



National Conference on Public
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GASB 45 Survey of NCPERS Members

In June, 2004 the Governmental Accounting Standards Board issued Statement No. 45 (GASB 45) which establishes uniform financial reporting and accounting standards for state and local governmental entities related to post-employment benefits other than pensions (OPEB). The Statement requires that expenses associated with OPEB benefits, primarily retiree medical, be accrued over the working lifetime of employees, rather than expensed on a pay-as-you-go basis as retirees incur claims.

To help NCPERS members get a better sense of what other members are doing with regard to the requirements of GASB 45, NCPERS and Gallagher Benefit Services conducted an online survey of its membership. Since this was a voluntary survey, and there were a limited number of responses (74), our results are not to be considered as a random sample.

According to the survey, nearly two-thirds of the participating entities have already completed their initial GASB valuations, while another 23.9 percent were in the process of having their obligations valued. Only 9.9 percent had not yet begun the valuation process.

Liabilities vary widely among entities, depending upon the plan design, retiree contribution levels, and the employer's demographics. Our respondents are large employers, and that is reflected in their obligations: 28.8 percent of respondents had OPEB liabilities exceeding \$500 million, while 15.1 percent had liabilities of less than \$50 million.

While GASB 45 does not require a funding methodology for entities with OPEB liabilities, some plans have already determined how they plan to meet their obligations. Nearly seven percent of surveyed entities expect to partially or fully fund the actuarial accrued liability (AAL); 11 percent plan to fully fund the actuarially required contribution (ARC); 19.2 percent will partially fund the ARC; and 21.9 percent plan to continue paying for the obligations on a pay-as-you-go basis. More than 50 percent of respondents have yet to determine how they will pay their OPEB obligations going forward.

Lastly, in response to GASB 45, plan sponsors may consider changes to eligibility for retiree benefits (age and service requirements), benefit design, and how much retirees are required to pay for coverage.



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NCPERS – Gallagher Benefit Services GASB 45 Survey

In June, 2004 the Governmental Accounting Standards Board issued Statement No. 45 (GASB 45) which establishes uniform financial reporting and accounting standards for state and local governmental entities related to post-employment benefits other than pensions (OPEB). The Statement requires that expenses associated with OPEB benefits, primarily retiree medical, be accrued over the working lifetime of employees, rather than expensed on a pay-as-you-go basis as retirees incur claims.

Effective Date

GASB 45 requires that governmental entities begin reporting in accordance with the new statement over the next several years, depending on the entity's annual revenues. GASB's rules become effective for fiscal years beginning after December 15, 2006 for public sector employers with annual revenues in excess of \$100 million; after December 15, 2007 for employers with annual revenues of \$10-100 million, and after December 15, 2008 for employers with annual revenues of less than \$10 million.

Depending upon the plan design, retiree contribution levels, and the employer's demographics, the impact of GASB 45 on the employer's financial statements can be quite dramatic. For example consider a county employer with 1,200 employees and 400 retirees that provides generous benefits with limited retiree contributions. The accrued liability is \$150,000,000. This employer's annual costs under the statement's rules are \$15 million, more than five times their pay-as-you go cost of \$2.7 million.

Employers will have to make important decisions about whether, how and how much to fund their plans, and whether and how to modify the benefits that are being provided.

NCPERS – Gallagher Benefit Services GASB 45 Survey

Many plan sponsors and participants have expressed interest in finding out where other entities stand on GASB 45 adoption and what decisions they have made regarding funding and plan design changes. To help NCPERS members get a better sense of what other members are doing, NCPERS and Gallagher Benefit Services conducted an on-line membership survey. Since this was a voluntary survey, and there were a limited number of responses (74), our results are not to be considered as a random sample.

Profile of respondents

The profile of respondents by type of plan sponsor is shown below:

City	28
Fire and/or police	19
State	12
County	8
Education	1
Other	6
Total	74



The profile of our respondents by annual revenues is very different than what would be expected in the general population, where most entities have annual revenues of less than \$100 million.

Annual Revenue	No.	Pct.
\$100 Million or more	46	62%
\$ 10 MM or more but <\$100MM	9	13
Less than \$ 10 Million	7	9
Unknown	12	16
Total	74	100%

Initial GASB Valuation Status

Our respondents have also been more diligent than the general population in beginning the initial valuation:

Chart I: Initial GASB 45 valuation status

	Counts	Percents	0	100
Completed	47	66.2%		
In process	17	23.9%		
Not started	7	9.9%		
Totals	71	100.0%		

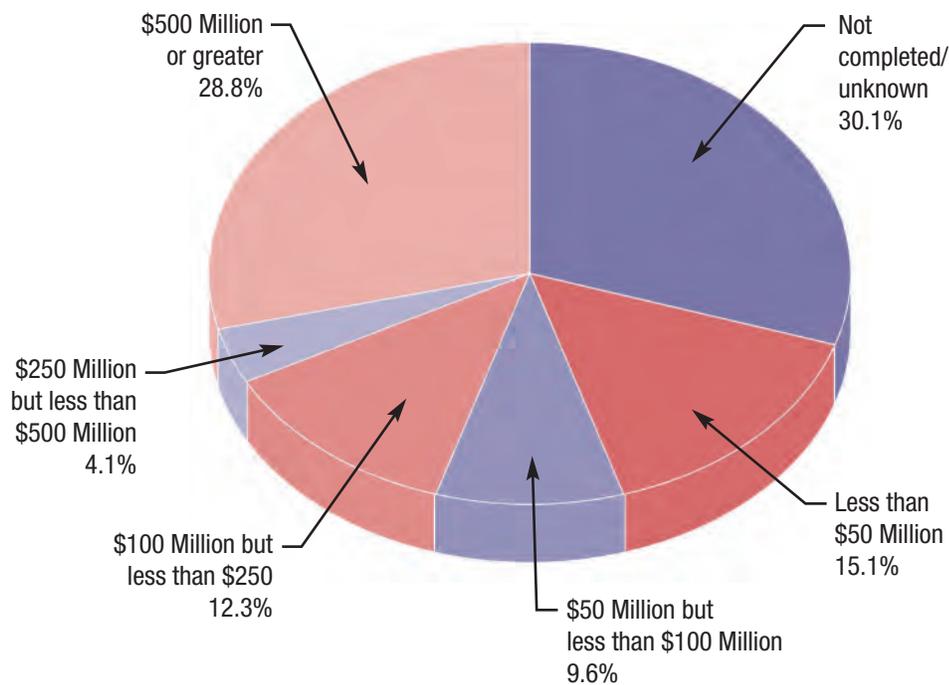
As expected, larger employers are further along in completing their initial valuations than the smallest entities.

Valuation status	Phase 1	Phase 2	Phase 3
Completed	71%	78%	33%
In process	20	22	67
Not started	9	0	0



GASB 45 Actuarial Accrued Liability

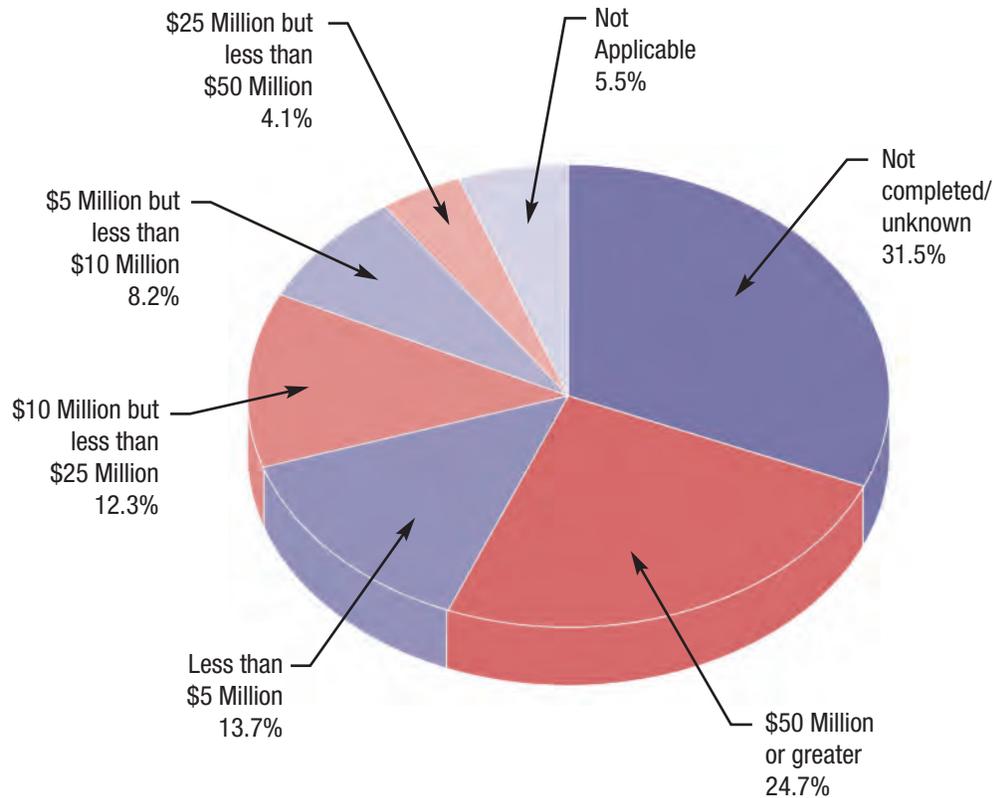
Nationwide, the OPEB liability has been estimated to be as much as \$1.3 trillion. Liabilities vary widely among entities, depending upon the plan design, retiree contribution levels, and the employer's demographics. Our respondents are large employers, and that is reflected in their liability:





GASB 45 Annual Required Contribution

Under GASB’s guidelines, single-employer OPEB plans are required to determine an Annual Required Contribution to the Plan (“ARC”) equal to the normal cost (the value of benefits being earned each year) plus an amortization of unfunded liabilities (the value of benefits previously earned less any assets accumulated to pay the benefits). Further, public employers will need to establish liabilities on their balance sheets equal to any recognized expense that has not been funded. There is a high correlation between accrued liability and ARC, since one of the expense components is an amortization of the unfunded liability. A large percentage of our respondents have an ARC of over \$50 million:





Retiree Healthcare Benefit Eligibility

Eligibility to receive retiree healthcare benefits varies widely between states, and among governments within state borders. Most of our respondents provide benefits to their retirees:

Chart 4: My public employer offers retiree healthcare benefits to eligible:

	Counts	Percents	0	100
Early and Medicare retirees	60	82.2%		
Neither Early or Medicare retirees	8	11.0%		
Early (pre-Medicare) retirees only	3	4.1%		
Unknown	2	2.7%		
Medicare retirees only	0	0.0%		
Totals	73	100.0%		

As shown above, retiree healthcare benefits are widely provided to both early and Medicare retirees. The variation in this coverage by type of plan and annual revenues is shown below:

By type		By revenue	
City	89%	Phase 1	96%
Fire/Police	63	Phase 2	78
State	83	Phase 3	71
County	88		



Implicit and Explicit Subsidy

The most obvious liability that GASB addresses is the direct contribution that an employer pays toward the cost of retiree health care. However, public employers that combine active and retiree claims experience to arrive at a “blended cost,” which becomes the cost basis for retiree’s coverage, will have to recognize the *implicit* subsidy associated with retiree coverage.

The blended cost technique is widely used, and in many states public employers are prohibited by law from charging more than this blended cost. In most cases, the true cost associated with retirees is greater than the blended active and retiree cost. If so, even if retirees pay 100% of the blended cost, there is still a cost to the employer (the implicit subsidy), and under GASB 45 the employer must recognize it.

The percentage of our respondents that provide explicit healthcare subsidies by retiree category, is shown in the chart below:

Chart 5: My public employer provides some direct (explicit) retiree healthcare subsidies for eligible:

	Counts	Percents	Percents	
			0	100
Early and Medicare retirees	47	64.4%		
Neither Early or Medicare retirees	13	17.8%		
Early (pre-Medicare) retirees only	6	8.2%		
Unknown	5	6.8%		
Medicare retirees only	2	2.7%		
Totals	73	100.0%		

The percentage of our respondents that provide explicit healthcare subsidies to both early and Medicare retirees by type of plan sponsor and annual revenues, is shown in the chart below:

By type		By revenue	
City	67%	Phase 1	74%
Fire/Police	58	Phase 2	67
State	83	Phase 3	50
County	50		

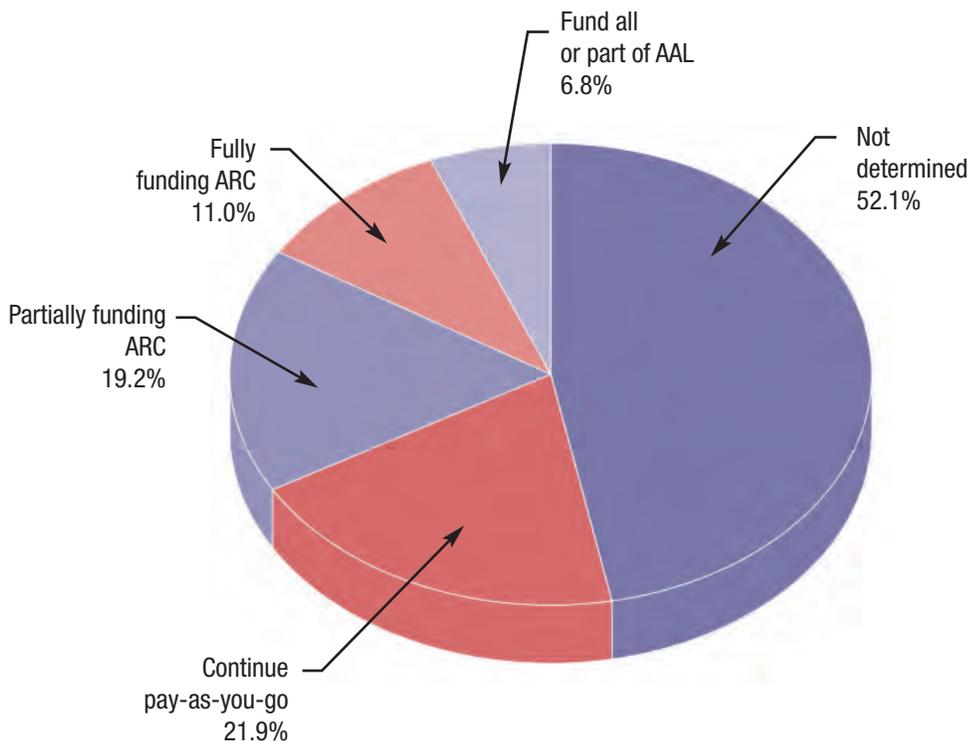


Funding

GASB rules do not require the employer to accelerate funding of their retiree medical plans. Therefore, employers may choose from a broad range of funding options. To preserve cash, employers may continue to use pay-as-you-go. However, an OPEB obligation will build on the balance sheet, equal to the cumulative difference between the ARC and the pay-as-you-go expense. Credit rating agencies may view this obligation negatively when setting ratings, impacting the ability of the entity to borrow and the cost of borrowing may increase.

Employers may choose to contribute the ARC, pre-fund their obligations by making accelerated payments, or even consider issuing OPEB bonds, to reduce the ultimate cost of providing benefits through the higher investment returns that may be available.

Most of our survey respondents have not determined whether they will fund their ARC, or have decided to continue to use pay-as-you-go.





Historically, very few plan sponsors have elected to fund their OPEB obligations. This is borne out in the funded ratio chart shown below:

Funded ratio	Percent
0 %	64%
1 – 24%	25
25 – 49%	4
50 – 74 %	4
75 – 99%	0
> 100%	4

There are a variety of vehicles that are available to accumulate assets to pay for OPEB liabilities, though not all vehicles may be available in all states. Our respondents have adopted many different approaches:

Chart 7: If you indicated in your response to #6 above that your public employer is funding its ARC and/or AAL, which funding method(s) are you currently using? (check all that apply)

	Counts	Percents	0	100
Other	9	16.7%		
Secion 115 or Integral Trust	8	14.8%		
VEBA Trust	5	9.3%		
Asset sale or transfer	3	5.6%		
401 (h) medical account	2	3.7%		
OPEB bonds	1	1.9%		
Not Applicable	29	53.7%		
Totals	54	n/a		



Employer Response

In response to GASB 45, plan sponsors may consider changes to eligibility for retiree benefits (age and service requirements), benefit design, and how much retirees are required to pay for coverage. Our respondents are considering all of these options:

Changing eligibility	68%
Changing retiree contributions	55%
Changing plan design	50%
Drop retiree healthcare pre – Medicare	7%
Drop retiree healthcare post – Medicare	2%



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