

GASB 43 and GASB 45

Finding Joy and Not Pain

By Carlton Harker

Comments by the author: Because of the reasons set forth on this Article, I express concern as to these two recent accounting pronouncements. However, the accountants do bring into focus what has long been a healthcare problem seeking a solution – namely, retiree coverage. The reader will find herein a simple response which will (a) help self-funded health care plans in general and (b) meet both the letter and spirit of such new pronouncements. That is, each participant with an expectation of a retiree benefit might be offered, as a cost equivalent exchange thereof, the option of a (a) pay increase, (b) an HSA, contribution, (c) an added plan benefit or (d) a deferred compensation contract, (absent state mandates or negotiated benefits).

Overview

In June of 2004, the American Institute of Certified Public Accountants released two pronouncements (GASB 43 and GASB 45) through its Government Accounting Standards Board (GASB). These pronouncements are part of sweeping accounting changes which impact general government entity accounting practices.

The import of GASB 43 and GASB 45 is to require that all postemployment welfare benefits, to the extent that they resemble pension benefits, are to be accounted for as though they were pension benefits. The rulings expect the non-vested aspects of such benefits to be ignored thereby equating vested pension benefits with non-vested welfare benefits.

All welfare plans with retiree benefits are affected: insured or self-funded; trustee or general asset plans; COBRA or non-COBRA postemployment participants.

This actuary believes that these new rules will have a significantly negative effect on this large block of health care plans (most of which are self-funded).

This brief critique examines two aspects of these new accounting pronouncements:

1. Risk-Related Issues
2. Entity Options in Response.



Many of the thoughts or suggestions expressed herein are equally applicable to private plan retiree benefits subject to FSAB 106. The benefits, however, are in their declining years.

Risk-Related Issues

The primary concerns of this actuary which are briefly discussed are as follows:

- Basic Premise of the Accountants Being Flawed
- Present Financial Status of Government Entity Plans
- Ethical Issues
- Retiree Benefits and Deferred Compensation Agreements

- Timing of the Pronouncements
- Legal Implications
- *Sarbanes-Oxley* and Retiree Reserves.

Basic Premise of the Accountants Being Flawed

The accountants justify GASB 43 and GASB 45 on the presumption that because retiree coverage has the *appearance* of pension benefits they should be accounted for accordingly. The fact is that retiree benefits are *not* vested and therefore should *not* be treated as pension benefits. In those rare instances where retiree benefits are vested, the logic of the accountants is quite proper.

Present Financial Status of Government Entity Plans

This actuary would describe the financial status of most government entity plans to be poor. Such plans (usually HR-dominated) have long embraced the paradigm (a) that "we don't have the best pay but our benefits are good" and (b) that a unified discipline over pay-benefits-time loss-productivity is not attainable. This old paradigm results in these plans being an attraction to people with health problems. While risk management disciplines are badly needed, GASB 43 and GASB 45 will lay a heavy and needless burden on them and may push some *over the cliff*.

Ethical Issues

It has become somewhat less objectionable to speak of virtue post-ENRON and with *Sarbanes-Oxley* in place. Consider two issues:

● Conflicted Interest

With the dramatic fall-off in defined benefit pension plan and FASB 106 valuations (retiree reserves for private plans), some of the many actuaries employed by accounting firm are facing significant work cutbacks. The terms of employment and the lack of

independence with these actuaries has been long recognized.

GASB 43 and GASB 45 to the rescue? For hire ads seeking actuaries with retiree experience are currently being seen. The twilight of private retiree benefits is not far off; the twilight of government entity retiree plans might also be inevitable if the new rules are applied without modification and/or risk management planning.

● Prudency Standards

The plan fiduciaries must be faced with this harsh question: How can we spend nearly as much money (or possibly even more) to account for the benefits than the benefits themselves are worth. It is more prudent to cancel the benefits and pay the actuarial-accounting fees in exchange.

Retiree Benefits and Defined Compensation

Retiree benefits do, of course, have many similarities to deferred compensation that fail to so qualify as such because they are noncontractual. Thus the accountants are correct in noting the similarities but incorrect in choosing to ignore the basic differences

Timing of the Pronouncements

The timing of GASB 43 and GASB 45 could not be worse. When great efforts are being expended to reduce the unacceptably high number of uninsured, having to deal with a *score-keeping* type of extra burden is not welcome. There are many special interests which appear to want employer-financed health care to fail (globalists, most so-called liberals, e.g.). These accounting pronouncements will serve their cause.

Legal Implications

If the entity stays on the yellow brick road which is set forth herein, there

should be no legal issues. However, what if the accountant denies the entity some or all of the options?

- If an isolated instance, the entity is free to change accountants.
- If the accountants and/or actuaries *en bloc* purpose to thwart reasonable entity options, to their proposed rules, might some sort of challenge by some industry group(s) be appropriate?

Sarbanes-Oxley and Retiree Reserves

When ENRON failed, the public was inundated with numerous allegations of accounting scandals. Congress responded by enacting the Sarbanes-Oxley Act of 2002. The legislation places new controls on the development and auditing of corporate financial statements. Where retiree reserves are required, the auditing firm may have the actuarial computation performed by either of two actuarial arrangement:

- One.* Actuary who is an employee of the accounting firm
- Two.* Actuary who is independent.

As regards the computation of retiree reserves, *Sarbanes-Oxley* would reasonably expect the auditing firm to perform the following work-related due diligence tasks:

- Request a SAS 70 on the service firm(s).
- Require evidence that actuary's assumptions are justified.
- Examine the actuary's checks, edits, crosschecks, etc.
- Perform other tests as may be appropriate (most recent plan document provisions, e.g.).

Where the actuary of the accounting firm calculates the retiree reserves, these due diligence tasks are essentially meaningless. When the retiree reserves are calculated by an independent actuary, the accounting firm has the potential of arbitrarily discrediting the work of the independent actuary for commercial competitive advantages.

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Entity Options in Response

The *yellow brick road* of entity options is as follows:

Eliminate Retiree Benefits by Plan Amendment

All retirees

In this instance, GASB 43 and GASB 45 do not apply.

All except for those correctly retired

In this instance GASB 43 and GASB 45 do not apply.

All except those newly hired

In this instance GASB 43 and GASB 45 do apply.

Retain Retiree benefits

Retiree Benefits are Participant-Pay-All¹

No entity subsidy outside the plan

Neither GASB 43 nor GASB 45 apply.²

With entity subsidy outside the plan³

GASB 43 does not apply; GASB 45 does apply.

Retiree Benefits are Employer-Subsidized

Both GASB 43 and GASB 45 do apply so long as subsidy is part of plan.

When GASB 45 Applies

Subsidy to the entity must be actuarially-determined by the following assumptions available to the actuary.

Early retirees may be classified as COBRAs.⁴

Plan costs (or premiums) may be age, sex, cost area sensitive.⁵

Accounting-recommended parameters should be expanded by the actuary to include the probabilities of these decrements:⁶

Benefit discontinuance

Plan discontinuance

Employer subsidy discontinuance.

Modify Plan Benefits

Each participant with an expectation of a retiree benefit will be offered a choice.⁷

Give up the expectation in exchange for:

Pay increase

HSA contribution

Expanded plan benefit of non-deferred nature

Retain that expectation in exchange for a deferred compensation agreement mutually agreed to by the entity and the participant where permitted by state mandates and/or negotiated labor agreements.

The deferred compensation agreement will be contractual and will be treated in accordance with GASB 32, (GASB 43 and GASB 45 do not apply).⁸

Benefits may or may not be vested

Entity subsidies may or may not be guaranteed.

There are other considerations, however:

Insured v Self-Funding

Both funding methods have the necessary means to determine plan costs so as to maintain a competitive standoff between them.

Self-funders can treat early retirees as COBRAs.

Both can have single, bifurcated or trifurcated risk pools for actives, early retirees and age 65 retirees.

Both can vary their premiums or contributions by age, sex, cost area, etc.

Mandated Retiree Benefits

These are found for two reasons:

State Law

See Florida, Massachusetts, Kansas, Montana, eg.

Labor Union Contracts

Many government entities have to provide retiree benefits to their public safety employees due to labor negotiations.



Investment Considerations

Two types of entities must be considered

Those Wanting Small Accrued Liabilities.

This would be most of the entities where asset creation is not an investment goal.

Those Wanting Large Accrued Liabilities.

Entities are free to use new rules in a manner to create the largest possible accrued liability where asset creation is a financial goal of such entities.

Regulatory Considerations

Internal Revenue Service

Not applicable; entities are not taxpayers.

Department of Labor

Not applicable; plans are ERISA-exempt

Other

COBRA, ADEA, ADA, EEOC etc. apply.

Endnotes

1. It must be actuarially demonstrated that participant contributions are sufficient to fund retiree costs in their entirety.
2. The pronouncements make clear that where no entity obligations are involved, GASB 43 and GASB 45 do not apply.
3. Since participant contributions make the plan whole, GASB 43 (plan-related) does not apply; this does not relieve GASB 45 (employer-related) from applying however.
4. Whether early retirees are classed by the plan as COBRAs or non-COBRA appears to be a matter of unconcern to GASB 43 and GASB 45.
5. Actuarially determined plan costs (COBRA premiums less 2 %) translate into entity annual retirement costs, which become, in effect, the pension benefit for GASB 43 and GASB 45 purposes. The actuary is free to determine such plan cost as such actuary sees fit. This including varying such plan costs by age, sex, cost area, etc.
6. The accountant-ideated model used to compute the unfunded accrued liability of retiree benefits as contemplated by GASB 43 and GASB 45 would be actuarially proper were such benefits vested; but they are not vested. A possible solution to obvious error is to create a model that computes the unfunded accrued liability contemplating those decrements that cause the retiree benefit to be not vested. That is, make the probability of (a) benefit reduction or termination or (b) participant contribution increases to be model assumptions. This is the only way to obtain a reasonable and/ or actuarially defensible estimate of such liability.
7. By offering each participant with an expectation of a retiree benefit (however remote) the retiree benefit will be legally converted from a plan benefit to an individual contract of deferred compensation. That is GASB 43 and GASB 45 are out and GASB 32 is in.
8. Had a clear entity-participant understanding been memorialized as a deferred compensation contract early on, the tragic and enervating parade of litigation over such benefits would have been avoided.

Carlton Harker, FSA, MAAA is a well known and respected member of the self-funding community and has been an active participant in the Self-Insurance Institute of America's educational programs for many years. In addition to authoring numerous books on a diversity of subjects related to self-funded health care, Carlton has appeared as a speaker and panel member at various industry educational functions. Harker has appeared as an expert witness in many hearings and trials. Mr. Harker is the Principal of Self-Funding Actuarial Services, 8025 North Point Blvd., Suite 207 W., Winston-Salem, NC 27106. (tel) 336-759-2035, (fax) (336)892-0392, or via e-mail at harker2@earthlink.net He maintains a web site at www.self-fundhealth.com

