



Dispelling OPEB “Urban Legends”

By Stephen J. Gauthier

Recently, it has become apparent that there are a number of common misconceptions about what GASB Statement No. 45 does and does not require. To avoid potential misunderstandings, this article underscores five important facts about GASB Statement No. 45.

In July 2004, the Governmental Accounting Standards Board (GASB) issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. States and large local governments will be required to implement the new guidance starting with the fiscal year that ends December 31, 2007. Medium-size and small governments will be required to do the same starting with the fiscal year ending December 31, 2008, and December 31, 2009, respectively.

The main thrust of GASB Statement No. 45 is to require for the first time that public-sector employers recognize the cost of other postemployment benefits (OPEB) over the active service life of their employees rather than on a pay-as-you-go basis. Early indications are that OPEB cost calculated in accordance with GASB Statement No. 45 is likely to be as much (or more) than three times the amount of pay-as-you-go payments, raising understandable concerns about the potential financial, managerial, and public-policy implications of implementing the new guidance.

Naturally, decision makers must have a sound understanding of the requirements of GASB Statement No. 45 if they are to develop an appropriate strategy for dealing with the issues raised by the implementation of that pronouncement. Unfortunately, many in this position appear to be laboring under some serious misapprehensions regarding exactly what the new GASB

guidance does and does not require. Indeed, five such misunderstandings have become so widespread as to take on a status akin to an accounting-style “urban legend.” This article seeks to dispel such legends so decision makers can focus on the real rather than the imaginary effects of implementing GASB Statement No. 45.

URBAN LEGEND 1 — THE OPEB-FUNDING POLTERGEIST

“We have no choice — we have to change how we fund OPEB if we want to keep getting a clean opinion from our auditors.”

The GASB’s authority is strictly limited to accounting and financial reporting. That is, the GASB cannot tell a government what to do — only how to reflect what it has done. Nothing in GASB Statement No. 45 prevents a government that elects to continue to finance OPEB on a pay-as-you-go basis from receiving an unqualified opinion from its independent auditors on the fair presentation of its financial statements.

URBAN LEGEND 2 — THE LOST FUND BALANCE

“The new accounting for OPEB will wipe out our fund balance overnight!”

“Fund balance” is reported only in funds that use the modified accrual basis of accounting (i.e., “governmental funds”). Under the modified accrual basis of accounting, expenditures for OPEB will

continue to be recognized *only as funding occurs*, regardless of how the amount thus funded is calculated (i.e., advance funding, pay-as-you-go funding). That is, *fund balance* will only be affected in a given year by the amount actually funded in that year, on whatever basis.

URBAN LEGEND 3 — THE GHOST OF OPEB PAST

“We are going to have to report a huge liability right away on the face of the financial statements for all of the OPEB we promised in the past.”

The present value of benefits earned to date but not funded (i.e., the *unfunded actuarial accrued liability*) will *not* be reported on the face of *any* financial statement. Instead, that amount will be amortized as part of *future* cost (i.e., a component of the actuarially determined *annual required contribution* — ARC) over a period not to exceed 30 years. As long as employers fully fund each year’s ARC, they will *never* report a liability on the face of their financial statements. Moreover, even if they do *not* fully fund the ARC, a liability (for the unfunded portion of the ARC rather than for the full amount of the unfunded actuarial accrued liability) would only be recognized *gradually*.

URBAN LEGEND 4 — WARDING OFF THE OPEB EVIL EYE

“We don’t have to worry about OPEB because we have no written agreement and the law specifically states that benefits are subject to appropriation each year.”

Accounting traditionally has emphasized economic substance over legal form. Accordingly, the GASB’s *Implementation Guide to GASB Statements 43 and 45* explains that employers can have OPEB to report even in the absence of a written

plan (question 56) and even in situations where “benefits are limited by the amount of funding approved by the legislature on an annual basis” (question 57). Simply put, OPEB exist whenever there is a mutual understanding between employers and employees (i.e., *substantive plan*) that such benefits will be provided, period.

URBAN LEGEND 5 — THE OPEB OSTRICH

“As long as the retirees pay the full amount of their healthcare premium, there is no OPEB for the employer to report.”

If retirees are allowed to pay the same healthcare premium as active employees, they are, in fact, enjoying an *implicit rate subsidy*. The GASB requires that such an implicit rate subsidy be treated as OPEB in its own right, even though the employer makes no direct payments on behalf of retirees. Thus, an employer must report OPEB cost today for active employees who will be able to continue to purchase health insurance once they retire at the same premium paid for active members.

CONCLUSION

There are important financial, managerial, and public-policy ramifications associated with the new employer accounting for OPEB. Clearly, a government’s failure to control OPEB costs could have a serious negative impact on the its future financial position and economic condition. Consequently, rating agencies will likely take the new information furnished by GASB Statement No. 45 into account in assigning future ratings. It seems reasonable, in this latter regard, to expect that governments that craft a workable strategy for financing their OPEB in the wake of GASB Statement No. 45 will probably fare better than those that do not.

Many observers expect to see significant changes in how OPEB are managed and funded in the wake of GASB Statement No. 45. It is important that decisions regarding such changes be based upon a sound assessment of what ultimately is best for the government financially and economically, rather than upon a misapprehension of what generally accepted accounting principles do or do not require. |

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