about key aspects of the standards, it is not intended as a comprehensive description. Statements Nos. 43 and 45 may be ordered from the GASB's web site (www.gasb.org) or by calling 800-748-0659.

OTHER POSTEMPLOYMENT BENEFITS

The GASB defines other postemployment benefits as:

- **Postemployment Health Care Benefits** such as medical, dental, vision, hearing, and other health-related benefits whether or not provided separately from a defined benefit pension plan, and
- **Other Postemployment Non-Pension Benefits** such as life insurance, disability, and long-term care, but only if provided separately from a defined benefit pension plan. If provided through a defined benefit pension plan, the accounting rules related to defined benefit pension plans apply.

The GASB specifically excludes “termination offers” from the OPEB definition. Termination offers include benefits provided to employees as inducements to terminate employment (e.g., severance pay and early retirement incentives).ⁱⁱ However, if such offers affect an existing OPEB plan, (e.g., by increasing the costs of retiree health care due to retirements that are earlier than would otherwise occur), the additional plan costs are recognized in accordance with the OPEB standards.

The GASB includes “implicit rate subsidies” in their OPEB definition, when annual health care premiums are based on a blended rate for both active employees and retirees. This is particularly relevant in situations where employers provide retirees with access to health care and charge them premiums based on a blended rate for both active employees and retirees. Although it may seem that the retirees are paying the full cost of coverage, the GASB disagrees, since it is likely the blended premium will be less than the premium for retirees alone.

The GASB originally proposed excluding the implicit rate subsidy from the OPEB standards in situations where retirees pay 100 percent of the blended premium. In the final standards, however, the Board reversed this decision and now requires the subsidy to be included as a benefit subject to the OPEB standards, regardless of whether retirees pay 100 percent of the blended premium.

GOVERNMENT RETIREE HEALTH CARE

The largest component of OPEB is retiree health care. Several surveys indicate that the majority of state and local governments provide some form of health care benefits for retirees. According to the Government Finance Officers Association’s 1998 publication, *Prefunding Retiree Health Benefits*, 74 percent of state governments and 57 percent of local governments provide health benefits to retirees over age 65. Approximately the same percent provide health benefits to retirees under age 65. In 2002, a study by the Municipal Employees’ Retirement System of Michigan showed that 74 percent of the 353 municipal respondents provided retiree health care, with most offering both pre-65 and post-65 coverage.

Many of the arrangements were developed at a time when employers could sponsor retiree health care programs at a relatively low cost, often only a few tenths of a percent of active member payroll. Currently, however, many retiree health care sponsors pay 5 percent to 10 percent (or more) of payroll for these benefits. Moreover, health care costs for employers and retirees are likely to continue increasing due to an aging population, ongoing medical cost inflation, increased utilization of medical services, and other factors.

THE GASB’S GENERAL FRAMEWORK

Currently, most governmental employers report OPEB costs as current expenses/expenditures and finance them on a pay-as-you-go basis. The GASB has long been concerned that this approach does not accurately reflect the magnitude of these costs or their long-term nature. The GASB sees OPEB benefits as similar to pension benefits in that they are accrued while the employee is working and paid after the employee leaves service or retires. Consequently, it argues that the costs of the promised benefits should be recognized when the employer receives the services (i.e., when the benefits accrue), rather than years later when the benefits are paid. The GASB has also been concerned that the employers’ financial statements do not provide information about the accrued OPEB liabilities and the extent to which these liabilities are funded.

Because of the apparent similarities between pensions and OPEB, the GASB modeled the

OPEB standards on its standards for pensions, as presented in GASB Statements Nos. 25 and 27. This is intended to make the standards easier to implement and interpret, since the OPEB standards will involve similar procedures, measurements, and financial reporting requirements.

ACTUARIAL VALUATIONS AND PARAMETERS

The GASB's primary requirement is that the long-term cost of retiree health care and other OPEB benefits be determined on an actuarial basis using methods and assumptions that are constrained in the ways described below. For OPEB plans with 100 or more total membersⁱⁱⁱ, an actuarial valuation would be done to calculate the employers' "annual required contribution" (ARC) associated with the benefit promise, as well as the actuarial accrued liability, actuarial value of assets, and other related information using the following parameters:

- **Substantive Plan** – this is the basis for determining the benefits to be included in the valuation. It is the terms of the plan as understood by the employer and members at the time of the valuation, as evidenced by written documents and communications, and including established patterns of cost sharing between the employer and members.^{iv} Changes in plan terms may be included to the extent they have been made and communicated to employees. Legal or contractual limits ("caps") on the employer's share of the benefits may also be included, if the limits are assumed to be effective given their record of enforcement and other relevant circumstances.
- **Valuation Frequency** – valuations must be done at least every two years for OPEB plans with 200 or more total members (including active employees, terminated vested members, and retirees), and at least every three years for plans with fewer than 200 total members.
- **Actuarial Methods** – six actuarial methods are allowed: entry age, attained age, frozen entry age, frozen attained age, projected unit credit, and aggregate. If the aggregate method is used to determine the contribution, the entry age method must be used to deter-

mine the actuarial accrued liability and unfunded liability that is reported in the notes to the employer's financial statements.

- **Actuarial Assumptions** – as guided by the Actuarial Standards Board, the assumptions should be based on the experience of the covered group (to the extent data are available) and reflect long-term future trends. Moreover, retiree benefit projections should be based on claims costs or on age-adjusted premiums.
- **Investment Return Assumption** – should reflect the long-term yield on investments expected to fund the benefits, considering the nature and mix of the expected investments. Both the investment return assumption and other economic assumptions should reflect the same inflation assumption.
- **Amortization Period** – the maximum period allowed for amortizing the unfunded actuarial accrued liability is 30 years. If a significant decrease in the actuarial liability results from a change in the actuarial cost method or method used to value assets, a minimum 10-year period is used to amortize the decrease in actuarial liability.
- **Actuarial Value of Assets** – must be a market-related measure: i.e., current market or a market-smoothing method.

A key point is that the investment return assumption should reflect the long-term yield on the investments that are expected to be used to finance the benefits. In this regard, the assumption is based on:

1. **Plan assets** where the employer's funding policy is to consistently contribute amounts at least equal to the ARC and the assets are held in a trust or equivalent arrangement;
2. **Employer assets** where the employer is funding on a pay-as-you-go basis, or where the assets are not held in a trust or equivalent arrangement; or
3. **A proportionate blend** of plan and employer assets where the employer is contributing an amount greater than the pay-as-you-go rate but less than the ARC.

An “equivalent arrangement” is one in which employer contributions are irrevocable, dedicated to providing plan benefits, and legally protected from creditors of the employer(s) or plan administrator. Monies earmarked in the general fund or in another fund without these protections would not be considered plan assets held in a trust or equivalent arrangement.

Plan assets will generally consist of diversified equity and long-term fixed income securities, whereas employer assets are often restricted to short-term, fixed income securities. Consequently, the standards allow a significantly higher investment return assumption to be applied to funded OPEB plans where the assets are held in a trust or equivalent arrangement than to unfunded plans or those where the assets are not held in trust. Use of the higher investment return assumption would result in significantly lower actuarial liabilities and annual required contributions.

STANDARDS FOR EMPLOYERS SPONSORING OR PARTICIPATING IN OPEB PLANS

The GASB draws a distinction between the standards that apply to employers that sponsor or participate in OPEB plans and the standards that apply to the plans themselves. Essentially, employers must measure and report the long-term costs of the benefits and the extent to which the employer has contributed to meet those costs. OPEB plans must report the amount of assets that have accumulated to provide benefits, annual inflows and outflows, and the funded status of the plan. Generally, for these purposes, the same actuarial methods and assumptions are required for both the plan and its participating employer(s).

The standards for employers depend, in turn, on whether the OPEB plan that they participate in is a single-employer plan, agent multiple-employer plan (“agent plan”), or cost-sharing multiple-employer plan (“cost-sharing plan”). A single-employer plan is a plan that serves one employer. An agent plan is a plan that serves multiple employers, under which separate actuarial valuations are performed to determine the required contributions of each participating employer. A cost-sharing plan is a plan that serves multiple employers, under which a single actuarial valuation is performed for all employers combined.

Under a cost-sharing plan, a single annual contribution rate is billed to all participating employers.

EMPLOYERS IN SINGLE AND AGENT OPEB PLANS

For governmental employers participating in single and agent OPEB plans, two key OPEB measures are calculated and included in the employer’s financial statements:

- **The OPEB Cost** is the annual required contribution (ARC) determined by an actuarial valuation conforming to the GASB’s parameters, with certain adjustments described below. The OPEB Cost is the basis for determining the employer’s annual OPEB expense/expenditure shown in the employer’s financial statements.
- **The Net OPEB Obligation** is the difference between the OPEB Cost and actual annual employer contributions to the OPEB plan, accumulated from the effective date of the OPEB standards.^v The Net OPEB Obligation is the basis for determining the OPEB liability (or asset) shown in the employer’s financial statements.

If the employer has a Net OPEB Obligation, the OPEB Cost must be adjusted annually to reflect interest accrued on the Net OPEB Obligation from the start of the year (with some additional adjustments). Unlike the GASB’s pension standards, under which employers had to calculate and report a Net Pension Obligation for the 10-year period prior to the standard’s effective date, the GASB does not require employers to calculate a prior Net OPEB Obligation, although an employer may elect to retroactively compute the Net OPEB Obligation.

In addition to requiring that government employers measure and report the long-term costs of retiree health care and other OPEBs in their financial statements, the proposed OPEB standards also require other disclosures in the employer’s annual financial report, including:

- **Notes to the Financial Statements** – summarizing plan provisions, authority for plan changes, significant accounting policies, contributions, reserves, investment concentra-

tions, funded status, funding progress, actuarial methods, and actuarial assumptions.

- **Schedule of Funding Progress** – showing actuarial accrued liabilities, actuarial value of assets, unfunded accrued liabilities, funded ratio, covered payroll, and unfunded liabilities as a percent of covered payroll for the three most recent actuarial valuations.
- **Schedule of Employer Contributions** – showing annual required contributions and employer contributions as a percent of the ARC for the three most recent actuarial valuations.

EMPLOYERS IN COST-SHARING OPEB PLANS

As noted earlier, a cost-sharing plan is a plan that serves multiple employers, under which a single actuarial valuation is performed for all employers combined. As a result, the benefits promised by individual employers are not valued separately. Instead, a single contribution rate is billed to all employers participating in the plan.

Instead of requiring employers in cost-sharing plans to individually value their OPEB Costs, the standards provide that these employers recognize their contractually required contribution to the cost-sharing plan as their OPEB expense/expenditure. Moreover, the employer's OPEB liability is the difference between the contractually required contributions and contributions actually made, rather than the Net OPEB Obligation.

However, if the assets of the cost-sharing plan are not held in a trust or equivalent arrangement, the OPEB rules for employers participating in an agent plan would apply to each participating employer. As a result, individual actuarial valuations would be required, and each employer would have to calculate and report its OPEB Cost and Net OPEB Obligation.

STANDARDS FOR OPEB PLANS

GASB's standards describe an "OPEB plan" as the trust or equivalent arrangement through which assets are accumulated to finance other post-employment benefits and benefits are paid as they come due. Assets that are not irrevocably

set aside in a trust or equivalent arrangement are considered employer assets, rather than plan assets.^{vi}

The standards apply to all types of defined benefit OPEB plans, including single employer, agent, and cost-sharing OPEB plans. If the OPEB plan is administered and funded solely by the employer, then the financial statements for the OPEB plan would be included in the employer's financial statements. If the OPEB plan is administered and funded through an entity outside the employer, then the OPEB plan would be reported in the outside entity's financial statements, which the employer could refer to in its own financial statements.

The standards require the following to be included in the OPEB plan's financial report:

- **Statement of Net Plan Assets** – showing the OPEB plan's assets, liabilities, and net assets. Investments are reported at fair value. Liabilities only include current liabilities and not unfunded actuarial accrued liabilities. (Note: unfunded actuarial accrued liabilities are shown in a separate schedule of funding progress, discussed below.)
- **Statement of Changes in Net Plan Assets** – showing additions to and deductions from assets, as well as the net change in assets. Additions include employer and employee contributions, investment income, and other additions. Deductions include benefit payments and administrative expenses. Investment expenses are shown separately as a reduction to income.
- **Notes to the Financial Statements** – summarizing plan provisions, authority for plan changes, significant accounting policies, contributions, reserves, investment concentrations, funded status, funding progress, actuarial methods, and actuarial assumptions.
- **Schedule of Funding Progress** – showing actuarial accrued liabilities, actuarial value of assets, unfunded accrued liabilities, funded ratio, covered payroll, and unfunded liabilities as a percent of covered payroll for the three most recent actuarial valuations.

- **Schedule of Employer Contributions** – showing annual required contributions and employer contributions as a percent of the ARC for the three most recent actuarial valuations.

ALTERNATIVE MEASUREMENT METHOD FOR SMALL OPEB PLANS

Employers in single-employer plans with fewer than 100 OPEB plan members (including active employees, terminated vested members, and retirees) may choose to use an alternative method for measuring annual required contributions and related OPEB liabilities. This was intended to ease the cost of complying with the standards for very small plans. Employers that use the alternative method must disclose its use in the notes to their financial statements along with the basis for all significant assumptions. Appendices in the GASB statements illustrate the calculations and assumptions to be used under the alternative method.

IMPLICATIONS

The GASB’s OPEB project will likely have a significant impact on retiree health care plan design, sponsorship, and funding by governmental employers and plans. Because the standards require the calculation and display of the plans’ annual required contributions and Net OPEB Obligations, a greater portion of OPEB plans will probably be pre-funded. Also, because the standards allow a higher interest rate to be assumed for assets held in a trust or equivalent arrangement, it is likely that employers will hold their retiree health care assets in trust and invest them in a diversified mix of securities. However, it is also likely that rapidly increasing retiree health care costs and their disclosure in governmental financial statements will cause employers to reevaluate the design of their OPEB plans.

EFFECTIVE DATES

The OPEB standards will be phased-in, with the effective dates determined by the total annual revenues of the participating employer, as follows:

Total Annual Revenue of the Sole or Largest Participating Employer in the Plan in the First Fiscal Year Ending After June 15, 1999	OPEB Statement will be Effective for that Employer for Periods Beginning After	OPEB Statement will be Effective for that Plan for Periods Beginning After
Phase 1 Governments - \$100 million or more	December 15, 2006	December 15, 2005
Phase 2 Governments - \$10 million or more, but less than \$100 million	December 15, 2007	December 15, 2006
Phase 3 Governments - Less than \$10 million	December 15, 2008	December 15, 2007

For example, a participating employer with a July 1 to June 30 fiscal year and total annual revenues of \$75 million for the fiscal year ending June 30, 1999, would need to incorporate the OPEB employer standards into its financial statements for the fiscal year starting July 1, 2008, and ending June 30, 2009. The GASB’s standards pertaining to OPEB plans would have to be incorporated into the OPEB plan’s financial statements one year earlier – for the fiscal year starting July 1, 2007, and ending June 30, 2008.

Gabriel, Roeder, Smith & Company provides actuarial and benefit consulting services to over 500 clients nationwide, and has helped state and local governments manage their benefit plans for over 60 years. Additional information about the OPEB standards and our related services is available on our web site (www.grsnet.com/opeb).

ENDNOTES

ⁱ Whether a cost is recognized as an expense or expenditure depends on the underlying accounting basis of the financial statement in which it is displayed. If the financial statement reflects the full accrual accounting basis, the cost is recognized as an expense. If the financial statement reflects the modified accrual basis, the cost is recognized as an expenditure.

ⁱⁱ The GASB's definition of OPEB also excludes the conversion of a terminating employee's unused sick leave credits to an individual account for payment of postemployment benefits. Instead, this conversion is treated as a "termination payment" and accounted for under GASB Statement No. 16. However, if the unused sick leave is used to provide for or enhance a defined benefit form of OPEB (e.g., by converting it to service credit for retiree health care benefits) the resulting benefit is subject to the OPEB standards.

ⁱⁱⁱ OPEB plans with fewer than 100 total members are allowed to use an alternative method for determining required contributions and accrued liabilities, as explained later in this memorandum.

^{iv} In some cases, plan documents may be out-of-date, poorly worded, or not defined in all situations. Consequently, professional judgment may be required to determine the substantive plan based not only on written documents but also on other communications and administrative practices. Clarification may require formal action by elected officials, may take time, and would need to be communicated with plan members. This process is best started as soon as possible.

^v In order to count against the Net OPEB Obligation, employer contributions must be made to a trust (or equivalent arrangement) or used to pay benefits or premiums.

^{vi} OPEB plans that are not administered as trusts (or equivalent arrangements) should be reported as agency funds. Employer contributions to agency funds do not count against the employer's Net OPEB Obligation.