Fact Sheet

What is GASB 45?

In 2004, the Governmental Accounting Standards Board (GASB) issued Statement 45, "Accounting and Financial Reporting by Employers for Post-Employment Benefits Other Than Pensions," which requires public agencies to report their costs and obligations pertaining to health and other benefits of current and future retired employees much like they now report pension plan obligations. These other post-employment benefits (OPEBs) — including such benefits as medical, dental, vision, hearing, life insurance, long-term care and long-term disability — must be recognized as a current cost during the working years of an employee. Thus, each district and county office of education must identify and disclose OPEBs as an expense and, to the extent not pre-funded, a liability on its financial statements.

The effective date of the GASB 45 requirements will be phased in over three years based on the district's or county office's annual revenues in fiscal year 1998-99, as follows:

Fiscal Year	*Annual Revenue*
2007-08	$100 million or more
2008-09	$10-100 million
2009-10	less than $10 million

Ensuring compliance with GASB 45 and making appropriate decisions for the fiscal health of the agency require an understanding of two separate and distinct financial aspects of retiree benefits: funding (for cash flow) and expensing (for the district's or county office's income statement). Most of the confusion surrounding any discussion of retiree benefits derives from an unintentional blurring of these two aspects.

"Funding" refers to the method used to pay the costs of retiree benefits. Most districts and county offices have used a pay-as-you-go method of funding retiree benefits, paying the current cost of retiree health care premiums in a given fiscal year. By using this method, however, districts and county offices are not making adequate provisions for future retirees, and are accruing a deficit with respect to those retirees that can be expected to increase as a result of both an ever-increasing retiree population and increases in benefit costs.

"Expensing" deals with how retiree benefits are accounted for. GASB 45 requires health and welfare benefits to be booked on an accrual basis over the retiree's active working lifetime.

Rather than simply entering the current cost of retiree health care premiums on its financial statements as the expense item for a given fiscal year, the district or county office will need to have its annual expense calculated by an actuary under the GASB 45 guidelines. GASB 45 permits a choice of six actuarial cost methods to determine the annual expense. For simplicity's sake, many actuaries prefer to use the "unit credit" actuarial cost method, under which an employee is assumed to earn retiree health benefits ratably over his or her working career. For example, a 30-year employee may be assumed to earn 1/30th of his or her benefit each year. By retirement, all benefits are assumed fully accrued.

Impact of GASB 45 on Local Educational Agency Finances

A survey conducted by CSBA in fall 2004 found that between 500 and 600 districts and county offices of education in California offer the types of benefits that are accounted for under GASB 45. Many would have large unfunded liabilities for these benefits if they made the change to GASB 45 accrual accounting today. For example, in the "Analysis of the 2005-06 Budget Bill," the Legislative Analyst's Office reported that one district's estimated liability for retiree benefits was about 80 percent of its general-purpose annual operating budget, and another district's was almost twice its annual budget.

These issues certainly demand attention from the board, superintendent and fiscal staff so that the costs of these benefits do not cause serious financial hardship in the future.

Board Considerations

It is important that districts and county offices assess the impact of any unfunded liabilities on their current and future finances so that steps can be taken to mitigate this impact. Boards should consider the following questions:

- **Does the district or county office currently provide benefits for retired employees other than pension benefits? Is this something that is being considered?**

  GASB 45 applies only to employers that offer OPEBs.

- **What method is currently used in the district or county office to account for health and welfare benefits for retired employees?**

  If the district or county office has been using a pay-as-you-go method of expensing retiree benefits, the board needs to be aware that this method will no longer be allowed once GASB 45 is effective.

- **What is the district's or county office's current unfunded liability? As a percentage of current-year income?**

  To estimate the liability of retiree benefits, boards should have an actuarial valuation performed. An actuarial valuation will be needed every two or three years depending on the number of benefit plan participants (i.e., retirees and active employees accruing future benefits).

- **Based on GASB 45 guidelines, what annual expense will be reported on the financial statements?**

  The actuarial valuation performed every two or three years will list the estimated annual expense under GASB 45 guidelines for that time period. Reporting the amount of annual expense, while subject to certain flexibilities inherent in GASB 45, is not discretionary.

- **What options does the board have for revising the benefit plan?**

  Reducing the number of retirees entitled to these benefits is one way to reduce the liability exposure. If retiree benefits are addressed in a collective bargaining agreement, the board would need to renegotiate these provisions in order to affect its future obligation for these benefits.

- **What options does the board have for setting aside money to cover the future costs of retiree benefits?**

  Options may include utilizing an irrevocable trust and contributing more funds into the irrevocable trust each year to reduce future liabilities. There have always been good reasons to pre-fund (i.e., set aside money to cover these future costs), completely independent of the advent of GASB 45. An actuary may assist in determining an appropriate amount to budget each year for pre-funding of retiree benefits. However, pre-funding is optional, and if a board does decide to pre-fund, the amount of pre-funding is discretionary.

  The amount the board decides to budget in a given fiscal year, including amounts to cover current retiree premiums/claims and amounts earmarked for pre-funding, need not bear any relationship to the amount expensed under GASB 45 for that year. If they are not equal, it is reconciled by means of a balance sheet liability or asset. If the district or county office expenses more than it funds, it develops a liability account that grows on a cumulative basis over the years. If the district or county office funds more than it expenses (which can happen in the case of a district with a significant retiree fund and a cutoff hire date for benefit eligibility), it develops a prepaid asset account on its balance sheet, again equal to the cumulative difference between accumulated assets and expense amounts.

  In the short run, the pre-funding amount and GASB 45 expense may differ, and the district or county office should feel at ease with this arrangement. In the long run, it's a good idea to avoid an ever-increasing balance sheet liability. The theory goes that if the balance sheet liability gets big enough, it will bespeak a lack of fiscal soundness; it may affect credit decisions, bond ratings and other financial health measures. Avoiding a large balance sheet liability can be accomplished by pre-funding according to an ongoing policy that balances current cash flow needs against considerations of fiscal soundness.

Resources

CSBA, in partnership with several professional firms, offers the “GASB 45 Solutions” program which provides access to qualified actuaries to estimate the GASB 45 liability; recommended strategies to address the unfunded GASB 45 liability; a GASB 45-compliant trust to pre-fund future obligations; a trustee to safeguard and administer funds; year-round administrative and compliance support; an investment oversight committee to review investment strategies and performance; a broad selection of investment strategies which include equity and fixed income products; and detailed investment and trust reports. For further information, see CSBA’s Web site at www.csba.org/ds/gasb45.htm or contact CSBA’s District and Financial Services office at 800-266-3382.

Source: This fact sheet is based on information provided by T. Louis Filliger, FSA, Demsey, Filliger and Associates.