Retiree and Post-Employment Benefits
GASB 43 and GASB 45

Funding retiree health and welfare benefits has been a major issue for many employers in both the private and public sectors. Because few employers are able to fund these benefits in advance, many, if not most, use the pay-as-you-go method.

New Governmental Accounting Standards Board (GASB) standards 43 and 45 direct how state and local governments account for and report other post-employment benefits (OPEB) that are separate from pension benefits. The most common OPEB is retiree health benefits.

GASB is a not-for-profit agency that develops and issues financial and accounting standards for state and local government agencies. These standards are consistent with the generally accepted accounting principles (GAAP), which cover non-state and non-local government agencies.

GASB 43, Financial Reporting for Post-employment Benefit Plans Other Than Pension Plans, provides financial reporting procedures for these benefits. These are contained in the district's annual audit report. GASB 45, Accounting and Financial Reporting by Employers for Post-employment Benefits, provides accounting procedures. The two statements are closely related and are usually considered together.

Districts that fail to implement the new GASB requirements could experience reduced bond ratings when rating agencies review their financial statements and find an unfunded liability. If the liability is not reduced, financial statements will weaken over time. Reduced bond ratings result in higher issuance costs and interest rates. A district's ability to borrow could also be affected.

Failure to implement GASB 45 could also result in an adverse opinion by a district auditor. Although the pay-as-you-go method is permissible, its use results in a growing liability that is not matched by a reserve of equal value. While professional accounting standards do not require public agencies to set aside the funding, failure to do so will have fiscal and reporting consequences. Because post-employment benefit costs continue to rise, incurring this type of debt should be avoided if possible.

GASB 43 and 45 will be phased in over three years, based on the governmental unit's size. The reporting standard is implemented before the accounting standard, so financial statement footnote disclosure will occur one year before the actual accounting changes are necessary. As with many new accounting standards, early implementation is encouraged. The effective dates are shown in this table:

Implementation Phase Based on Agency Revenue	Effective Date for GASB 43	Effective Date for GASB 45
$100 million or more	July 1, 2006	July 1, 2007
$10 million to $100 million	July 1, 2007	July 1, 2008
Less than $10 million	July 1, 2008	July 1, 2009

The new reporting and accounting requirements were created to help districts realize how past negotiated retiree benefit commitments affect current and future budgets. The requirements also help districts accurately show the cost of those commitments in the years when employees work for the district and the costs are incurred. GASB 45 requires OPEB to be recognized as an expense and obligation, if applicable, on the local educational agency's (LEA's) financial statements reported on the full accrual basis of accounting. This is for districts with any benefit structure for retirees.

Future benefits result in a liability that will soon be reflected on financial statements. Because the district,

like most LEA's, has funded this liability on a pay-as-you-go basis in the past, the new GASB reporting and accounting requirements will substantially affect financial statements due to the large cost that will soon be included. The cost is currently booked and the expenses funded based on the amount actually paid out for retiree benefits in the current year, not the total amount of the liability the district will need to pay in both the current and future years. However, the new standards require an actuarial determination of the total liability and expense, which will be reflected in the district's financial statements on an annual basis. When a district has more than 200 participating employees, it is required to have a biannual actuarial report to value its plan costs.

The new standards also require that the existing unfunded retiree benefit liability be amortized. This unfunded liability does not have to be booked in the first year of implementation, and the amortization can take place over a maximum of 30 years. GASB 45 also requires disclosure of information about the plans in which an employer participates, the funding policy followed, the actuarial valuation process and assumptions, and, for certain employers, the extent to which the plan has been funded over time.

The actuarial valuation uses the following to make certain calculations related to the plan:

a. Actuarial cost method. Several acceptable actuarial cost methods are available. The district will need to consult with its actuary to determine which method will best meet the district's needs.
b. Actuarial assumptions. These include demographic information such as employee life spans, marriage status, termination status, and economic data such as current and future investment returns and cost trends.
c. Plan assets. These must be transferred to an irrevocable trust to be counted as part of the funding available to pay the plan liability. Plan assets are reported based on market values, either on a specific date or as an average over the reporting period.
d. Employer census data. This consists of demographic data related to eligible plan members.

The actuarial report will show the district's annual required contribution (ARC), which is the district's accrued expense and related liability in its current year financial statements. Although it is labeled as a contribution, the district may choose not to fund the ARC, resulting in an unfunded liability. The ARC has two components:

- The normal cost. This is the current actuarial cost of the retiree benefits earned by employees in the current year.
- Amortization of the prior unfunded liability. This is the amortization of the prior unfunded employee benefits liability for up to 30 years.

After the total prior unfunded liability has been recognized, the ARC will consist solely of the current year actuarially determined costs of benefits. Contributions toward the annual cost are made through premiums paid to the insuring agency and through contributions to an irrevocable trust (Fund 71), the assets of which are held for future premium payments. One advantage of an irrevocable trust is that the annual actual costs (normal costs) of retiree benefits can be charged equitably to all programs, including categorical programs. Under the pay-as-you-go method, the unfunded liability unfairly burdens the unrestricted general fund. The pay-as-you-go method also drastically understates the actual cost of each district employee; the cost lags considerably because expenses are not recognized until the employee actually retires. All other employee costs are expensed during employment.

According to the Office of Management and Budget, *Circular A-87, Cost Principles for State, Local, and Indian Tribal Governments*, post-retirement health benefits may be equitably charged to federal categorical funds based on either the pay-as-you-go method or the actuarially determined GAAP-

compliant expense, if an irrevocable trust is in place. Specifically, the circular states the following:

a. To be allowable in the current year, the post-retirement health benefit (PRHB) costs must be paid either to:
   1. An insurer or other benefit provider as current year costs or premiums, or
   2. An insurer or trustee to maintain a trust fund or reserve for the sole purpose of providing post retirement benefits to retirees and other beneficiaries.

This circular goes on to state that an equitable portion of the prior unfunded liability also may be charged to federal funds, as follows:

1. When a governmental unit converts to an acceptable actuarial cost method and funds PRHB costs in accordance with this method, the initial unfunded liability attributable to prior years shall be allowable if amortized over a period of years in accordance with GAAP, or, if no such GAAP period exists, over a period negotiated with the cognizant agency.

The district can therefore charge to federal categorical programs a pro-rata share of the cost of these benefits, including amortization of the prior unfunded liability, if all funds in excess of the pay-as-you-go amount level are deposited to an irrevocable trust. Although no such guidance exists for state categorical funds, the state often follows the guidelines set forth for federal grants.

The circular does not provide details about how categorical programs can be charged for retiree liabilities, so the district may generate its own method. The most acceptable method found across the state is to base the pro-rata rate on all relevant salaries. Based on GASB 45, it seems permissible to charge a rate on current costs and phase in costs of the prior unfunded liability, which most districts will probably amortize over 30 years. The amortized liability and expense will appear in the district's audited financial statements and may reduce net assets.

The method chosen should be fair and equitable to both categorical and unrestricted funds, and should be applied consistently district-wide. Like other payroll costs, it should be charged based on a rate on relevant payroll. For instance, if only teachers have lifetime benefits, then charges for lifetime benefits should be based only on teachers' salaries.

Whatever method the district chooses, it should be fully documented and the records retained indefinitely. Documentation is critical because these new requirements will receive much attention in the near future. In addition, the rate should be recalculated each time a new actuarial report is received. As more districts implement the new standards, it will be possible to see what methods other districts are using.

If you have any questions, please do not hesitate to contact Business Advisory Services.