Summary of GASB 43 and 45

by

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A. Introduction - The Government Accounting Standards Board (GASB) issued Statement No. 43 of the GASB (GASB 43) entitled "Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans" in April, 2004. GASB issued GASB 45 entitled "Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions" in June, 2004.

The purpose of GASB 43 is to require the accrual of liabilities in plans providing other postemployment benefits (OPEBs) generally over the working career of plan members rather than on a pay-as-you-go basis which is the current practice for most government sponsored plans. The purpose of GASB 45 is to require the accrual of the OPEB expense over the same period of time.

B. Benefits included in OPEBs - With the exception of postemployment healthcare benefits OPEBs generally include any benefit not provided under a pension plan. Postemployment healthcare benefits are covered by GASB 43 and 45 even if provided through a defined benefit pension plan. Besides healthcare benefits, OPEBs include life insurance, disability, and long-term care benefits when they are provided separately from a defined benefit pension plan.

C. Effective dates - For the purposes of defining the effective date of the standards, GASB 43 and 45 use the terms *phase 1 government, phase 2 government* and *phase 3 government* where such terms are defined in GASB 34, paragraph 143. The following table shows the definition of these three phases and their respective GASB 43 and 45 effective dates:

Phase	Total annual revenues (1)	GASB 43 applies for periods beginning after the following dates:	GASB 45 applies for periods beginning after the following dates:
1	$100,000,000 or more	12/15/05	12/15/06
2	$10,000,000 - $100,000,000	12/15/06	12/15/07
3	Less than $10,000,000	12/15/07	12/15/08

Note 1 - Based on a government's total annual revenues in the first year ending after 6/15/99.

D. Summary overview- Although GASB 43 and 45 are accounting standards, they require a significant number of actuarial calculations. Conceptually, the accounting entries are based on the actuarial calculations and vary to some extent depending on the type of government financial statement to which the Statement applies.

For the sake of simplicity, this summary focuses only on the actuarial calculations which do not vary by type of financial statement except for a simplified alternative measurement method that would be available to employers in plans with fewer than 100 members. A further simplification is made in this summary by not considering certain adjusting calculations that might be required in the second and subsequent years by employers.

E. Actuarial calculations overview

1. Actuarial valuation - The actuarial calculations are performed in what is referred to as an actuarial valuation. The frequency of the actuarial valuation depends on the total membership as shown in the following table:

Total Membership (1)	Required Frequency
200 or more	At least biennially
Fewer than 200	At least triennially

Note 1 - Total membership is the sum of the number of employees in active service, terminated employees who have accumulated benefits but are not yet receiving them and retired employees and beneficiaries currently receiving benefits.

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

a. Actuarial cost method
b. Actuarial assumptions
c. Plan assets
d. Employer census data

2. Actuarial cost methods - There are the following six acceptable actuarial cost methods:

   a. Entry age
   b. Frozen entry age
   c. Attained age
   d. Frozen attained age
   e. Projected unit credit (with unprojected unit credit being acceptable in certain situations)
   f. Aggregate

   All methods differ only in the manner in which they amortize the value of benefits which are generally split between benefits related to past and future service. None of the methods can be characterized as overly aggressive or conservative from the standpoint of the results generated. For this reason, with the exception of the Aggregate method, there does not seem to be any inherent advantage or disadvantage in any of the methods. The Aggregate method does have the disadvantage of not generating some form of actuarial accrued liability which is required for the notes to the financial statement. For this reason, it does have a disadvantage in this regard.

3. Actuarial assumptions - The following are the common actuarial assumptions used in a valuation:

   a. Demographic - the probability of the following events occurring at various ages:

      i. Dying
      ii. Terminating employment
      iii. Becoming disabled
      iv. Retiring
      v. Being married at retirement
      vi. Electing coverage in a contributory plan

   b. Economic

      i. Investment return
      ii. Healthcare cost trend rate
      iii. Current cost of healthcare coverage
      iv. Compensation increases
      v. Plan expenses

4. Plan assets - In order to be considered for the purposes of the Statement, assets must be transferred irrevocably to a trust for the sole purpose of paying benefits to plan participants when they become due. Earmarking of employer assets or other means of financing that do not meet this condition do not qualify as assets for the purposes of the Statement. For the purposes of the actuarial valuation, the value of assets should generally be related to their market value. This can include using the actual market value of the assets on the valuation date or some method that averages the market value over some period of time.

5. Employer census data - This will generally include various demographic data on currently active employees, retirees and terminated employees if they will be eligible for benefits some time in the future.

6. Plan - The plan comprises the provisions as generally understood by the employer and employees. This is referred to as the "substantive plan" and is generally the written plan subject, in some situations, to modification if certain written provisions do not reflect the general understanding of the parties involved. For example, if the employer has, in the past, increased the medical deductible to reflect inflation and it is generally understood that such practice will continue, the substantive plan will reflect this notwithstanding that the written document only references the current deductible. Also, it should be understood that the substantive plan includes, in most cases, benefits that are extended beyond the ending date of the current collective bargaining agreement.

7. Resulting calculations - It is easiest to view the resulting actuarial calculations as consisting of two phases as described below:

    a. Final calculation - The final step in the actuarial calculation process is the determination of the annual required contribution of the employer (ARC). The ARC is what is used to determine the expense and liability values that appear on the employer's financial statements for the purposes of GASB 45.

       It should be noted that despite the terminology used by GASB 45 (i.e. the "Annual Required Contribution"), the ARC, as well as the annual OPEB cost resulting from the ARC, do not refer to actual contribution requirements, but to the employer's accrual expense. For this reason, they should not be interpreted as an amount required to be contributed to the trust, nor should any inference be made as to whether the ARC or the annual OPEB cost would be the optimum contribution amount if the employer decides to pre-fund the plan.

    b. Calculations on which the ARC is based - Except for the Aggregate actuarial cost method, the ARC is the sum of the following:

        i. An amount calculated to amortize the unfunded actuarial liability - The Statement permits such amount to be amortized over a period of up to 30 years. Immediate recognition is permitted.

        ii. An amount equal to the value of benefits considered as being earned in the current year - This is referred to as the Normal Cost.

   The Aggregate method does not split out the unfunded actuarial liability for special amortization and, as such, the above two components are combined into a single calculation of the ARC under this method.

F. Cost sharing employers and employers with defined contribution plans - These employers should recognize an annual OPEB expense or expenditure (such term varying by the applicable type of financial statement) equal to their required contribution to the plan. Recognition should be made on either an accrual or modified accrual basis, again depending on the type of applicable financial statement.

G. <u>Financial statement notes</u> - This includes such items as the plan description, funding policy, information regarding the actuarial valuation, and other financial information related to the current cost and funding progress of the plan. Please see paragraphs 30 to 32 in GASB 43 and paragraphs 24 to 27 in GASB 45 for the items required of a plan and employer, respectively, to include in the notes to financial statements.

H. <u>Glossary</u> - This section contains the definitions included in GASB 43 & 45 that the author of this summary believes are most important.

1. <u>Agent multiple-employer plan (agent plan)</u> - An aggregation of single employer plans, with pooled administrative and investment functions. Separate accounts are maintained for each employer so that the employer's contributions provide benefits only for the employees of that employer. A separate actuarial valuation is performed for each individual employer's plan to determine the employer's periodic contribution rate and other information for the individual plan, based on the benefit formula selected by the employer and the individual plan's proportionate share of the pooled assets. The results of the individual valuations are aggregated at the administrative level.

2. <u>Annual OPEB cost</u> - An accrual-basis measure of the periodic cost of an employer's participation in a defined benefit OPEB plan.

3. <u>Annual required contributions of the employer (ARC)</u> - The employer's periodic required contributions to a defined benefit OPEB plan, calculated in accordance with the parameters.

4. <u>Cost-sharing multiple-employer plan</u> - A single plan with pooling (cost-sharing) arrangements for the participating employers. All risks, rewards, and costs, including benefit costs, are shared and are not attributed individually to the employers. A single actuarial valuation covers all plan members, and the same contribution rate(s) applies for each employer.

5. <u>Defined benefit OPEB plan</u> - An OPEB plan having terms that specify the *benefits* to be provided at or after separation from employment. The benefits may be specified in dollars (for example, a flat dollar payment or an amount based on one or more factors such as age, years of service, and compensation), or as a type or level of coverage (for example, prescription drugs or a percentage of healthcare insurance premiums).

6. <u>Defined benefit pension plan</u> - A pension plan having terms that specify the amount of pension benefits to be provided at a future date or after a certain period of time. The amount specified usually is a function of one or more factors such as age, years of service, and compensation.

7. <u>Defined contribution plan</u> - A pension or OPEB plan having terms that (a) provide an individual account for each plan member and (b) specify *how contributions to an active plan member's account are to be determined*, rather than the income or other benefits the member or his or her beneficiaries are to receive at or after separation from employment. Those benefits will depend *only* on the amounts contributed to the member's account, earnings on investments of those contributions, and forfeitures of contributions made for other members that may be allocated to the member's account. For example, an employer may contribute a specified amount to each active member's postemployment healthcare account each month. At

or after separation from employment, the balance of the account may be used by the member or on the member's behalf for the purchase of health insurance or other healthcare benefits.

8. Employer's contributions - Contributions made in relation to the annual required contributions of the employer (ARC). An employer has made a contribution in relation to the ARC if the employer has (a) made payments of benefits directly to or on behalf of a retiree or beneficiary, (b) made premium payments to an insurer, or (c) irrevocably transferred assets to a trust, or an equivalent arrangement, in which plan assets are dedicated to providing benefits to retirees and their beneficiaries in accordance with the terms of the plan and are legally protected from creditors of the employer(s) or plan administrator.

9. Healthcare cost trend rate - The rate of change in per capita health claims costs over time as a result of factors such as medical inflation, utilization of healthcare services, plan design, and technological developments.

10. Insured benefit - An OPEB financing arrangement whereby an employer pays premiums to an insurance company, *while employees are in active service*, in return for which the insurance company unconditionally undertakes an obligation to pay the postemployment benefits of those employees or their beneficiaries, as defined in the employer's plan.

11. Investment return assumption (discount rate) - The rate used to adjust a series of future payments to reflect the time value of money.

12. Market-related value of plan assets - A term used with reference to the actuarial value of assets. A market-related value may be fair value, market value (or estimated market value), or a calculated value that recognizes changes in fair value or market value over a period of, for example, three to five years.

13. Net OPEB obligation - The cumulative difference since the effective date of this Statement between annual OPEB cost and the employer's contributions to the plan, including the OPEB liability (asset) at transition, if any, and excluding (a) short-term differences and (b) unpaid contributions that have been converted to OPEB-related debt. (GASB 45 only)

14. OPEB assets - The amount recognized by an employer for contributions to an OPEB plan greater than OPEB expense. (GASB 45 only)

15. OPEB expenditures - The amount recognized by an employer in each accounting period for contributions to an OPEB plan on the modified accrual basis of accounting. (GASB 45 only)

16. OPEB expense - The amount recognized by an employer in each accounting period for contributions to an OPEB plan on the accrual basis of accounting. (GASB 45 only)

17. OPEB liabilities - The amount recognized by an employer for contributions to an OPEB plan less than OPEB expense/expenditures. (GASB 45 only)

18. OPEB-related debt - All long-term liabilities of an employer *to an OPEB plan*, the payment of which is *not* included in the annual required contributions of a sole or agent employer (ARC) or the actuarially determined required contributions of a cost-sharing employer. Payments generally are made in accordance with installment contracts that usually include

interest. Examples include contractually deferred contributions and amounts assessed to an employer upon joining a multiple-employer plan. (GASB 45 only)

19. Other postemployment benefits - Postemployment benefits other than pension benefits. Other postemployment benefits (OPEB) include postemployment healthcare benefits, regardless of the type of plan that provides them, and all postemployment benefits provided separately from a pension plan, excluding benefits defined as termination offers and benefits.

20. Pension benefits - Retirement income and all other benefits, including disability benefits, death benefits, life insurance, and other ancillary benefits, *except healthcare benefits*, that are provided through a *defined benefit* pension plan to plan members and beneficiaries after termination of employment or after retirement. Postemployment healthcare benefits are considered other postemployment benefits, whether they are provided through a defined benefit pension plan or another type of plan.

21. Plan assets - Resources, usually in the form of stocks, bonds, and other classes of investments, that have been segregated and restricted in a trust, or in an equivalent arrangement, in which (a) employer contributions to the plan are irrevocable, (b) assets are dedicated to providing benefits to retirees and their beneficiaries, and (c) assets are legally protected from creditors of the employers or plan administrator, for the payment of benefits in accordance with the terms of the plan.

22. Plan liabilities - Obligations payable by the plan at the reporting date, including, primarily, benefits and refunds due and payable to plan members and beneficiaries, and accrued investment and administrative expenses. Plan liabilities do not include actuarial accrued liabilities for benefits that are not due and payable at the reporting date. (GASB 43 only)

23. Plan members - The individuals covered by the terms of an OPEB plan. The plan membership generally includes employees in active service, terminated employees who have accumulated benefits but are not yet receiving them, and retired employees and beneficiaries currently receiving benefits.

24. Postemployment - The period between termination of employment and retirement as well as the period after retirement.

25. Postemployment healthcare benefits - Medical, dental, vision, and other health-related benefits provided to terminated or retired employees and their dependents and beneficiaries.

26. Postretirement benefit increase - An increase in the benefits of retirees or beneficiaries granted to compensate for the effects of inflation (cost-of-living adjustment) or for other reasons. *Ad hoc* increases may be granted periodically by a decision of the board of trustees, legislature, or other authoritative body; both the decision to grant an increase and the amount of the increase are discretionary. *Automatic* increases are periodic increases specified in the terms of the plan; they are nondiscretionary except to the extent that the plan terms can be changed.

27. Projected salary increase assumption - An actuarial assumption with respect to future increases in the individual salaries and wages of active plan members; used in determining the actuarial present value of total projected benefits when the benefit amounts are related to

salaries and wages. The expected increases commonly include amounts for inflation, enhanced productivity, and employee merit and seniority.

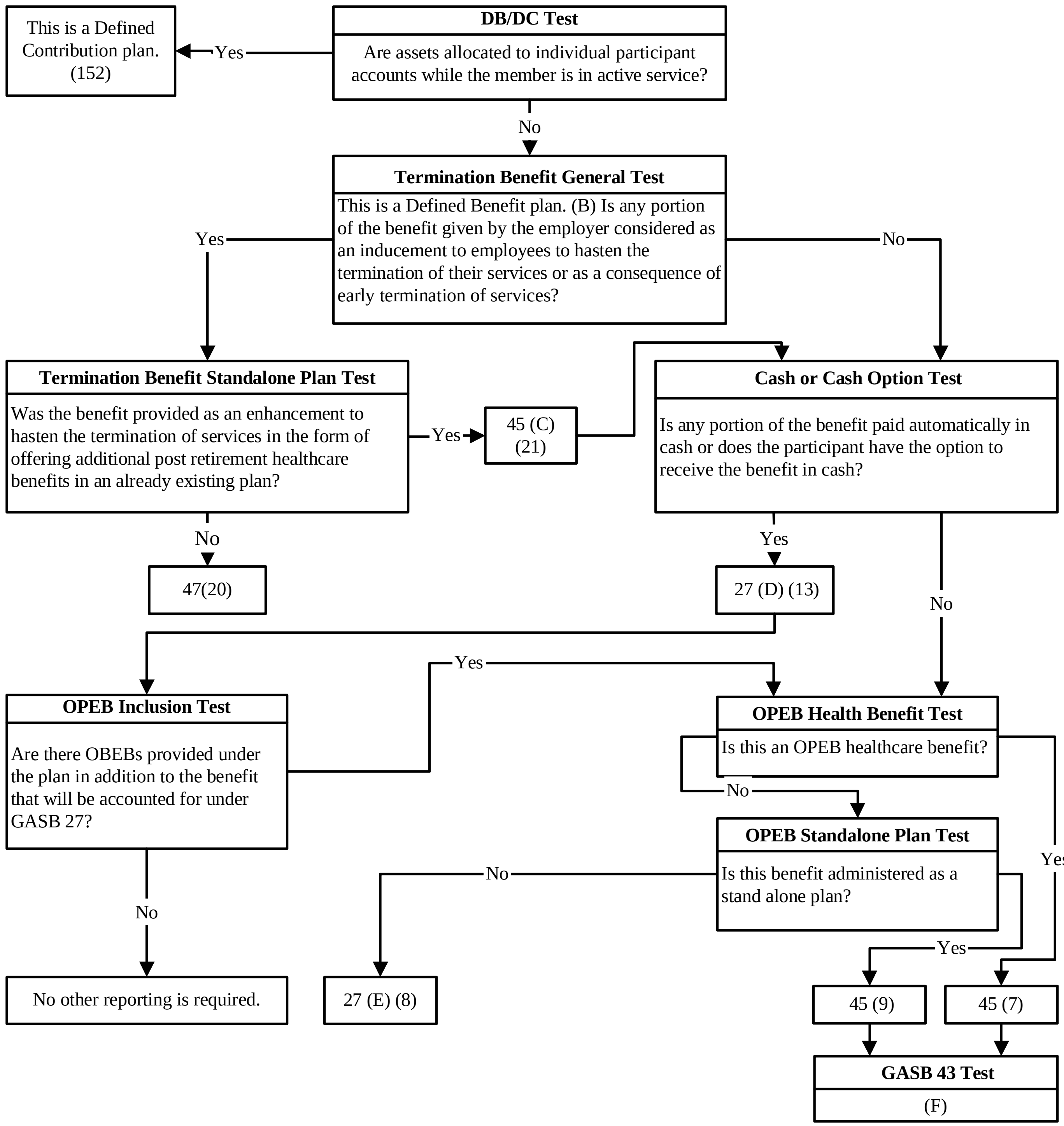
28. Single-employer plan - A plan that covers the current and former employees, including beneficiaries, of only one employer.

29. Sponsor - The entity that established the plan. The sponsor generally is the employer or one of the employers that participate in the plan to provide benefits for their employees. Sometimes, however, the sponsor establishes the plan for the employees of other entities but does not include its own employees and, therefore, is not a participating employer of that plan. An example is a state government that establishes a plan for the employees of local governments within the state, but the employees of the state government are covered by a different plan.

30. Substantive plan - The terms of an OPEB plan as understood by the employer(s) and plan members.

Plan Types and Applicable GASB Standards Decision Tree

(Please see Note A following the decision tree.)



Notes

A. This decision tree can be used to determine the applicable GASB standard for a given pension or Other Postemployement Benefits (OPEB) plan. The letters in parenthesis refer to the notes following the decision tree. The numbers in the boxes (without any parenthesis) refer to the GASB standard which applies in the given situation. The numbers in parenthesis refer to the applicable question from the Guide to Implementation of GASB Statements 43 and 45 on Other Postemployment Benefits published in June, 2005 by GASB.

B. All defined benefit plans are one of three types whose definitions in GASB 27, 43 and 45 are shown below:

1. Single-employer plan - A plan that covers the current and former employees, including beneficiaries, of only one employer.

2. Agent multiple-employer plan (agent plan) - An aggregation of single employer plans, with pooled administrative and investment functions. Separate accounts are maintained for each employer so that the employer's contributions provide benefits only for the employees of that employer. A separate actuarial valuation is performed for each individual employer's plan to determine the employer's periodic contribution rate and other information for the individual plan, based on the benefit formula selected by the employer and the individual plan's proportionate share of the pooled assets. The results of the individual valuations are aggregated at the administrative level.

3. Cost-sharing multiple-employer plan - A single plan with pooling (cost-sharing) arrangements for the participating employers. All risks, rewards, and costs, including benefit costs, are shared and are not attributed individually to the employers. A single actuarial valuation covers all plan members, and the same contribution rate(s) applies for each employer.

C. Both the existing postretirement benefits and the effects of early termination benefits are to be accounted for under GASB 45 as a single plan unless GASB 27 accounting is called for on the basis of the Cash or Cash Option Test.

D. The benefit that is paid in cash or which the participant has an option to take as cash is treated as retirement income.

E. This benefit is accounted for along with the benefit(s) that it is combined with as a single plan under GASB 27.

F. Unfortunately, there are too many ways in which government sponsored OPEB plans are funded to be able to develop a simple test for whether GASB 43 reporting is required. The following paragraph from Q&A 8.69.3 of the Comprehensive Implementation Guide --- Guides Issued through June 30, 2006 illustrates this point:

"Statements 43 and 45 do not specify how an OPEB plan should be structured administratively. That is, those Statements do not prescribe the precise workings of the trust, or equivalent arrangement, or the responsibilities of the trustee(s) in relation to the responsibilities of the employer, employer officials, or other entities or persons that may be involved in administering the preceding financial activities associated with the functions of financing and paying benefits. A variety of plan structures may arise in practice to fit specific circumstances."

The answer to Question 214 of Guide to Implementation of GASB Statements 43 and 45 on Other Postemployment Benefits has five parts labeled a through e which illustrate the varied nature of government plan funding arrangements. The following table summarizes such answer:

	Q&A 214				
Fact	**a**	**b**	**c**	**d**	**e**
1. A governmental entity sponsors and administers a single-employer defined benefit plan.	x	x			
2. The plan is funded with a trust that meets the criteria of statement 43, paragraph 4 (see below).	x	x			
3. The administrator issues a plan financial report.	x			x	
4. The administrator includes the trust fund in its own financial report.		x			x
5. A governmental entity administers a multiple-employer defined benefit plan.			x		
6. The plan is funded in such a manner that does not meet the criteria of Statement 43, paragraph 4 (see below).			x		
7. A government entity sponsors and administers a defined contribution plan.				x	x

According to Statement 43, paragraph 4, if a trust or equivalent arrangement is used to fund a plan providing OPEBs, it must meet the following criteria in order for its assets to be eligible for consideration in the OPEB actuarial valuation.

1. Employer contributions to the trust (or equivalent arrangement) are irrevocable.

2. Plan assets are dedicated to providing benefits to their retirees and their beneficiaries in accordance with the terms of the plan.

3. Plan assets are legally protected from creditors of the employer(s) or the plan administrator.

G. The following example is designed to illustrate two concepts that are frequently misunderstood with respect to GASB 43 and 45:

City A has negotiated a contribution of 2% of pay with its firefighters to fund future retiree healthcare benefits. The group of firefighters covered by the agreement are all employed by City A. Such contributions are paid into a trust on an unallocated basis. The firefighters, through their elected representatives, handle all the administration of the plan including setting the benefit level in conjunction with an actuary hired by the firefighters, investing the trust assets and, through a TPA hired by the firefighters, performing all the general administrative functions of the plan. A summary of the agreement with City A, which was written in layman's terms and distributed to all member firefighters, clearly explains that (1) City A's legal liability does not extend beyond the payment of the negotiated contributions and (2) City A does not bear responsibility for any part of the administration of the plan.

The two points of clarification in this example are as follows:

1. <u>Plan considered as a defined benefit plan</u> - Because City A's legal commitment is restricted to only paying the contributions, some interpret this plan as a defined contribution plan. However, because the plan does not allocate plan assets to individual accounts during the pre retirement phase, from an accounting perspective, it is a defined benefit plan sponsored by City A with such to be reported under GASB 45. Please note this example is very similar to the example in question 8.7.2 on page 8-11 of the Comprehensive Implementation Guide --- Guides Issued through June 30, 2006 which was published in October, 2006 by GASB.

2. <u>Plan not subject to GASB 43 reporting</u> - Because the association, which is not a governmental entity, performs all the administrative functions, GASB 43 does not apply. In this situation, SOP 92-6 (as amended by SOP 01-2) would apply.