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## ACCOUNTING FOR THE COST OF RETIREE HEALTH AND OTHER BENEFITS (GASB 45)

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New rules issued by the Governmental Accounting Standards Board (GASB) that change the way states account for the future cost of health and other non-pension benefits for retirees will force states to make some hard choices.

- For the first time, state and local governments must treat the costs of health and other non-pension benefits for retirees the same way they treat pension costs when preparing budgets and financial statements — that is, put the future cost of those benefits in their accounts as they are earned. Moreover, state and local governments must show the liability for those benefits that have already been accrued for past and current employees.
- The new requirements apply only to the way these costs are accounted for — not to how they are paid. However, this rule will likely result in pressure to pre-pay more of these costs because it will require governments to put a number — often for the first time — on a large future liability. In total, this liability is estimated to top \$1 trillion.
- State and local governments may respond to this new rule in ways that will affect funding for services; pre-funding retirement benefits could reduce funds available for annual expenditures on education, health or services. They may also respond by reducing the level of post-retirement benefits provided to employees. To date, responses by state and local governments have run the gamut from doing nothing to entirely eliminating retiree health benefits. The opportunities and pitfalls of the options open to states are discussed in this report.

The new GASB rule leaves states between a rock and a hard place. If a state chooses to pre-fund these costs, the combination of funding requirements for current employees, the transition costs and maintaining payments for current retirees are likely to require significant cutbacks in important services in the rest of the state's budget. Moreover, it is very difficult to accurately predict the future rate of growth in health costs; if the cost projections prove to be overstated, a state could make cuts to future benefits or to their budgets that could later prove unnecessary. If, on the other hand, a state chooses not to pre-fund, this invites future pressure from bond raters. In addition, if current trends in health care and other non-compensation costs do continue, the state risks reaching a point where health benefits for retirees become unaffordable on a pay-as-you-go basis.

## Background

The compensation of state and local employees generally includes a pension and a health insurance benefit package. In many cases, coverage of some or all of the cost of health insurance continues after an employee retires from public service. Although the financial responsibility of the government is fairly similar for both pensions and health benefits for their retirees, retiree benefits other than pensions have traditionally been treated differently from pensions in government budgets and financial statements.<sup>1</sup>

### Pension Costs are Pre-Paid

Pension costs are usually *pre-paid* — that is, most state and local governments have established dedicated trust funds where money is deposited to cover the anticipated costs of pensions for current and past employees. A state's annual budget shows the amount deposited in the trust fund to cover liabilities accrued that year as an expense of the general fund. In addition, the amount that is withdrawn from the trust fund to be spent on pensions for current retirees is shown as an expense of the *trust fund* rather than of the annual budget. States and local governments are also required to calculate and show an estimate of the future costs of public employee pension benefits in the governments' annual financial statements in order to meet generally accepted accounting procedures for state and local governments. These also include estimates of the funding ratio — the share of the future liability that is covered by the assets in the pension trust fund. Currently, the assets in state and local pensions are sufficient to cover 87 percent of future liabilities on average.

### Financing of Retiree Health and Other Non-pension Benefits is Typically Pay-As-You-Go

Traditionally, the treatment of the future costs of health and other non-pension benefits for retirees has been very different from that of pensions. Rather than pre-paying these benefits through deposits to a trust fund, most state and local governments appropriate money in their annual budgets for the annual premium costs of retiree health insurance or other benefits. This is known as *pay-as-you-go*.

One of the main reasons for the difference in the treatment of pension costs and retiree health costs is that state and local governments have never been required to calculate and report the future cost of non-pension retiree benefits promised to current and past employees. Very few have done so voluntarily. In contrast, state and local governments have been required to report pension costs for future retirees since the early 1990s. In addition, at least on a legal basis, the obligation of state and local governments to pay retiree health costs is typically less binding than their obligation to pay pension benefits. Public employee pension benefits are often guaranteed in a state's constitution while health benefits are not. Finally, the amount of pension that will be paid to any retiree is a known amount — determined by formula — while health insurance costs after retirement cannot be predicted with certainty.

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<sup>1</sup> In a number of state and local governments, there is a question of whether the government's legal requirement to continue to pay retiree health benefits at the level promised is as strong as the requirement to pay pension benefits.

## What is GASB?

This is how the Governmental Accounting Standards Board describes itself:

The Governmental Accounting Standards Board or GASB is an independent, private-sector, not-for-profit organization that — through an open and thorough due process — establishes and improves standards of financial accounting and reporting for U.S. state and local governments. Governments and the accounting industry recognize the GASB as the official source of generally accepted accounting principles (GAAP) for state and local governments.

The GASB is not a federal agency. The federal government does not fund GASB, and its standards are not federal laws or rules.

Source: GASB at a Glance, Governmental Accounting Standards Board fact sheet, updated, July 16 2007.

## GASB Rules Will Change Reporting of Retiree Health

The treatment of retiree benefits other than pensions is changing as the result of a rule issued by the organization that sets accounting standards for the public sector — the Governmental Accounting Standards Board (GASB.) These standards govern the annual financial reports used by bond rating agencies and others to determine the fiscal health of state and local governments.

In June 2004, GASB issued statement number 45 which requires that state and local governments move from a cash (pay-as-you-go) basis for accounting for the costs of benefits other than pensions to an accrual basis. In other words, instead of just showing the amount that the government is paying each year to employees that are already retired, it must estimate and show the total amount that will be owed to all its employees to date — current and past — when they are retired. The most costly retiree benefits are medical insurance including dental, vision and prescription drug benefits. In addition, costs for life insurance, legal, long-term care and disability benefits outside a pension plan are included in the GASB 45 definition. The box on page 5 shows the information required using Maryland as an example.

GASB 45 applies *only* to the way the costs are accounted for — that is, how they are shown in the government's financial statement. It does not, in and of itself, mandate how the government pays for these costs. As described below, however, it can have expenditure implications.

The GASB 45 requirements went into effect for all states for fiscal year 2007-2008 budgets. In addition a number of large local governments will be required to report these costs in their upcoming budgets. The requirements are being phased in over the next two years for smaller local governments.

The cost of retiree benefits other than pensions is large. Estimates of the total liability — the present value of future costs — for all state and local governments ranges from \$1 trillion to \$1.3

trillion over the next 30 years.<sup>2</sup> This compares to the estimated \$2.4 trillion in future pension liability.

While the future cost of OPEB (Other Post Employment Benefits) is lower than the future cost of pensions, OPEB's immediate impact on state fiscal situations has the potential to be greater because it is a new requirement. The reason for this lies in how states have traditionally handled these two retiree benefits. For a long time, most states have routinely set aside money in a trust fund to pay for current and future pension costs. These funds currently contain enough assets to cover 87 percent of expected costs on average.<sup>3</sup> As noted above, benefits other than pensions have traditionally been handled on a pay-as-you-go basis.

### **State Bond Ratings Are Potentially Affected**

Complying with GASB 45 will force state and local governments to put a number on a significant future unfunded liability. State and local governments and bond rating agencies have known for a long time that the costs of retiree health care for public employees are large and growing. However, they generally have not had an estimate of how large the future cost may be. If this liability is large and the state does not have a plan to address it, this could affect a state's bond rating and the cost of borrowing money (i.e. the interest rate it must pay to lenders).

So far, the bond rating agencies are saying that they won't consider it a negative if states don't pre-fund their retiree health liability right away. They do seem to want to see a plan to deal with the liability and trends may matter in the future. For example, it could be a problem if a state has a large and growing liability for retiree health and has not identified a way to pay for it. Or, if several states do start pre-funding some or all of their retiree health liabilities, bond raters may look more favorably on those states compared to pay-as-you-go states in the future.

### **Other Parts of Budget May Be Squeezed**

The way that state and local governments act to address this liability will affect their budgets. Once the dollar amount of these future liabilities has been identified, there may be pressure for state and local governments to begin to set funds aside now to pay future costs — as they do with pension obligations. As noted, government officials may be concerned about the impact on the state's bond rating if they do not pre-fund. Or, they may simply consider it prudent fiscal policy to reduce future liabilities. Public employees or their unions may want the increased security that a trust fund would bring.

If a state decides to set money aside each year for this liability, it would have to appropriate an amount over and above the cost of paying the state's share of the health insurance costs for employees who have already retired. This would put a strain on other parts of the state budget as these funds would not be available for other purposes.

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<sup>2</sup> Credit Suisse, You Dropped a Bomb on me, GASB, March 22, 2007  
<http://online.wsj.com/public/resources/documents/DroppedB.pdf>

<sup>3</sup> The remaining unfunded liability equaled about \$340 million in 2005.

## What Does GASB 45 Require? – An Example

GASB 45 requires that state and local governments begin to report the estimated future cost of retiree health benefits and other non-pension benefits for retirees as soon as they have been earned, just as they currently do for pension benefits.

Table 1 compares Maryland’s pension cost information to the information on retiree health costs. Maryland operates its pension on a pre-paid basis. It reports the amount of the annual contribution to the pension trust fund<sup>a</sup>, the amount that is withdrawn from the fund to make pension payments as well as the total assets in the trust fund. In addition, the state reports an estimate of the total amount that the state would need to have on hand to pay all pensions promised to current and past retirees and shows the funding ratio — a comparison of the assets on hand to the total amount needed. All of the pension information in Column A can be found in either the budget or the financial report published by Maryland each year.

<b>Maryland Pension and Retiree Health Costs – FY2006</b>		
	<b>(A) Pension (currently reported)</b>	<b>(B) Retiree Health (after GASB 45) (1)</b>
<b>Assets</b>	\$35.795 billion	\$0
<b>Liabilities</b>	\$43.243 billion	\$ 24.400 billion
<b>Funding Ratio</b>	82.8%	0%
<b>Payments to Retirees</b>	\$ 1.931 billion	\$311 million
<b>Trust Fund Deposits (Normal Cost)</b>	\$936 million	\$634.0 million needed

(1) Before GASB 45, only the \$311 million paid to retirees was reported.

Retiree health, in contrast, is operated on a pay-as-you-go basis. There is no trust fund. In FY2006, Maryland reported only one number — the \$311 million it paid for health benefits for employees who have already retired. GASB 45 changes this. States are not required to pre-fund but they are required to calculate the amount of funds that would be needed to pre-fund their retiree health benefits and report the normal cost of these benefits— the projected cost of retiree benefits earned by Maryland state employees each year — as well as the amount of assets it would need to have on hand to cover the costs of retiree health benefits promised to current and past employees. Column B shows these amounts for Maryland. The assets and funding ratio equal zero because Maryland had no trust fund or other assets set aside for retiree health costs in FY2006.

GASB 45 also requires that states determine the Annual Required Contribution (ARC). The ARC equals the sum of (1) the annual amount that would be needed to fully fund the trust fund over the course of 30 years for past liabilities (estimated to equal \$1.325 billion), and (2) the normal cost (\$634.0 million). Maryland’s Annual Required Contribution of \$1.959 billion (\$634.0 million plus \$1.325 billion) is considerably more than the \$311 million that Maryland is currently paying for retiree health on a pay-as-you-go basis.

The state’s full liability (\$24.4 billion) does **not** have to be “booked”<sup>b</sup> in the state’s financial statement but there are two amounts that must be booked under GASB 45 rules. The first is the Annual OPEB cost (which basically equals the Annual Required Contribution) which must be booked as an expense in the Government-wide financial statements.

In addition, a liability must be reflected in the statement of assets and liabilities if the state doesn’t make the full Annual Required Contribution. This only needs to be recorded going forward. So, for FY2008, this amount will equal zero. In future years it will be the cumulative amount of the ARC that has *not* been made. If the state pays the full ARC each year, the liability will equal zero.

a) Each year Maryland makes a deposit into the trust fund. This deposit equals the amount of money that would be required to pay pension costs accrued by employees that year after earning interest. This is known as the normal cost.

b) “Booked” is an accounting term which means that the liability or expense shows up on the organization’s official financial statements.

## Texas Plans to Continue to Use Pay-As-You-Go Funding

The state of Texas offers a retiree healthcare plan to state employees. The retiree health system of Texas — like that of most states — is funded on a pay-as-you-go basis. That is, Texas has no assets allocated for future payments but rather pays its share of retiree health care costs with an annual appropriation. Texas plans to continue to fund its retiree health system on a pay-as-you-go basis. The state does not plan to establish a trust fund or appropriate monies to pre-fund retiree health costs.

As of this year, Texas is not unusual in continuing to pay for retiree health care on a pay-as-you-go basis — many state and local governments have the same plan.

What is unusual is that Texas has also decided not to comply with the provisions of GASB 45 that require that a state calculate its future liability whether it intends to pre-fund these costs or not. The comptroller of the state of Texas argues that it has no future liability because retiree health benefits are not a *legal* obligation of the state. Each year the Texas legislature decides whether to grant these benefits to retired state employees as a part of the state budget process. Furthermore, the comptroller argues that it would be impossible to estimate an accurate figure for the unfunded liabilities even if they were not subject to legislative changes because of the uncertainty of the rate of growth in health care costs and of interest rates so far into the future.

In the spring of 2007, Texas enacted a law that effectively exempts the state and local governments in Texas from complying with the provisions of GASB 45.

Sources: Texas House Bill 2365 and fiscal note; “Bill would protect Texans from costs of accounting rule”, op-ed by Comptroller Susan Combs, State Senator Robert Duncan and State Representative Vicki Truitt, Austin American Statesman, June 8, 2007.

## Public Employee Benefits May be Cut

Alternatively, a state could decide to reduce the size of its GASB 45 liability by cutting benefits for existing or future employees. In many states, the cost of paying for retiree health benefits on a pay-as-you-go basis has been increasing as health care costs rise and the number of retirees increase as the population ages. States already face pressures to reduce these costs by scaling back benefits. The publication of estimates of the future cost of these benefits may increase these pressures.

## What States Can Do

There are a host of possible ways to fund the current and future costs of retiree health and other post-employment benefits.

### Continue As Pay-As-You-Go

Some states will decide to continue on a **pay-as-you-go** basis. This means annually appropriating the money needed to pay the costs of health and other non-pension benefits for current retirees. Most states currently fund non-pension retiree benefits this way. Texas plans to continue with pay-as-you-go funding for the state and has passed legislation that would exempt local governments in Texas from having to calculate anything except the cost of continuing to use pay-as-you-go to fund non-pension benefits for retirees. (This has the effect of exempting governments in Texas from GASB 45.)

### **Maine Recently Established a Trust Fund for Retiree Health Benefits**

The state of Maine offers a retiree healthcare plan to state employees and to teachers. Maine's retiree health system — like that of most states — is funded on a pay-as-you-go basis. That is, Maine has no assets allocated for future payments but rather pays its share of retiree health care costs with an annual appropriation.

When Maine calculated its future liability for retiree health costs in 2006, as a result of the issuance of the GASB 45 rule, the state estimated a total liability for retiree health benefits for state employees equal to \$3.2 billion to \$4.8 billion. The state's current ratio of assets to liabilities equals zero percent; that is, they have no assets dedicated to offset this liability.

In 2007, the state established the Irrevocable Trust Fund for Other Post-Employment Benefits. The proceeds of this fund are to be used to pay the state's share of the costs of retiree health benefits. Beginning in FY 2008, the state will appropriate and deposit each year an amount equal to the state's obligations for current retirees (the pay-as-you-go amount) plus an amount equal to the estimated future cost of benefits for active employees. In addition, annually beginning in the FY2010 fiscal year, the state will begin to reduce the state's accrued unfunded liability for past and current employees by annually appropriating and depositing an amount that is sufficient to eliminate that liability in 30 years or less.

By not beginning the deposits that will reduce accrued liability until 2010, Maine has postponed the decision about how to pay for these costs. When the state prepares its FY2010-11 biennial budget, it will have to decide whether to cut spending in other parts of the budget or raise revenues to meet this new expense.

Source: Part RRR of Maine Public Law, Chapter 240 123<sup>rd</sup> Legislature, First Regular Session.

There are advantages to continuing to fund retiree health on a pay-as-you-go basis:

- There would be no immediate budget impact as the state would not be significantly changing the amount of funding needed each year.
- As a result there would be no immediate need for additional revenue or reductions in health or other benefits.

The pay-as-you-go approach comes with disadvantages as well.

- As the population ages and longevity increases, most states will have a greater ratio of retirees to workers in the future than they do now. In addition, if current trends continue, health care costs are projected to grow at a rate that is in excess of many states' rate of budget and revenue growth. Whether the state calculates or funds liabilities or not, retiree benefits may become unaffordable in the future. If the state has not put money aside, it will not have time to come up with a solution to the problem of rising costs. As a result, a state may have to cut back benefits that employees are expecting and have included in their retirement plans, or may be forced to raise revenues on short notice or cut back state services.

## Ohio Will Continue to Pre-fund Retiree Health Benefits

Ohio state employees with 10 or more years of service qualify for retiree health insurance. The percent of cost covered by the state increases with years of service until it reaches 100 percent at 30 years of service.

The state's share of the cost of this benefit is paid from the state's Healthcare Trust Fund. Each year the employer (the state of Ohio) makes contributions to this fund for active employees. In 2006 the state's contribution equaled 4.5 percent of payroll.

Ohio's retiree healthcare plan is well-funded compared to other states. As of December 31, 2005 assets in the fund equaled \$11.1 billion — some 35 percent of the state's estimated accrued liability (\$31.1 billion).

Ohio measures the health of its retiree health trust fund by calculating the number of years of benefits that could be paid from the assets of the fund. Their goal is to maintain enough monies in the trust fund to cover between 15 and 25 years of payments. As of 2006, the state was well within this range with an estimated solvency of 22 years.

Ohio's public employee health benefits are well-funded compared to other states but this status has come with some costs. In addition to setting aside money in a trust fund to help pay for future retiree health benefits, the state moved to contain costs by capping lifetime benefits and increasing deductibles and co-payments for state retirees — actions that reduce the value of those health benefits.

Sources: State of Ohio Comprehensive Annual Financial Report for the fiscal year ended June 30, 2006 and Ohio Public Employees Retirement System press releases.

- States that continue with pay-as-you-go will be required by GASB rules to show a growing liability for future costs in its annual financial statements. This could have a negative impact on the state's bond rating and the cost of borrowing money. Even if a state refuses to calculate future liabilities, as Texas has, bond raters or outside organizations could make an estimate of what it might be and act accordingly.

### Switch to Pre-funding

Another approach that states can take is to fully or partially pre-fund these retiree health costs.

Some of the advantages of pre-funding include the following:

- Setting money aside at the time that employees accrue the right to retiree health benefits strengthens the state's promise to its employees by ensuring that there will be funds available for that benefit. This may help states attract and keep well-qualified employees.
- Pre-funding allows the state to plan ahead. Each year, the state must pay its share of health insurance costs for current retirees. If the state has set aside assets in a trust fund or reserve for this purpose, it can draw on those funds to make these payments rather than appropriating the funds each year. Some years, health care costs may go up more than anticipated as the result of changes in the number of eligible retirees or higher-than-expected cost increases. If a state has



built up reserves, it can draw down more than expected and take some time to determine how to build the reserves back up.

- A reserve could also be helpful if an economic slowdown reduces state revenues or the state faces unexpected expenditures in other parts of the budget due to a natural disaster or other crisis. If the state maintains a reserve, it can postpone one year's deposit while still paying its share of health insurance costs for state employees who have already retired.
- Pre-funding also allows employees to plan ahead. Any changes to the benefit structure that are required to make the health care costs affordable to the state can be put in place well before employees need to draw benefits on which they have relied.
- Setting aside money for future health benefits for retirees fund will reduce or eliminate any future liability that GASB 45 requires that the state show in its financial statement, thus improving its fiscal status for bond raters. It also allows the state to take advantage of the compounding effect of interest. A completely pre-funded retiree health plan will require smaller annual contributions to fund a given level of health insurance than a pay-as-you-go system.

Some of the disadvantages to pre-funding that are common to all types of pre-funding include:

- During the transition period, when a state is both paying for benefits for current retirees from the general budget and building up the trust fund, the funding requirements will be greatly increased compared to the pay-as-you-go system most states use now. The annual cost could be triple or more current annual costs. Meeting these higher costs could require tax increases or significant reductions in other services.
- If a state pre-funds, it may lose some of the flexibility to reduce retiree benefits in the future, because setting up a fund could create a stronger legal right to the benefits than exists with a pay-as-you-go system.
- Another concern is that a state — when faced with the estimated bill for pre-funding — may overreact and cut benefits when it is not really necessary. Estimates of the funds needed to pre-fund are the product of many variables including future health costs and future interest rates over a period of 50 to 70 years. There is a general consensus that the current rate of growth of health care costs is unsustainable and that the nation's system for funding health care is likely to change in some way. This makes it very difficult to accurately predict what the future rate of growth will be. If the cost projections prove to be overstated, a state could make cuts to future benefits that could later prove unnecessary. Similarly, if a state's return on its funds proves higher than expected it may find that it has cut benefits more than needed.

### Ways to Pre-Fund

There are two main ways to pre-fund these costs. One is to appropriate monies for pre-funding as part of the budget process, particularly in years in which "surplus" funds are available. The second is to establish a trust fund that the state is legally bound to use only for this purpose.

### North Carolina has Cut Retiree Health Benefits

Until 2006, North Carolina provided fully subsidized retiree health benefits to employees after they had worked for the state for five years. Beginning in 2006 the length of time that a new employee has to work to “vest” in the state’s retiree health plan — that is, to become eligible for fully subsidized health benefits after retirement — was increased dramatically to 20 years. Employees will become eligible for a subsidy of 50 percent after working 10 years for the state. The subsidy will increase each year until it reaches 100 percent after 20 years of service. Employees with less than 10 years of service will not receive retiree health benefits. This change applies only to new employees hired after October 1, 2006.

Over time, the increase in the vesting requirement will reduce North Carolina’s costs for retiree health by reducing the number of retirees eligible for state subsidies and the average size of the subsidy.

Source: North Carolina State Health Plan, News Archive, December 7, 2006.

- Annual appropriations in excess of pay-as-you-go amount: State or local governments could appropriate money each year (or some years) above the amount needed to pay benefits for current retirees. The excess could be set aside in a reserve.
- A trust fund: State and local governments could establish a trust fund dedicated to paying future non-pension retiree benefits. Alabama voters approved the establishment of a trust fund in June 2007. Ohio already deposits money in its pension fund for this purpose. Establishing a trust fund is similar to the way most governments currently fund pension benefits. The state would then have to decide where to get the money to deposit in this fund. Options include transfers from budget surpluses, employee or employer contributions based on payroll, annual appropriations, issuing bonds or depositing the proceeds of asset sales.

In addition to the general pros and cons of pre-funding, setting up a non- revocable trust fund allows the state to assume a higher interest rate under the GASB rules. A higher interest rate assumption means that the state can reduce or eliminate the future liability on its books with smaller deposits.

Some states plan to issue bonds to fill a trust fund. Borrowing money to establish a trust fund replaces the one type of payment stream with another. The state would have to make payments to reduce the debt rather than to fill the trust fund. The potential advantage comes because the state can earn interest on the proceeds of the borrowing which have been deposited in the trust fund. If the interest rate “spread” remains favorable — that is, the interest paid to lenders is less than the amount earned by the fund — the state will make money from the borrowing. In addition, issuing bonds may do more to guarantee funding for retiree health benefits because the debt becomes a legal obligation that the state is required to pay.

This strategy does carry significant risks. Issuing bonds for future non-pension retiree benefits carries the same basic risks as bonding for future pension costs. If the interest rate that determines the costs to the state of borrowing – paying back those who bought the bonds – ends up being higher than the interest that the state is earning on the funds deposited in the trust fund, this method will be more costly than either appropriating funds for the trust fund or pay-as-you-go.

This could also put future benefits at risk if the trust fund attempts to get higher interest rates by relying on risky investments.

### Cost-Cutting Measures

Another approach states could take is to reduce or eliminate the future liability by significantly cutting retiree health benefits. Utah and North Carolina have taken this approach.

The advantages of this approach include:

- Eliminating retiree health and other benefits for retirees would eliminate the liability that a state would have to estimate and report. There would be no need to set aside funds for the future cost because it would be zero. A less drastic measure of eliminating benefits for future employees while maintaining it for current and past employees would reduce but not eliminate the liability.

There are a number of disadvantages to eliminating retiree health benefits from the perspective of both the employees and state governments.

- The complete elimination of retiree health benefits would break a promise to current and past employees, some of whom have made career with the government. In some cases these changes may not be legal for current and past employees and may result in extended legal battles. In places where employees are unionized, eliminating retiree health benefits would require negotiations that are likely to be difficult.
- The elimination of retiree health benefits may make government jobs less attractive and hinder the recruitment and retention of well-qualified employees.
- If a state eliminates only the retiree health benefits for future employees, it will not see the benefits for a long time but the political and recruitment problems would likely come immediately.

### Conclusion

The affordability of retiree health benefits is a huge issue for public employees and public employers. It is an important part of the national debate over healthcare costs and coverage. The issuance of GASB 45 sheds a bright light on the problems that state and local governments are having and will continue to face in meeting these obligations.

While the numbers involved seem large, there is no need for state and local governments to overreact and make hurried decisions. Last year, in a speech discussing the state of California's estimated liability for retiree benefits which equals between \$30 and \$50 billion, State Comptroller John Chaing said, "This obligation was not a crisis 30 years ago, it was not a crisis yesterday and it is not a crisis today. And, if we work toward a plan to pay this obligation in a reasoned manner, it will not be a crisis 30 years from now."

State and local governments have time to proceed cautiously and they would be wise to do so. Bond rating agencies have indicated that they do not expect these liabilities to be eliminated overnight and will be satisfied with a plan for the future. The form that health insurance for all employees both public and private will take continues to be the subject of much debate.

## APPENDIX Summary of GASB 45

### Reporting Requirements

Specifically GASB 45 requires state and local governments to report three figures:

- Annual Required Contribution (ARC) – The ARC (which the government has to show but is not required to fund) is the sum of the value of the benefits earned by current employees in the current year plus the amount the government would need to contribute each year to eliminate the future unfunded liability in a specified number of years that cannot exceed 30. (The rule only requires that these costs be reflected in the state or local government's financial statement. It does not require that these costs be pre-paid.)
- Annual OPEB Cost (AOC) – For the first year this is the same as the Annual Required Contribution (ARC). In future years, the AOC equals the ARC adjusted for prior differences between the ARC and actual contributions.
- Net OPEB Obligation (NOO) — The NOO equals the historical difference between the Annual Required Contribution and the actual contributions made each year. The NOO equals zero if the government has made a contribution equal to the ARC each year.

### Compliance Timeline

This new requirement is being phased in over three years based on the size of the state or local government. Places with revenues equal to or greater than \$100 million must begin to report this information for fiscal years that began after December 15, 2006. The rules apply to those with revenues over \$10 million but less than \$100 million for fiscal years that begin after December 15, 2007 and the rest must comply for periods that begin after December 15, 2008.