Governmental Accounting Standards Board (GASB) Statement 45, better known as GASB 45, has already placed requirements on large government entities. Now smaller public agencies are faced with compliance—in 2008-2009 for government offices with annual revenues of $10 million to $100 million and in 2009-2010 for offices with annual revenues of less than $10 million. Yet most business managers of small municipalities, utilities, school districts and other governmental entities are only beginning to learn what GASB 45 is all about and how it will affect them. This article strives to fill that information gap.

Small But Not Simple:

Solving Small Employers' GASB 45 Puzzle

by Joanne Fontana and Michael Westover

The Effect on Small Employers

In 2004, GASB 45 was issued; it requires government employers of all sizes to measure, recognize and disclose the value of nonpension postemployment benefits. These benefits, sometimes collectively referred to as other postemployment benefits (OPEB), include medical, dental, vision and other benefits provided for both pre-65 and post-65 retirees. Full disclosure of retiree benefit costs, growing as a result of high medical cost inflation, will produce a more complete and accurate picture of a government employer's financial status and be more consistent with private sector financial reporting. GASB 45 is the public-entity equivalent of the Financial Accounting Standards Board (FASB) Statement 106 adopted in 1990.

To get an idea of the financial effect of GASB 45 on a small entity, let's imagine a public employer medical plan that has 12 active employees and no current retirees; the plan's future retirees may retain medical coverage. Under the current pay-as-you-go accounting, the cost from nonpension postemployment benefits is zero, since there are no retirees currently receiving OPEB. The manager, realizing that compliance with GASB 45 will soon be required, is aghast to learn that the actuarial valuation to compute the GASB 45 liability and related values will cost the trust management organization around $10,000. This cost must be incurred repeatedly every two to three years, in order to keep assumptions and results current.

This is only the beginning of the bad news. Using the accrual method required by GASB 45, the liability on financial statements will likely be tens of thousands of dollars, since an accounting for a portion of future costs is now also required.

This is a true story. Others are even worse. Even employers with one beneficiary who will qualify for benefits have to comply; they'll need to scramble to find money in the budget to do so.

Why Take on This Burden?

With a few notable exceptions (see the boxed article on page 25) an employer that fails to follow GASB standards will not clear an audit and may risk lower credit ratings. This is a particular worry for small employers, which do not have the financial clout of large public entities. And, after all, the liability is not new. Only the transparent acknowledgment of it is new.

State and local governments generally face increasingly burdensome retiree OPEB costs. People are living longer; baby boomers are retiring; health care costs are skyrocketing. These demographic and economic factors are compounded by a belief among many public employees and by the unions that represent them that they deserve the best benefits available, a reasonable expectation since many public employers have used benefits as the pillar of their employee retention strategy. Bringing the true long-term costs to the light of day is the first step to managing these liabilities wisely and determining how to fulfill longstanding promises.

How Can Small Agencies Bear the Cost?

The bad news: Nothing will make this transition easy. The good news: There are less expensive ways to get a valuation than to have it done by an established actuarial firm. The first is to have the valuation done by a one- or two-actuary shop. That is perfectly acceptable, as long as the actuaries are experts and the shop will still be in existence for as long as an audit trail is needed. The second is to get together with other, similar municipalities to form a purchasing coalition that can negotiate substantial discounts from an actuarial firm.

Even better news: GASB realized that the valuation cost per employee for small employers could easily be 20 times the cost for midsized-employers. Also, because there are a limited number of actuaries with the skills and experience required to complete a GASB 45 actuarial valuation, some small employers may have difficulty finding an affordable actuary that is able to complete the valuation by the deadlines. Therefore, GASB created a compliance option other than a full actuarial valuation, which is available to small public employers.

The Alternative Measurement Method (AMM): Another Approach to Valuing OPEB Liability

AMM allows qualifying government entities to comply with GASB 45 at a presumably lower cost than a traditional actuarial valuation. While the approach is actuarially sound, the use of the AMM does not require a government entity to hire an actuary. This provides considerable relief, since a full actuarial valuation for a small-to-midsized plan typically costs between $10,000 and $25,000.

The AMM is a valuation that uses simplified techniques, but still generates all of the information required to comply with GASB 45. The AMM uses the same variables for projecting future benefit costs as other valuation methods, and all of the variables must still be set to values appropriate for the particular employer. However, some pieces of the calculation are streamlined and some assumptions are simplified. The assumptions include standard turnover rates, mortality rates and so on. It is important to understand that "simplified" does not translate to "inferior." There are good reasons, besides cost, for small employers to use the AMM. An actuarial valuation uses many assumptions that are specific to the client's health-spending history. This works very well for a large client. But the experience of a small group of people may not be very reliable for predicting the future. The AMM's assumptions make sense for a smaller group. Table I includes a comparison of the AMM versus other valuation methods.

Who Qualifies to Use the AMM?

The AMM may be used by qualifying employers with fewer than 100 plan members, no matter how much revenue the employer has. Based on data compiled by the U.S. Census Bureau, over 50% of government employers in the United States have fewer than 100 employees and would likely be eligible to use the AMM if they offer OPEB.

For the purposes of GASB 45, plan members include:

- Active employees that may become eligible for an OPEB plan upon retirement
- Terminated employees with rights to future OPEB not yet being received
- Retired employees currently receiving OPEB
- Covered surviving dependents of a deceased retiree.

A small employer participating in an agent multiemployer plan may use the AMM in certain instances. An *agent multiemployer plan* aggregates single employer plans and combines investment and administrative functions, but maintains separate accounts to assign contributions and claim costs of a given employer only to that employer.

If an individual entity within an agent multiemployer plan has its own OPEB trust (entities with OPEB trusts must comply with GASB 43 as well as GASB 45), it may still use the AMM. If an individual entity within an agent multiemployer plan participates in a group OPEB trust that covers multiple entities within the agent multiemployer plan, then those entities may not use the AMM.

A small employer participating in a cost-sharing multiemployer plan does not perform its own actuarial valuation and therefore may not use the AMM. This plan pools costs for all participating employers, so the same contribution rates apply to each employer, and a single actuarial valuation is performed for the entire plan.

Options for Performing the AMM Calculation

1. In theory, a do-it-yourself calculation is the least expensive method. In practice, there may be a high cost in

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Table I

Financial Reporting Requirements

Options using the Alternative Measurement Method (AMM)	Cost	Additional auditing requirements?	Issues to think about
Online tool that uses AMM	Lower cost	Probably not, unless the tool was created by nonexperts	Online tools may not handle all situations. Results are only accurate if inputs are keyed in correctly, and additional consulting will cost extra.
Actuary or actuarial firm using AMM	More expensive generally than other AMM methods	No, if valuation is done by experts	Many actuaries are not familiar with the AMM.
Nonactuary performs AMM	Lower cost	Most likely will require additional auditing	Additional auditing may eliminate cost savings.
Perform AMM yourself	Lowest cost (unless you factor in time needed to learn AMM and the additional auditing requirements)	Almost certainly will require additional auditing	May not be advisable due to the complexity of the calculation and the additional auditing requirements
Options using an actuary	***Cost***	***Additional auditing requirements?***	***Issues to think about***
Valuation by an established actuarial firm	Generally the highest cost option	No, if valuation is done by experts	Appropriate for groups that desire consulting in addition to valuation services
Valuation by a one- or two-actuary shop	Less expensive than established actuarial firm, but likely more expensive than the AMM	No, if valuation is done by experts	Make sure you feel confident that the actuarial shop will exist a few years down the road in case of future audit.
Group purchasing arrangement	Less expensive than established actuarial firm, but possibly more expensive than the AMM	No, if valuation is done by experts	Some actuaries will offer substantial discounts if similar groups with similar benefits all contract with them at once.

Source: Milliman.

time, effort, frustration and anxiety. An AMM valuation, although simplified, still contains plenty of complexity. GASB Statement 45 is about 200 pages long and the implementation guide is more than another 200 pages. Both may be purchased at gasbpubs.stores.yahoo.net. Then there is the time to develop the required spreadsheets, and to document them for audit purposes. Not only that: the employer will probably end up paying for an actuary in any case—to verify the results of an AMM valuation performed by a nonexpert.

2. The public agency can hire a nonactuary (for instance, an accountant or financial services firm) to perform the AMM. While it requires less time and hair pulling, this result, too, may require additional auditing.
3. Another possibility is to hire an actuary to perform the AMM. Although the resulting valuation would probably not be flagged for additional auditing, this is a rather expensive option. Also, it may not be easy to find an actuary who is familiar with the AMM.
4. Online self-help tools are an attractive and relatively inexpensive option. Some of them were created by experts and thus are not likely to require additional auditing requirements. Also, they may have access to more accurate data on small employers than the typical actuary. Like self-service tax software, they require the user to enter accurate employer-specific data and then calculate and report on the GASB 45 results. Although anyone eligible for AMM can use the self-help tools, they are most appealing for small public entities with relatively simple benefit structures that don't desire high-touch consulting services. An employer with complex benefits, or one considering an OPEB trust, may need to hire a consultant who can not only perform the AMM valuation, but also discuss options to manage the liability.

Some states have created their own online valuation system for their government entities; this option only works if a state has an overarching benefits plan, so that the majority of the entities in the state have the same benefits.

After the Valuation

Key results from the valuation must be reported on financial statements, but GASB 45 requires no more than this. An agency may continue as before, paying only the current year's cost of providing OPEB in a given fiscal year. Now, however, the mounting future liability will be glaringly obvious. One of the required GASB 45 disclosures is the annual required contribution (ARC), which represents the value of OPEB earned by active employees for this year's service, and an amortization of any unfunded OPEB earned by active employees and current retirees for service done in previous years. If an employer is contributing less than the ARC, then, all else equal, over time its liability will rise. The ARC is one of several elements of a GASB valuation, as depicted in Table II.

In most cases, the prudent thing to do, to avoid future fiscal crises, is to fund or otherwise manage the liability. The options include cost sharing, cost containment and funding set-asides.

Managing Costs

Collective bargaining agreements, existing contracts, management philosophy and capital limitations may realistically limit an employer's ability to alter the OPEB structure. Nevertheless, there are many options to reduce the OPEB liability associated with GASB 45.

For instance, small employers generally pay premiums to an insurance company, which then takes on any risk associated with the actual level of health claims (a fully insured arrangement). Employers can work with the insurance company to creatively adjust either the level of benefits provided or the structure of the premiums. Small employers can discuss the following options with an insurer:

- Adopting or increasing deductibles, copayments, or retiree contributions toward the premium and out-of-pocket maximums
- Switching any blended active and retired rates to a retiree-only rate and making retirees pay a greater portion, or the full cost, of benefits
- Switching to a defined contribution (DC) plan instead of a defined benefit (DB) plan
- Switching current medical coverage to a health reimbursement arrangement (HRA) with an irrevocable trust; the HRA will then indirectly offset some of the OPEB liability
- Switching current medical coverage to a health savings account (HSA) that may accumulate funds for retirement
- Redesigning coverage for future retirees
- Dropping pre-Medicare-eligible OPEB, Medicare-eligible OPEB, or both.

There are further avenues to reduce liability. One is creating an employer group waiver plan (EGWP), allowed by Medicare Part D, to reduce some of the OPEB liability associated with pharmacy benefits, while maintaining a similar plan design and cost structure. Purchasing coverage with a Medicare Advantage Plan could also provide some relief. Or, consider changing eligibility requirements so that employees must work longer, and/or retire later, in order to receive OPEBs.

Then there are funding set-asides, such as an OPEB trust.

Funding Costs Through an OPEB Trust

An OPEB trust is a funding mechanism to provide for future OPEB obligations. The contributions to them are irrevocable; the assets are legally protected from creditors and the assets are dedicated to providing OPEB for retirees and beneficiaries. Employers that establish OPEB trusts must comply with GASB 43 in addition to GASB 45. The deadlines for those with a preexisting trust and complying with GASB 43 are one year earlier than the GASB 45 implementation deadlines.

There are several trust options. The employer may create an IRC Section 115 trust, an IRC Section 501(c)(9) trust (VEBA trust) or a 401(h) trust. Section 115 trusts are the most frequently chosen funding vehicle, but employers should explore the pros and cons of each option with legal counsel.

Also, if a DB plan is significantly overfunded, Section 420 allows these plans to transfer qualifying excess pension assets to a 401(h) trust. The employer could also issue OPEB bonds, invest the proceeds and create one of the OPEB trusts mentioned above.

Dedicated funds that do not meet the requirements of an OPEB trust may be set aside to fund benefit promises, but these funds will not reduce the liability associated with GASB 45. Why do this, then? It may be more advantageous from a bond-rating perspective to set aside funds in a liquid account to maintain flexibility.

The Advantages of an Irrevocable OPEB Trust

Creating an OPEB trust may serve as a "buffer" during times of financial stress when the ability to fulfill OPEB promises is jeopardized. It may also help employees feel more confident that the employer will fulfill any OPEB promises.

An OPEB trust may help secure bond ratings. And the discount rate used to calculate the liability of a plan with an OPEB trust is generally much more desirable than that of an unfunded plan. Depending on the amount of funding, a better dis-

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Information Needed for a GASB 45 Alternative Measurement Method Valuation

- A list of nonpension postemployment benefits (OPEBs)
- The total premiums associated with OPEBs
- The portion of the total premiums paid by the plan members and by the employer
- The eligibility requirements to receive the OPEBs
- Basic HR information on each plan member and eligible dependents (such as gender, birth date, hire date, retirement date, employment status and selected benefits)

Table II

Key Numbers Derived From GASB 45 Valuation

Number	Common Abbreviation	What It Means
Actuarial Accrued Liability	AAL	The portion of the OPEB liability that has already been earned by plan members over past service years
Unfunded Actuarial Accrued Liability	UAAL	The actuarial accrued liability minus any assets that have been designated in a trust to prefund OPEB obligations. The UAAL is the amount of past service liability that is unfunded at the present time.
Annual Required Contribution (ARC) =	ARC	The dollar amount which should be contributed toward OPEB in the current period in order to avoid a net OPEB obligation (NOO)
Normal Cost	NC	The portion of the OPEB liability earned this year by active employees
+ Amortization Payment	AP	The annual payment required to amortize the UAAL over ten to 30 years. The payment can be computed as a level dollar amount or as a level percentage of payroll.
Net OPEB Obligation	NOO	The cumulative difference between the ARC (with minor adjustments prescribed by GASB) and the actual contributions made by the employer for OPEB

Source: Milliman.

count rate will result in a dramatic reduction in the OPEB liability. Even partial funding of a trust can reduce the liability significantly.

Why an OPEB Trust May Not Work for a Small Entity

Many smaller public entities simply do not have the money to set aside for a trust. Even those that have the money to put into a trust might not have money for the legal fees, setup fees and maintenance fees associated with the trust. In some cases, state trusts have been set up with limited fees that might make setting up a trust feasible.

The concept of irrevocable OPEB trusts is new to many government entities, and the regulatory environment is still evolving. This might stop an employer from moving forward. Several states, including New York and Massachusetts, do not allow the creation of OPEB trusts.

In spite of the many challenges involved, small employers can move beyond viewing GASB 45 as an accounting requirement, and create an OPEB cost-management solution that meets the needs of the organization. **B&C**

For information on ordering reprints of this article, call (888) 334-3327, option 4.

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