



## GASB 43 and 45

### Information about Alliance Benefit Group

Alliance Benefit Group of Indiana is an office within Alliance Benefit Group, one of the largest retirement consulting and administration firms in the country. ABG provides consulting and administration services to over 4,000 plans that hold over \$10 billion in retirement assets. ABG of Indiana is an employee benefit consulting, actuarial, and administration firm that has been doing business since 1943. We are 100% employee-owned.

Below is a brief summary of our professional credentials in working with government employers and GASB studies.

- GASB analysis for the legislative body of a Mid-Western state
- GASB studies and long-term retiree health projections for cities, municipalities, and utilities
- Postretirement healthcare study presented to the United States Senate regarding Medicare retirement age
- Medicare Part D consulting and analysis for over 20 organizations (universities, corporate, and government entities)
- Over 600 retiree healthcare disclosures
- Actuarial healthcare calculations for premium rate setting, COBRA rates, active and retiree reserves, and plan design pricings
- Actuarial certifications of financial health for multiple-employer health plans

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## What is GASB 43 and 45?

GASB 43 and 45 are new governmental financial reporting requirements for all state and local governments that sponsor postemployment healthcare benefits. The major covered benefits include medical, dental, life insurance, and disability.

GASB 45 covers the financial reporting for the sponsoring employer. Some employers have set up a trust, agency fund, or fiduciary component fund to accumulate assets to finance retiree health benefits. GASB 43 covers the financial reporting for these funds and not the sponsoring employer.

## What is so different from the current disclosure requirements?

Current disclosures are done on a cash accounting basis. The annual expense equals the actual cost for the year. Also, there is no differentiation between expenses for current and retired employees.

Under the new accrual disclosures, the cost of retiree healthcare benefits is treated as current compensation and is expensed during an employee's active career. See other Q & A's for other differences.

## When do I have to take action?

The effective date varies by size of the government entity and whether GASB 43 or 45 applies.

Size	GASB 43	GASB 45
\$100 Million in Revenue for the 1st FYE After 06/15/1999	Fiscal Years Beginning After 12/15/2005	Fiscal Years Beginning After 12/15/2006
\$10 to \$100 Million in Revenue for the 1st FYE After 06/15/1999	Fiscal Years Beginning After 12/15/2006	Fiscal Years Beginning After 12/15/2007
Less than \$100 Million in Revenue for the 1st FYE After 06/15/1999	Fiscal Years Beginning After 12/15/2007	Fiscal Years Beginning After 12/15/2008

## Why is there a GASB liability if retirees must pay the full COBRA rate?

This is another change created by accrual accounting. The objective is to disclose retiree healthcare liabilities using retiree costs and assumptions. Active healthcare liabilities continue to be accounted for on a cash basis and are not part of the new GASB disclosures.

For most employers, the COBRA rate represents the average cost of participants enrolled in their medical plan. Typically 90% or more of enrollees are actively employed. Continuing with this logic, the COBRA rates are effectively the average cost of the "active population". Medical costs for a retired population are considerably higher than an active population.

Below is a chart that breaks down the actual medical costs into age-groups using actuarial health factors.

Age Group	Enrollment	Health Factor	Monthly Medical Cost
Under 40	380	80	\$295
40 to 55	210	100	\$369
Over 55 and Retirees	60	170	\$627
All Ages	650	95	\$350 <sup>1</sup>

<sup>1</sup>The COBRA rate for single coverage is \$357 (\$350 plus 2%)

Using the above table for a 60-year old retiree with single coverage, the GAAP implicit employer subsidy is \$270 per month (\$627 retiree medical cost less the \$357 COBRA single-coverage premium). Under the current cash basis, the employer subsidy would be considered \$0 (\$350 medical cost less \$357 COBRA contribution). When measuring the GASB disclosures, it is the implicit subsidy that must be recognized in the calculations.

## How will new disclosures affect our bond or credit rating?

Any negative impact will be a function of how large the accounting liabilities are, how much control plan sponsors have over plan design, and the cashflow of any future explicit or implicit subsidies.

## Why is the liability so large when there are only a few retirees enrolled in the health plan?

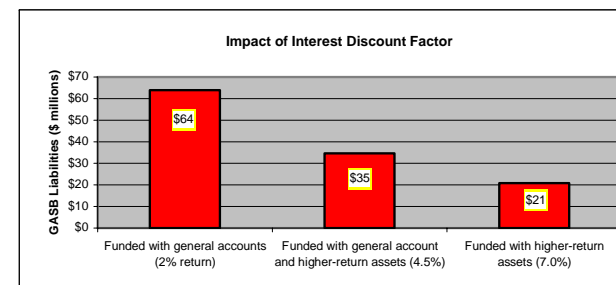
It isn't only the number of existing retirees that generate the GASB liabilities. Future retirees, spouses of retirees, and healthcare inflation are other factors that generate GASB liabilities.

## Will accumulating a dedicated pool of assets reduce the GASB liability?

Accumulating assets in certain trusts or funds will help reduce the GASB liabilities in two ways.

Dedicated assets will reduce the unfunded liabilities and ongoing annual expense. For example, a plan with \$10,000,000 in liabilities and \$0 assets will have a higher annual expense than a plan with \$10,000,000 in liabilities and \$4,000,000 in accumulated assets.

Having dedicated assets will allow the actuary to use a higher interest discount assumption than otherwise would have been possible. The interest discount is one of the key assumptions used in the healthcare actuarial projections. Per GASB requirements, this assumption must be based on the underlying investment return of assets used to finance the retiree health benefits. Employers that pay benefits using general account assets, which typically are restricted to very secure low-return investments, will earn a return in the range of 1.5% to 3%. The low return will then translate to a low interest discount assumption. Accumulated assets in certain trusts are able to earn much higher investment returns and, therefore, will have a higher interest discount assumption. Below is a table quantifying the effect on liabilities from using different interest discount assumptions.



## What other design options are available?

- Switch to an individual account-based approach to retiree health coverage. The accounts may be funded or unfunded
- Set contribution requirements that vary by service and/or age
- Use a different plan design for retirees (such as a high-deductible plan) than for active employees
- Implement a cap on the maximum amount of employer-provided subsidy
- Begin accumulating assets dedicated to financing retiree health benefits

Some government employers may be restricted by state laws that mandate certain types of health coverages or place restrictions on the maximum percentage of costs that may be passed on to retirees.

## What is the process for estimating the liabilities?

You will need to engage an actuary experienced in healthcare benefits and retirement actuarial valuations to prepare an initial measurement of your GASB liabilities. It is to the employer's advantage to know its GASB liabilities early enough to:

- react to the results and take corrective action before the official disclosures must be disclosed,
- gauge the rating agency's possible reaction to the liabilities, and
- understand better what the long-term cost of retiree health benefits really are.

The typical timeline for a GASB study is:

- Select an actuarial firm
- Collect census, premium, and other plan information
- Hold a planning meeting with actuary to discuss GASB requirements and appropriate assumptions
- Review preliminary results and internally discuss implications
- Determine if changes to plan design or actuarial assumptions are needed
- Finalize study results