

New Accounting Rules for Retiree Insurance Benefits

What is the Governmental Accounting Standards Board?

The Governmental Accounting Standards Board (GASB) establishes standards for accounting and reporting by state and local governments. It is an independent, non-profit organization, funded by contributions from states and local governments. GASB members include preparers, auditors and users of financial statements, and academicians.

What is GASB 45?

GASB Statement 45 is an accounting rule that requires state and local governments to provide more information in their financial reports about benefits – other than pensions – offered to retirees. GASB 45 changes the way governments report the cost of these “other post-employment benefits” such as retiree health insurance, in their financial statements.

While this is a change for *financial reporting*, it is *not a change in benefits or in costs* to the state. For Washington state government the change in financial reporting may make it look like the state has a new liability when in fact the benefits and the obligations of the state do not change at all.

GASB rules require the use of the term “liability” but these retiree insurance benefits reported by the state are not contractual obligations. Instead, for Washington the liability is an estimate of long term expected costs arrived at by projecting past practices. Other states and local governments may be in a different situation depending on the way they provide these benefits.

What are Other Post-Employment Benefits?

Other post-employment benefits (OPEB) are benefits other than pensions, like health insurance benefits, that are provided to retirees. Washington allows retirees who are not yet eligible for Medicare to buy health insurance at group rates as part of a ‘community pool’ of employees and retirees. Retirees pay the full cost of their benefits but they buy them at a lower price than they would pay if they were to purchase the insurance coverage on their own. Each retiree that participates in the community pool saves an estimated \$263 dollars a month this way. The state also provides a subsidy to Medicare-eligible retirees who purchase additional coverage. For 2008, this subsidy costs \$164 dollars a month per retiree.

How are Other Post-Employment Benefits funded?

In Washington, retiree insurance benefits are set each biennium as part of the budget process. The benefits are funded on a pay-as-you-go basis, which means that each budget covers the benefits to be provided during that budget period. By comparison, pension benefits are set in statute and are generally pre-funded, which sets aside money now to cover benefits that may be paid in the future. In some states, OPEB benefits are earned or accrued by employees over time like pension benefits. While this is not the case in

Washington, GASB 45 requires that OPEB and pension benefits be accounted for in the same way as pensions even though their funding structures are different.

What is the cost of retiree insurance now?

The current yearly cost of retiree insurance is \$67 million, including both the value of allowing retirees not yet eligible for Medicare to pay community pool rates (the implicit subsidy)) and the explicit subsidy for Medicare retirees purchasing additional coverage. Meanwhile, the federal government sends an estimated \$24 million to the state for to pay for providing a prescription drug benefit that would otherwise be provided by Medicare Part D, but GASB 45 does not allow this to count as an offset. This is an important difference between government accounting rules and the rules for private firms where a similar accounting rule allows federal Medicare funds to offset a firm’s future costs.

When is GASB 45 imposed?

Depending on their size, public entities are required to start providing the information specified by GASB 45 in financial reports for fiscal years 2007-08 through 2009-10. Washington is required to include the information in its fiscal year 2008 financial reports, expected to be published in December 2008.

To whom does GASB 45 apply?

The new method of reporting applies to all state and local governments including cities, counties, and school districts.

What is the state’s “actuarial accrued liability” for other post-employment benefits for retirees?

Even though these benefits are established each biennium and are not a contractual obligation, GASB 45 requires that they be reported *as if they were contractual obligations*, that are accrued over time. Solely to conform to these rules and requirements, Washington’s “liability” reported under GASB is estimated by the State Actuary estimates that the “Actuarial Accrued Liability” is \$3.8 billion for the state, \$3.4 billion for K-12 employers, and \$340 million for other political subdivisions that participate in the state’s insurance plan.

What is the “annual required contribution” referred to in the GASB rule?

Assuming pre-funding were appropriate or desired for Washington state, the Annual Required Contribution (ARC) is an amount the state would need to contribute each year to pre-fund other post-employment benefits in a manner similar to pension funding. Even though GASB 45 requires governments to disclose what their ARC would be, no government is *required to actually make such a contribution*. This is an accounting and reporting requirement – not a funding requirement.

What happens if the state doesn’t make the annual required contribution?

If the state does not make an annual required contribution (ARC) outlined in the GASB rule, the state must make a record of a “liability” for the difference between the amount contributed for OPEB and the ARC amount.

How did the actuary estimate the state’s “liability”?

In order to determine the GASB 45 liability amount for the state, the actuary did an actuarial valuation, which is a way to determine what benefits are projected to be paid over the lifetimes of current plan members. To make this actuarial valuation, the actuary needed data on who gets benefits, what benefits are provided, how they are funded, and various other assumptions as to how members and economy are expected to behave.

In terms of the benefit provided, the actuary assumed the current practices of retiree participation in the community health insurance pool and the subsidy for Medicare-eligible retirees would continue – even though there is no legal obligation on the part of the state to do this. The actuary also had to disregard the federal payments to the state of about \$24 million a year for prescription drug coverage for Medicare-eligible retirees (but these payments are included in calculations under rules for private employers while being excluded under GASB 45 rules).

What does this mean for Washington state government?

We welcome the visibility and transparency that GASB 45 tries to bring to this important issue. While disclosing the actuarial estimate under GASB provides valuable transparency to our financial statements, Washington’s OPEB amount is for a benefit that is provided at the discretion of each Legislature. This is a different situation than what may apply to other states and local governments where OPEB benefits are an obligation.

While pre-funding could allow the calculations to be made in a way that makes the amount disclosed on financial statements appear smaller, and could also be invested to earn interest to help pay for benefits, pre-funding would have to be done through an irrevocable trust. This means we could unintentionally create an obligation where none now exists by setting up a fund that can be used for no other purpose.

The state currently does not have a contractual obligation to provide these benefits. Putting contributions into an irrevocable trust for pre-funding could apply permanent funding to benefits that can change with each Legislature.

Should Washington reduce retiree insurance benefits to affect this liability?

No. The modest benefits Washington provides have been affordable on a pay-as-you-go basis in past and are expected to remain affordable well into the future. While some governments pay for the complete cost of retiree medical insurance, Washington retirees pay most of the cost of their insurance themselves. Instead, Washington is focused on exercising comprehensive cost control in health care purchasing, which will be essential in keeping benefits affordable for the state as well as for both active and retired workers.

Is this the only estimate the state will have of its cost for these benefits?

No, it is not. GASB 45 requires the state to obtain an actuarial valuation of the cost of these other post employment benefits every two years.