

Accounting for Retiree Health Care: An Overview of GASB OPEB

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Presentation Outline

- GASB OPEB Overview
- Proposed Standards for Employers Sponsoring OPEB
- Proposed Standards for OPEB Plans
- Potential Impact

GASB Overview

- Governmental Accounting Standards Board
 - Nonprofit organization established in 1984 under the Financial Accounting Foundation
 - 7 member Board appointed by Foundation and selected from individuals knowledgeable about governmental accounting
- Establishes financial accounting and reporting standards applicable to state and local governments
 - Governments that do not follow the standards will have this noted in the auditor's opinion that is included with their annual financial reports

GASB OPEB Project Importance

- Establishes the financial reporting framework for measuring and reporting OPEB benefits sponsored by governmental entities
- Sets the context for future discussions of the design and sustainability of retiree health care offered by state and local governments
- Final statements expected to be issued June 2004

Other Postemployment Benefits

- When promised in the form of a defined benefit, OPEB includes:
 - Postemployment Health Care Benefits
 - Medical, dental, vision, hearing, and other health-related benefits whether provided separately or through the pension plan
 - Other Benefits
 - Life insurance, disability, long-term care, etc., when provided separately from a defined benefit pension plan
- But Not
 - Termination offers or benefits that are not, in substance, compensation for services (e.g., severance pay and early retirement incentives)

Retiree Health Care

- Largest component of OPEB
- According to 1998 GFOA study, the vast majority of state governments and 2/3rds of local governments provide some form of retiree health care benefits
- Many of these arrangements were developed when costs were a few tenths of a percent of payroll
- Many employers are now paying 5% to 10% (and more) of payroll and facing dramatic increases in health care costs

GASB's Concern

- For the most part, governmental employers report OPEB costs as current expenses and fund them on a pay-as-you-go basis
- GASB sees these benefits as similar to pension benefits:
 - Accrued while employed; paid during retirement
 - Costs should be recognized when service is rendered
 - If not, financial statements fail to reflect the accrued benefit obligation and extent to which funds have accumulated to meet the obligation

GASB's General Framework

- Establish uniform standards for OPEB, consistent with pension standards and actuarial standards of practice
- GASB's primary change would be to require measurement of long-term OPEB costs through an actuarial valuation
- Valuation to be done in accordance with certain constraints (parameters) related to:
 - Definition of the plan – the “Substantive Plan”
 - Frequency of valuations
 - Actuarial methods and assumptions, etc.

The Substantive Plan

- The terms of the plan as understood by the employer and employees
- Evidenced by:
 - written plan documents, other written communications
 - established pattern of cost sharing
- Projected benefits based on benefits approved and communicated to members at time of valuation
 - including legal or contractual caps on the employer's share, if the cap is assumed to be effective given its record of enforcement

Valuation Parameters

- Valuation Frequency – at least every
 - 2 years for plans with 200 or more total members
 - 3 years for plans with less than 200 total members
 - Sooner if a change occurs that significantly affects costs
- Actuarial Methods
 - Entry age, frozen entry age, attained age, frozen attained age, projected unit credit, aggregate
 - If aggregate method, UAAL and funding ratio must be based on entry age method
- Actuarial Assumptions
 - Generally guided by Actuarial Standards of Practice
 - Interest rate assumption should reflect the long-term yield on investments expected to finance the benefits

Valuation Parameters (cont.)

- Maximum/Minimum Amortization Period
 - 30 year maximum amortization period
 - 10 year minimum, if significant decrease in actuarial liability results from change in actuarial cost method or change in method used to value assets
- Liability at Transition
 - Zero for sole employer and agent plans
 - But employer may elect to disclose if consistently calculated data are available
- Actuarial Value of Assets
 - Market related (market or smoothed market)

Investment Return Assumption

- If OPEB assets are held in trust, GASB would allow assumed investment return to reflect the diversified mix of stocks and bonds held by the trust.
- If OPEB assets are not held in trust (e.g., are in a fund earmarked by the employer), assumed return may only reflect the return on assets available to the employer (e.g., short-term, fixed-income securities).
- Could mean the difference between an 8% return assumption and a 4% return assumption – a significant incentive for holding the assets in trust.
- Note: trusts include equivalent arrangements in which:
 - Employer contributions are irrevocable and dedicated to providing benefits in accordance with the terms of the plan, and
 - Fund assets are legally protected from creditors.

OPEB Standards for Employers

- Standards would apply to employers sponsoring OPEB through a defined benefit approach
- But not those sponsoring OPEB through a defined contribution approach

OPEB Cost/Obligation for Employers

Providing OPEB through Single-Employer or Agent Multiple-Employer Defined Benefit OPEB Plans

- **Employer OPEB Cost =**
 - Annual Required Contribution (ARC) + interest – adjustments
- **Employer Net OPEB Obligation =**
 - Accumulated (ARC – Actual Employer Contributions)
- To count against the Net OPEB Obligation, employer contributions must be made to a trust (or equivalent arrangement) or used to pay benefits

OPEB Cost/Obligation for Employers

Providing OPEB through Cost-Sharing Multiple-Employer Defined Benefit OPEB Plans

- **Employer Cost =**
 - Contractually required contribution to cost-sharing OPEB plan
- **Employer Liability =**
 - Difference between contractually required contribution and actual contribution
- If the cost-sharing plan is not a formal trust (or equivalent arrangement), then OPEB rules for employers participating in agent multiple-employer plans apply

Other OPEB Provisions for Employers

- Note Disclosures
 - Plan Description
 - Funding Policy and Limitations (e.g., caps, 401(h))
 - OPEB Cost and Contributions Made
 - Funded Status of the Plan
 - Actuarial Methods and Assumptions
- Required Supplementary Information
 - Schedule of Funding Progress (3 valuations)
 - Schedule of Employer Contributions (3 valuations)

For Employers with DC OPEB Plans

- Employer cost = required contribution
- Employer liability/(asset) = accumulated difference between required and actual contribution
- Required note disclosures
 - Name of plan and administering entity
 - Plan provisions and authority for administering and amending them
 - Contribution requirements for employer, employees, and others, as well as authority for amending the requirements
 - Contributions actually made

OPEB Provisions for DB OPEB Plans

- Provisions applicable to all types of defined benefit OPEB plans, regardless of whether they are single employer, agent, or cost-sharing multiple-employer plans
- Assets that are not irrevocably set aside in trust (or an equivalent arrangement) are considered employer assets, rather than plan assets

OPEB Provisions for DB OPEB Plans

- Financial Statements
 - Statement of Plan Net Assets
 - Assets, Liabilities, Net Assets
 - Investments at Fair Value
 - Statement of Changes in Plan Net Assets
 - Additions, Deductions, Net Increase (Decrease)
 - Investment expenses shown separately
- Required Supplementary Information
 - Schedule of Funding Progress (3 valuations)
 - Schedule of Employer Contributions (3 valuations)

OPEB Provisions for DB OPEB Plans

- Notes to the Financial Statements
 - Plan description
 - Significant accounting policies and limitations (e.g., caps, 401(h))
 - Contributions and reserves
 - Concentration of credit risk (5%+ in one issuer)
 - Funding status and progress
 - Actuarial methods and assumptions

Alternative Measurement Method for Small Plans

- For single-employer OPEB plans with fewer than 100 total plan members (including active, terminated vested, and retired members)
- Uses the same general calculations performed in an actuarial valuation (including all 6 methods), but allows some simplifying assumptions
- Requires use of age-adjusted premiums and provides an adjustment method when only the blended premium is known

Implicit Rate Subsidy

- In some cases, governments provide retirees with access to group health care and charge them a premium based on the blended rate for active and retired members
- Earlier in its deliberations, GASB did not plan to include this implicit subsidy as an OPEB cost when the retiree paid 100% of the premium
- GASB has reconsidered – it now considers the subsidy significant and should be treated as an OPEB cost

OPEB Effective Dates

| Total Annual Revenues 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 <u>Beginning After</u> | OPEB Statement will be Effective for the Plan for Periods <u>Beginning After</u> |
|--|--|---|
| Phase 1 Government --\$100 million or more | December 15, 2006 | December 15, 2005 |
| Phase 2 Government --\$10 million or more, but less than \$100 million | December 15, 2007 | December 15, 2006 |
| Phase 3 Government --Less than \$10 million | December 15, 2008 | December 15, 2007 |

Potential Impact

- OPEB is likely to have a significant impact on retiree health care plan design, sponsorship and funding:
 - Likely that increasing retiree health care costs will cause employers to reevaluate plan design
 - Likely that the advantages of holding assets in trust will cause employers to establish trusts for retiree health care plan assets