Overview of Governmental Accounting Standards Board (GASB) 45 and Preliminary Results

Finance, Audit and Accountability Committee

June 11, 2007

Purpose

- Update of GASB 45 – “Accounting and Financial Reporting by Employers for Post-employment Benefits Other Than Pensions”
- GASB 45 Implementation for the City of Dallas

Background

- GASB 45 was issued in June 2004 by the Governmental Accounting Standards Board (GASB)
  - GASB establishes accounting procedures for governments, known as Generally Accepted Accounting Procedures (GAAP)
  - City Bond Ordinances currently require the use of GAAP in preparing financial statements
- The FAA Committee was briefed on this subject in May 2006 before the actuarial study had been completed.

Accounting versus Financing

- The difference between accounting for a liability and financing (providing cash flow for) a liability is best explained by this excerpt from the City of Los Angeles financial statements:
  - "… accounting is primarily concerned with when a liability is incurred, financing focuses on when a liability will be paid. The city like many other governments, raises and budgets resources needed to liquidate a liability during the year in which the liability is to be liquidated rather than during the year in which the liability is incurred."
- An annual budget must ensure that cash is available when cash is needed to pay an expense

Current General Practice for Municipalities

- Most Post-Employment Medical Benefits plans are financed on a *pay-as-you-go* basis
  - Dallas operates on a pay-as-you-go basis
  - No funds are set aside and "reserved" for payments beyond the current fiscal year
- Therefore, current financial reporting does not:
  - Recognize the future cost of retirement health benefits in periods when an employee is providing services
  - Provide information useful in assessing potential future cash flows

GASB Statement No. 45 in Brief

- Covers the cost of certain post-retirement benefits programs (e.g., retiree medical and life benefits), also called “Other (than pension) Post Employment Benefits” or “OPEBs”
  - Does not include pension benefits
- Establishes uniform standards for recording OPEB liability consistent with standards already being applied to pension benefits and consistent with recently changed private sector accounting policies

<u>GASB Statement No. 45 in Brief</u>

- Requires the “full cost” (salaries, current health benefits and retiree health) of an employee be recognized and recorded <u>while</u> the employee is working
  - Salaries and some benefits will be <u>paid while</u> the employee is working
  - Other benefits, like retiree health benefits, will be <u>paid after</u> the employee retires
- Requires actuarial and accounting analysis to evaluate the cost of OPEBs at least every two years
- Effective for the City’s fiscal year beginning October 1, 2007
- Results will be reflected in the City’s basic financial statements

What Will Be Different?

- Current Accounting Methodology
  1. Reflects cash-basis expense for current employees
  2. Reflects cash-basis expense for retirees
  3. Does not reflect liability for future benefits that are being earned right now by current employees
  4. Does not reflect liability for future benefits previously earned by current employees
  5. Does not reflect liability for future benefits previously earned by retirees
- GASB 45 requires #1 continue to be recorded
- GASB 45 requires #3 to be recorded going forward
- GASB 45 requires #4 and #5 be recorded on the financial statements over the next (not to exceed) 30 years
- GASB 45 results will “offset” #2 with #4 and #5 (completely offset following the 30-year transition)

Options for Addressing OPEB Liability

1. Advance fund / or not advance fund the cost of future benefits

2. Change retiree health benefits

   - Eligibility

   - Subsidy levels

Advance Funding - Overview

- GASB 45 does not require advance funding future benefits in the current period; cities may elect to continue pay-as-you-go approach
- The City may elect to not advance fund, fully advance fund or partially advance fund the plan
- Advance funding would allow different actuarial assumptions that would reduce the liability that is recorded
- The City could create an irrevocable trust fund to manage the funds

1a. Advance Fund

- Results in a $48.2M first year cash expense and unfunded liability of $412.4M
  - This is an on-going annual expense (grows with medical inflation)
  - The accounting liability is reduced through use of actuarial assumptions for earnings on funds put in trust for future benefits
- Benefits
  - Current budgets incur the costs of retiree health benefits related to services provided by current employees
  - Reduces the annual <u>accounting</u> expense
- Concerns
  - Would almost certainly require the issuance of bonds to fund a dedicated trust fund
    - Legal issues associated with a Retiree Health Benefits Trust Fund
  - Significant increase to current budgets due to resulting debt service payments
  - Potential national healthcare initiatives may reduce the need for all or part of the advance funded resources
  - Would require additional administrative oversight

1b. Do Not Advance Fund

- Results in a $64.4M first year non-cash accounting expense and unfunded liability of $647.4M
  - This is an on-going annual expense (grows with medical inflation)
- Benefits
  - No impact on current budgets
  - No impact on the property tax rate
  - No impact on future operating budgets
  - No impact on operating fund balances
  - Informal discussion with bond rating agencies indicate there would be **no adverse bond rating impact** if the City elects to remain on a pay-as-you-go basis
- Concerns
  - Future budgets will continue to incur the costs of retiree health benefits related to services provided by current employees
  - Higher annual accounting expense reflected in the basic financial statements

1c. Advance Fund a Portion of the Liability

- Accounting Expense, cash needed and budget impact ranges depend on amount advance funded. Total accounting expense is between the fully advance funded and non-advance funded amounts
  - Accounting expense liability of between $412.4M and $647.4M
  - Annual cash need and budget impact between $48.2 M and $0
- Benefits
  - Current budgets incur some of the costs of retiree health benefits related to services provided by current employees
  - Reduces the annual accounting expense (compared to a non-advance funded plan)
- Concerns
  - Increase to current operating budgets
  - Potential national healthcare initiatives may reduce the need for all or part of the advance funded resources
  - Would require additional administrative oversight

2. Change Retiree Health Benefits

- Continue to review retiree health benefits and subsidy levels – currently approximately 50% for the retiree and 0% subsidy for a spouse or dependent
- Review post-retirement health plan and eligibility requirements for retirees, active employees and/or new hires
  - Dallas made a significant change several years ago that dramatically limited former employees’ eligibility for retiree health benefits
  - To be eligible, an employee must retire and be immediately eligible for pension benefits
    - Prior to this change, an employee (vested in the pension system with as little as 5 years of service) could terminate and be eligible for retiree health benefits when their (limited) pension began (many years later)
  - Increase the employee contribution rate for all active and/or new hires at retirement
  - Implement a sliding subsidy scale, where the City contribution rate increases depending on years of service

2. Change Retiree Health Benefits

- Explore a “Defined Contribution” plan for new hires
  - The amount of money available to an employee at retirement would vary based on contributions made by the City and/or the employee
  - The City would make regular contributions to the plan for existing employees
  - Rather than receiving specific future benefits, employees would have a fund available to them to pay for benefits
  - Defined Contribution plans have no OPEB liability for new employees provided the required contribution is made; OPEB liability would only apply to current employees on the existing plan

2. Change Retiree Health Benefits

- Retiree health benefits are important
  - Past employees expect them and rely on them
  - The retiree health benefit is appropriate in order to retain the current workforce and compete for new employees (now and in the future

What are other Cities Doing?

- Austin – Remain pay-as-you-go with no changes to retiree benefits
- Chicago – Awaiting response
- Fort Worth – Council Committee recommends eliminating retiree subsidy to new hires and partial advance funding for current employees
  - The current Fort Worth subsidies are substantially greater than the Dallas subsidy
- Houston – Awaiting response
- Los Angeles – Plan is fully advance funded. The City of Los Angeles began advance funding the plan in 1987.
- Philadelphia – Remain pay-as-you-go with no changes to retiree benefits

What are Other Cities Doing?

- Phoenix – Changes to current benefits include a defined contribution plan for employees more than 15 years from retirement.
- San Antonio – Police and Fire are partially advance funded. Civilians are pay-as-you-go
- San Diego – Initially will continue with pay-as-you-go. Long-term approach is to begin partially funding the liability, and eventually build up to a fully-funded plan.
- Seattle – Remain pay-as-you-go with no changes to retiree benefits
  - Seattle currently provides a low subsidy for retires

Summary of Presentation

- Key points
  - GASB 45 is effective for fiscal year ending 9/30/08
  - City must decide whether to advance fund plan or change benefits or do nothing
  - Will result in increased financial statement expense, but the impact on the budget depends on advance funding decisions
  - Plan changes will have some impact on GASB 45 calculations, updated valuation would be needed measure any impact
    - Eliminating or reducing retiree health benefits would negatively impact efforts to attract and retain employees

Summary and Recommendations

- Implementation of GASB 45 is fundamentally an accounting issue
- Cities' responses to GASB 45 are in flux
  - The National Healthcare issue is "uncertain"
- Bond rating agencies indicate no adverse impact on the Dallas rating if Dallas remains pay-as-you-go
- Retiree health benefits are important
- GASB 45 does not need to have any impact on day-to-day operations or current annual budgeting philosophy
- Staff should continue to plan to implement GASB 45 without any current plans to advance fund future cash needs
  - The issue can be revisited at a later time
- No action of the Committee or Council is necessary