



NORTH CAROLINA
DEPARTMENT OF STATE TREASURER
STATE AND LOCAL GOVERNMENT FINANCE DIVISION
AND THE LOCAL GOVERNMENT COMMISSION

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Memorandum #2010-32

TO: Officials of Local Governments and Public Authorities Implementing Statement 45 as Phase III Governments and their Certified Public Accountants

FROM: Sharon G. Edmundson, Director, Fiscal Management Section

SUBJECT: Application to Phase III Governments of Governmental Accounting Standards Board Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*

DATE: April 30, 2010

Summary:

The Governmental Accounting Standards Board (GASB) has issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions.* The purpose of Statement No. 45 is to establish the accounting and reporting requirements for an employer's expenses and liabilities (or assets when over-funded) related to other post-employment benefit (OPEB) plan(s). What this means is that if your local government provides healthcare benefits to retirees or allows retirees to pay for their own healthcare at group rates you are subject to this standard, which must be implemented at June 30, 2010. Contact your auditor and/or an actuary if you have not already done so. The standard applies regardless of how small the pool of retirees and employees. **Materiality cannot be used as an excuse to avoid the calculations.** The details of implementation are discussed below.

Implementation Dates:

The requirements of this Statement have become effective in phases and we are now into the third year with Phase III governments required to implement in this accounting period and report at June 30, 2010 or your normal year end for this reporting cycle. For governments that are not component units of another government, these phases are determined by the phase in which the unit implemented GASB Statement No. 34. Units formed since the implementation of Statement No. 34 that are not component units of larger governments, will implement Statement No. 45 in Phase III. Component units will implement in the year that their primary government implements. See our Memorandum #928 for a list of governments by GASB 34 Phases.

Definitions and Requirements:

From an accounting standpoint, Statement No. 45 requires that post-employment benefit cost be recorded in the time period when the employee's service is rendered as a form of employee

compensation and that any accounting liability be recorded in the full accrual statements. This method contrasts to the recording of OPEB cost when the benefit is actually paid, as is done currently for budgetary reporting (modified accrual). Statement No. 45 requires that units record expenses as benefits are earned by the employee rather than when paid. It also requires the calculation of actuarial liabilities for benefits related to employees' past service (these were not previously recorded) and assesses to what extent those benefits have been funded. The recognition of the accounting liability; how it is calculated; and how much of it is recognized in any given year depends on decisions made by each local government about funding the plan. If an "irrevocable trust"¹ is established and monies are set aside to pay benefits in the future, then the recorded liability can be significantly reduced or eliminated. An actuarial valuation must be done to calculate the OPEB liability which includes a portion for the current cost and a portion for the unfunded past service. The actuary will provide most of the data required to record the proper accounting entries and prepare note disclosures.

The definition of OPEB benefits under the standard is those retirement benefits that are not offered through a pension plan; post-employment healthcare regardless of how it is provided is always considered to be OPEB. OPEB also can include such items as life insurance, disability insurance, and long-term care insurance for retirees and their dependents. If these benefits are provided as part of the pension plan, then they are considered to be pension benefits. If they are provided at retirement separate from the pension plan, then they are OPEB benefits. Post-employment healthcare however, is always classified as a post-employment benefit, including such items as medical, dental, vision, hearing, and any other health related benefit. The determination of a unit's OPEB benefits should be based on the current "substantive plan", i.e. the plan terms as understood by both the unit and the employees, rather than written documents that may be outdated.

Most OPEB plans for local governments in North Carolina are single employer "defined benefit plans." This means that only that one government is in the plan and that the plan has specified terms regarding the benefits to be provided upon retirement. This type of plan will be unique for each local government based on participant factors such as age, years of service, or other criteria defined in their substantive plan. Each local government that qualifies as a single employer plan will be required to have an actuarial valuation to compute the annual required contribution if the plan has 100 or more plan members. Total plan membership is defined as current employees, separated employees who are vested but not yet drawing benefits, and retirees. Family members or dependents are not included when counting members even if they are covered by the benefit. **Units with less than 100 total plan members are allowed to complete calculations under the "alternative method"** but any unit approaching a total of 100 plan members should consider having a valuation completed by an actuary.

Statement No. 45 will affect every local government that offers post-employment benefits, including those who provide benefits passively through an "implicit rate subsidy". An OPEB benefit is provided to retirees when a unit allows retirees to pay for their own healthcare with a

¹ An irrevocable trust is a legally established trust created for the accumulation and payment of Other Post-employment benefits to retirees. It is restricted to the purpose for which it was established and the monies are free and clear from the Board's creditors. Once money has been deposited into the trust, it cannot be removed for any reason other than to pay benefits or administer the plan. If not needed for benefits, funds held in this trust must be retained until the last eligible employee/retiree is deceased.

blended or common premium where retirees and current employees pay the same amount. This use of a blended rate results in the “implicit rate subsidy.” Units that are not using age adjusted premiums for retirees may be providing OPEB benefits without knowing it. Your unit may have both a stated plan and an implicit rate subsidy; in which case, all factors will be included in your actuarial valuation. If your unit pays no benefits but allows retirees to participate at group rates then your unit is subject to these requirements. If you are unsure about what type of rates your retirees pay, please contact your insurance provider and/or your agent.

An actuarial valuation must be obtained every two years for plans with 200 or more members, and every three years for plans with total membership less than 200. For those units with less than 100 total members, the **alternative method** is allowed to be used rather than obtaining a valuation from an actuary. The alternative method uses simplified choices for the purpose of making actuarial assumptions. The LGC staff has created an Excel spreadsheet that will apply the alternative method. It is available at our website at www.nctreasurer.com under “Auditing and Reporting Resources”. Please note that once total plan membership reaches or exceeds 100, an actuarial valuation is required. Using immateriality as a reason for avoiding the actuarial valuation (or the alternative method calculation) is not allowed. The calculation is required to determine the materiality. Based on our experience of the last two years, we would also suggest that any local government who uses the worksheet and finds that their OPEB liability (actuarial and/or accounting) is material may want to consider having an actuarial valuation done in the future for verification. The actuary could then confirm their assumptions and more accurately compute the liability. This could be true for a scenario with as few as 20 to 25 members in the plan.

As stated earlier, for those local governments with less than 100 total members, the **alternative method** is allowed to be used rather than obtaining a valuation from an actuary. Assumptions are required to complete the calculations including issues such as expected age for benefits to begin; amortization period of liability; discount rate; estimated payroll growth rate; healthcare cost trend rate; age-adjusted insurance premiums; and other plan coverage options. Units using the spreadsheet will need to obtain certain information from their insurance companies and must enter each employee and retiree into the worksheet. Multiple versions of the worksheet may be required if a unit has differing cost pools within its membership. The alternative method, although simplified from a true actuarial valuation, may require professional assistance to complete. The local government’s auditor may be able to assist with this task as long as any decisions arising from the use of the LGC alternative method spreadsheet are made by the management of the local government. The worksheet will cover those local governments having only an implicit rate subsidy OPEB plan with less than 100 members. Please note that once total plan members equal 100 or more, an actuarial valuation is required. If you have questions about the alternative method worksheet, please call Ken Wease at (919) 807-2391 or email him at ken.wease@nctreasurer.com or call Melinda Canady at (919) 807-2384 or email her at melinda.canady@nctreasurer.com

Management Issues:

There are many management issues and concerns arising from this GASB statement beyond the accounting and reporting requirements. Units will be recording the expense of employees’ retirement benefits as the employees work even though the benefit may not be paid for many years. The option is available to management to advance fund these benefits, allowing the money

to grow with interest until it is needed to meet benefit costs in the future. Advance funding the benefits can drastically change the calculation of the accounting liability. It is important to note that GASB only requires the proper recognition of the cost and the disclosures about the plan. *The statement does not require that any money be set aside for payment of future benefits.* Whether management decides to fund, or not will affect the actuarial computations and the amount of the OPEB liability that must be recorded. If the Annual Required Contribution (ARC) computed by the actuary is funded each year, then no liability is recorded.

Legislation was approved in the 2007 summer session of the General Assembly that will allow local governments to invest OPEB funds with the State Treasurer in an irrevocable trust. Any monies placed in this trust can only be used for the purpose of the trust – retiree OPEB benefits – and the monies are free and clear from the Board’s creditors. These funds cannot be used for any purpose other than the purpose of the OPEB plan, even in emergencies. Any OPEB monies invested with the State Treasurer will be allowed to be invested similarly to the Retirement funds providing for a better return on investment than Boards may be able to achieve on their own. This higher investment return positively affects the OPEB calculation by reducing the OPEB liability. Even with the higher returns, Boards should think carefully about the wisdom of advance funding. Monies placed in the trust are irrevocable and cannot be used for any other purpose even by subsequent governing bodies. See LGC Memo 1102 and the other resources available at “OPEB Resources” under “Auditing and Reporting Resources” at the Treasurer’s website referenced earlier.

If your Board decides to advance fund your benefit plan by setting up an irrevocable trust, the requirements of GASB Statement No. 43 also will apply (*Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*). Statement No. 43 applies to the plan itself (the irrevocable trust fund) as opposed to the employer’s reporting requirements in Statement No. 45. In addition to advance funding, management decisions regarding benefits for future employees can have a significant effect on benefit cost as employee benefits are expensed and the liabilities recorded. Please note that attorneys with the School of Government have indicated that they believe that benefits for current **vested** employees and retirees cannot be changed.

Transition:

More detail information is available in LGC Memo 1064. Those local governments that are component units may want to contact their auditors and their primary governments. The staff of the Local Government Commission (LGC) is available for support. The illustrative financial statements for the City of Dogwood, Carolina County, and Carolina County BOE, all fully illustrate Statement 45 and the proper note disclosures. Memo #1107 shows the variations for the different note disclosures that fulfill the requirements of GASB Statement No. 45. If you have any questions concerning this memorandum please call Sara Shippee of the LGC staff at (919) 807-2356 or email sara.shippee@nctreasurer.com or contact Amy Szalaj at (919) 807-2385 or email at amy.szalaj@nctreasurer.com.