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PUBLIC VERSUS PRIVATE SECTOR OPEB ACCOUNTING

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The new United States accounting standard (GASB45) requires local and state governments to account for their post-retirement medical and life insurance programs on an accrual basis for the first time. This new standard is creating new demands for actuarial services. Some actuaries who are entering this market are experienced public sector pension actuaries, who have worked with the public sector pension accounting standard GASB27. For these actuaries there are several important differences between pension plans and post-retirement medical plans (referred to as “other post-employment benefits,” or OPEB, in GASB45) that they will need to understand before they can perform GASB45 valuations. However, this article is written for the experienced private sector post-retirement medical plan actuaries with a strong FAS106 background who is now working on GASB45 valuations. For these actuaries there are many similarities between a FAS106 valuation and a GASB45 valuation:

- The underlying benefits are the same.
- Both require accrual accounting.
- Under both FAS106 and GASB45 an annual expense is determined.
- Under both FAS106 and GASB45 the cumulative difference between the expense and the actual amount spent on the benefits is a liability on the entity’s balance sheet. Under FAS106 the cumulative difference is the Accrued Expense. Under GASB45 the cumulative difference is the Net OPEB Obligation (NOO).
- There are separate disclosure requirements.

However, there are so many differences between the FASB and GASB standards that I would recommend that you initially work with an experienced public sector pension actuary who understands public sector accounting.

Some background information might be useful to understand why there are so many differences.

First the GASB and FASB standards are drafted by separate sister organizations, the Governmental Accounting Standards Board (GASB) and the Financial Accounting Standards Board (FASB). Both organizations are under the umbrella of the Financial Accounting Foundation. Businesses or governments are required to follow the applicable standards to be considered to be operating under Generally Accepted Accounting Principles (GAAP).

This year, the 2008 Halmstad Prize will be awarded to the best actuarial science paper published in 2006. The selection committee makes its determination taking into account the originality and thoroughness of the ideas expressed in the paper, the readability of the paper, and the timeliness and relevance of the research.

Nominations for papers on pension-related topics are being sought. Please send a brief email that includes the name of the paper, the journal (with volume number) in which it was published, and a few sentences explaining why the paper should be considered to kelley.mckeating@sympatico.ca before June 15, 2008.

Nominations for the 2009 prize (for the best paper published in 2007) are also welcome at this time.

For more information on the Halmstad Prize, click here.

Why are there separate accounting standards for governments and business in general and for employee benefits in particular? The GASB Web site (*www.gasb.org*) has an excellent article explaining the need for separate accounting standards. The following is paraphrased from the article:

1. Governments do not operate in a competitive marketplace.
2. Governments rarely go bankrupt or are liquidated.
3. Governments do not have equity owners.
4. Governments do not generate income.
5. While both businesses and governments have creditors, government creditors focus on the ability to raise taxes and the cost of activities that could compete for those resources.
6. Finally, taxpayers are concerned with generational equity. That is, future tax payers should not have to pay for today's services.

In short, because governments do not face competition they do not have to focus as much as businesses on the present. A business at any time could be sold or liquidated so its current value needs to be as accurate as possible. However, there is a responsibility to future taxpayers to ensure generational equity.

The authors of the GASB standards are clearly aware of these differences and they are reflected in the GASB45 standard for OPEB benefits (and the GASB27 standard for pensions).

With this in mind here are some of the differences between the FASB and the GASB standards.

1. FAS106 requires the use of the Projected Unit Credit funding method. The GASB permits the use of other funding methods beside the projected unit credit funding method. For example a GASB valuation can use an Entry Age Normal Funding method. The projected unit credit funding is more consistent with a solvency standard. The entry age normal funding method is designed to produce level costs; this goal is very much consistent with the purpose of the GASB standards.

2. FAS106 requires that the discount rate be based on that for high quality bonds. The GASB discount rate used is based on the actuary's best estimate of future investment return. For a trust invested in equities that would be the best estimate of the long-term expected return for the equity market. Because most OPEB plans have not been pre-funded, under the GASB45 the discount rate used depends upon the expected funding level of the plan. (For a more complete discussion of the GASB45 discount rate assumption see my article in the summer 2007 issue of *The Actuary*).

3. Projected unit credit normal costs are calculated differently for FAS106 compared to GASB45. For FAS106, normal costs accumulate between entry and full eligibility for benefits. For GASB45, normal costs accumulate between entry and assumed exit from the plan.

4. Generally, unfunded amounts can be amortized over a period of as long as 30 years. The amortization period is not tied to expected future working lifetime or expected working lifetime to first eligibility for benefits.

5. Generally, GASB amortizations can be as a level percentage of payroll. This can result in negative amortizations where the unfunded amounts actually increase (at least initially) under the amortization schedule. This is not a concern if the amortization payments are approximately the same in real dollars for future taxpayers. Plans that are closed to new entrants cannot amortize as a level percentage of pay.

6. GASB amortization periods can be reset each year. Thus the government can consistently reamortize the unfunded over 30 years, in effect refinancing the mortgage.

7. GASB has no special accounting for special termination programs except for disclosure purposes.

8. GASB disclosures require a schedule of funding progress. The schedule includes for the current valuation and for two of the preceding valuations the accrued liability, the actuarial value of assets, the funding ratio, and the annual covered payroll and the ratio of the unfunded liability to the payroll. The purpose of this schedule is to gauge the plan's progress in managing unfunded liabilities as a percentage of payroll. This exhibit is consistent with the goal of ensuring generational equity.

9. GASB does not require an end of year snapshot disclosure of the funding status of the plan. For a July 1, 2007 fiscal year, the end of the year disclosure will show the results as of the valuation date, which could be as much as 24 months prior to the beginning of the fiscal year.

10. FAS158 has recently required OCI charges for unamortized losses and prior service costs. There is no such GASB requirement.

Finally, there are some differences, which may just have to do with the fact that they have different authors. Or perhaps I just haven't figured out what they have to do with the way governments operate versus companies.

Under the GASB standard if there is a NOO, the final expense includes two additional components.

- Interest on the NOO minus
- The NOO adjustment which is equal to the NOO divided by the amortization factor used for the unfunded liability.

This is more analogous to the treatment of a credit balance in the pre-PPA ERISA funding world.

Finally, while this article focuses on the technical differences between the GASB and FASB standards (because we are after all technical people), the actuary should also be aware of the difference between business and government in his face-to-face meetings and his communications with government officials and governing bodies.

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