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PUBLISHER
Jeffrey L. Esser

EDITOR IN CHIEF
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CONTACT INFORMATION

Government Finance Review
c/o Government Finance Officers Association
203 N. LaSalle Street, Suite 2700
Chicago, Illinois 60601-1210
phone 312-977-9700 • fax 312-977-4806
e-mail GFR@gfoa.org

WEB SITE
www.gfoa.org

EDITORIAL
gfr@gfoa.org

ADVERTISING
Natalie Laudadio
nlaudadio@gfoa.org;
312-578-2298

PERMISSION AND REPRINTS
Karen Utterback
kutterback@gfoa.org;
312-578-5467

SUBSCRIPTIONS / CHANGE OF ADDRESS
Lynn Chorak
lchorak@gfoa.org;
312-578-4408

[from the executive director]

COMING TO GRIPS WITH OTHER POST-EMPLOYMENT BENEFITS

Post-retirement healthcare and other post-employment benefits (OPEB) are certainly nothing new to the public sector, where they have long been an important element of employee compensation. All the same, GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, has focused attention now, as never before, on the ultimate cost of such benefits to state and local government employers. The challenge of funding OPEB provides government finance officers with an unparalleled opportunity to assume financial leadership as governments weigh their options and craft a strategy to respond to the challenge.

"JUST THE FACTS"

The first step in effective problem solving, of course, is to correctly identify the problem. As noted previously in this publication (*Government Finance Review*, "OPEB Urban Legends," June 2006), there are a number of common misconceptions that must be dispelled before the real issues raised by OPEB can be addressed:

- *GASB Statement No. 45 does not force governments to change how they fund OPEB.* Nothing in GASB Statement No. 45 prevents a government that decides to continue to finance OPEB on a pay-as-you-go basis from receiving an unqualified opinion from its independent auditors.
- *GASB Statement No. 45 will not immediately create a fund balance deficit in the general fund.* Under GASB Statement No. 45, governments will continue to recognize expenditures for OPEB only as funding actually occurs, regardless of how the amount funded is calculated (i.e., fund balance will only be affected in a given year by the amount actually funded in that year).
- *GASB Statement No. 45 will not cause a liability to be reported in the financial statements for benefits earned in the past.* GASB Statement No. 45 calls for the cost of OPEB earned as a result of past service to be only gradually amortized (up to 30 years) as part of future OPEB cost. Thus, the financial statements will report no liability at all for OPEB so long as the employer fully funds the actuarially determined annual required contribution (ARC) each year. Moreover, even if this contribution is not fully funded, a liability will be recognized only for the underfunding.
- *GASB Statement No. 45 applies even if benefits are "contingent."* Because accounting emphasizes economic substance over legal form, employers may have OPEB to report even in the absence of a written plan and even in situations where benefits are legally limited by the amount of funding approved by the legislature on an annual basis.

continued on page 4

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continued from page 3

- *GASB Statement No. 45 may apply even if retirees pay their full healthcare premium.* GASB believes that retirees who are allowed to pay the same healthcare premium as active employees are, in substance, being subsidized, and that the indirect cost of this "implicit rate subsidy" needs to be recognized as OPEB by government employers.

Once these misconceptions have been eliminated, it becomes clear that GASB Statement No. 45 really requires only that OPEB be subject to the same accounting and financial reporting used for pension benefits (i.e., the cost of benefits must be recognized as expense as benefits are earned).

"SELECTING THE RIGHT MEDICINE"

It is important to distinguish accounting and financial reporting (i.e., form) from what they reflect (i.e., substance). GASB Statement No. 45 did not "create" the issue of OPEB. The new GASB guidance has simply spotlighted a major, ongoing issue that has challenged public sector finance officials for some time. Keeping this distinction in mind can be helpful in avoiding the very real risk of seeking an *accounting* remedy for what is fundamentally an *economic* problem. Just as the primary focus of a doctor must be on curing the disease, rather than just alleviating its symptoms, so too, government finance officers must strive to ensure that deliberations on OPEB in the wake of GASB Statement No. 45 focus on the underlying economics rather than just the accounting impact.

"BORROWING FROM PETER TO PAY PAUL"

In the wake of GASB Statement No. 45, a number of private-sector concerns have been urging government employers to issue tax-exempt bonds to help finance the cost of OPEB. Even in the best of circumstances, the decision to issue debt to finance post-employment benefits is a difficult one, given all of the attendant risks. Thus, GFOA issued a recommended practice urging governments considering the possibility of issuing pension obligation bonds to exercise caution. In the case of OPEB, the risk factors inherent in such borrowings are only exacerbated because of the lack of experience with advance funding such benefits. Therefore, government finance officers will best serve their governments by resisting efforts to promote the use of debt to finance OPEB.

"FAIR IS FAIR"

It is only natural, of course, that government employers would wish to re-evaluate all aspects of their OPEB, including program design, in the process of determining how best to respond to the long-term funding challenge. All the same, it clearly would be inequitable to expect hard-working government employees alone to shoulder the full burden of potential changes in plan design in the form of decreased or eliminated benefits. Few would argue that the best solution to the parental challenge of financing a child's college education is to discourage the child from attending college; so too, it is difficult to argue that drastic benefit reductions (or the elimination of benefits altogether) alone are the best "solution" to this challenge.

"THE OUTER LIMITS OF TRANSPARENCY"

GFOA has been a long-time leader in promoting full and timely disclosure. Thus, we firmly believe that any relevant, reliable, and timely information on OPEB should be disclosed promptly to current and potential purchasers of a government's debt securities. Conversely, we are concerned that the premature disclosure of purely preliminary and potentially inaccurate information could be misleading rather than helpful to investors. The GASB wisely provided a significant transition period for GASB Statement No. 45 to allow adequate time for employers to craft appropriate implementation strategies. An early step in this process is for a government to obtain a preliminary estimate of its unfunded actuarial accrued liability for OPEB. Some individuals have argued that governments with outstanding debt have a duty to automatically disclose such preliminary information as soon as it becomes available. We disagree. In our view, preliminary (and hence possibly inaccurate and potentially misleading) data are *not* an appropriate subject for disclosure unless governments are advised to do so by counsel.

CONCLUSION

The new spotlight that GASB Statement No. 45 puts on OPEB offers state and local governments a welcome opportunity for taking decisive steps to ensure the proper funding and viability of future benefits. It also provides government finance officers a unique opportunity to exercise financial leadership. The key challenge is to avoid misinformation and focus on the underlying economic issues highlighted by GASB Statement No. 45. In doing so, governments should resist proposals to use debt to finance the OPEB. Likewise, in fulfilling their disclosure obligations to current and potential purchasers of their debt, governments should seek the advice of counsel before disclosing potentially erroneous and misleading preliminary data.

Jeffrey L. Esser

Jeffrey L. Esser
Executive Director/CEO