Collective Bargaining & Member Advocacy

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Myths and Facts about New Accounting Standards For Education Employers

Health care benefits for retired public education employees, won through collective bargaining or legislative initiative, have increasingly moved into cost-cutters' sights. One key reason is that new accounting standards call on governments and school districts to determine the value of the retiree health care benefits they've promised to active and retired workers. Unfortunately, myths about the new standards can do serious damage to our members' retiree health care benefits.

This NEA Collective Bargaining and Member Advocacy fact sheet identifies and dispels seven common myths about these new accounting standards.

Basic Content of the New GASB Standards

The new standards are contained in Statement 45 of the Governmental Accounting Standards Board (GASB), a nongovernmental organization that creates accounting principles. The rules say that, in their financial statements, employers should measure, recognize, and present information on the value of non-pension retiree benefits such as health care, life insurance, vision plans, and dental coverage. These benefits are called "other postemployment benefits" (OPEB). Similar standards already exist for pension accounting. This fact sheet focuses on retiree health care benefits, given their cost. At present, most employers pay for retiree health care benefits on a pay-as-you-go basis, covering the costs for current retirees but putting no money aside to pay for the benefits the employer faces in the future. The value of OPEB could be 10, 20, or even 50 times the amount paid annually to cover current retirees' benefits. The new standards will be phased in starting in 2007.[1]

Myths and Facts about the New Standards

- **MYTH ONE: The new accounting standards require the funding of retiree health care benefits.**

Fact: The new standards only say that employers should account for their non-pension retiree benefits, not that they must fund them. The new rules also say that employers can have up to 30 years to spread out (amortize) the liabilities.

Implication: Employers certainly do not have to rush to change their approach to providing retiree health care benefits. In some cases, when employers falsely say that funding is a requirement, they do so to suggest that the only options available are to siphon money from the education budget or eliminate retiree health care benefits. In reality, employers have a variety of options for dealing with the new accounting standards.

- **MYTH TWO: The new accounting standards are law.**

Fact: Except in the limited number of jurisdictions that mandate compliance, the standards do not carry the force of law, and school districts and governments cannot be obligated to use them. Nonetheless, the standards become part of "generally accepted accounting principles," which auditors use when examining employers' financial statements. As a result, compliance is very important, and we expect most governments and districts to adopt the standards.

Implication: Experience suggests that employers who say the new accounting standards are law usually do so to make their demands for cutting benefits read like a legal requirement or, at least, like an inevitability.

- **MYTH THREE: The bond rating of school districts and other government entities that do not fully fund or eliminate retiree health care benefit liabilities will be jeopardized.**

Fact: Public employers want to have good bond ratings, and that makes sense. However, with respect to the issues covered by the new accounting standards, the companies that rate the creditworthiness of governments will look at many factors, both financial and governance-related, to draw their conclusions about bond ratings and creditworthiness. Overall, they'll be looking for a reasonable plan, but every jurisdiction's plan should be based on its own situation, and plans could vary a lot from place to place.

Implication: Blanket statements about the negative impact of unfunded retiree health care benefits can lead to an exaggerated sense of urgency to deal with liabilities and a harmful impulse to cut or eliminate benefits. In some instances — and based on specific information and analyses — concerns about bond ratings might be legitimate, but don't let generalized concerns about bond ratings set the context for your discussions or drive your actions.

- **MYTH FOUR: The accounting standards create new expenditures that will affect the school budget by requiring the inclusion of retiree health care benefits promised to active employees and current retirees.**

Fact: There is no causal link between an employer's budget and the value of promised retiree health care benefits to be reported on financial statements. That's because the standards don't require funding, and budgets only include the items expected to be paid during the year. If a government or school district decides to put money aside to pay for retiree health care benefits promised to active workers and current retirees, only then would the cost appear in the budget.

Implication: Watch out for tough talk on benefits based on the myth that the new standards will bust the budget. Engaging with employers over options for implementing the new accounting standards could include discussions about pre-funding, but the budget impact should be a *result*, not a *cause*, of your decisions.

- **MYTH FIVE: Once liabilities for retiree health care benefits are calculated, the liability figure is set in stone.**

Fact: Actuaries use a series of facts and assumptions to determine the value of the retiree health care benefits that employers have promised. Assumptions often rely on judgment calls on factors that are very sensitive to the slightest variation, including investment rates of return. By changing the assumptions, or by using outdated facts, the total value of promised retiree health care benefits can change significantly. The facts that actuaries use, like the demographic makeup of your membership, can change over time.

Implications: Actuarial valuations are crucial to the process created by the new standards, because they provide governments with information on the scope of the costs the employer will face in the future. So, know which actuarial assumptions have the biggest impact on the valuation, and make sure those assumptions make sense. Smaller districts can opt to calculate the value of promised benefits without using an actuary, although the calculations will still be quite complicated. In either case, don't accept figures on projected costs without making sure the facts and assumptions are reasonable.

- **MYTH SIX: We need to be prepared for the worst-case scenario, so the only liability figures we want to look at are the largest ones.**

Fact: Actuarial valuations sometimes include different sets of conclusions based on alternative but equally realistic scenarios. If you haven't reviewed the actuarial valuation itself or talked about this with your employer, you can't be sure that you have received all of the relevant information in the valuation. Perhaps you received only the worst-case-scenario numbers that highlight liabilities versus other realistic conclusions that the valuations could make. If the valuation contains conclusions drawn from a single scenario, your discussion about retiree health care benefits might be unnecessarily limited by that fact.

Implication: Know what's in the valuation before you talk about it. If only one set of assumptions was used, determine if other assumptions might have been equally reasonable and whether you need further information before discussing the future of members' retiree health care benefits.

- **MYTH SEVEN: The new GASB standards created a funding problem that we can resolve if we can just find the right funding structure and financing mechanism.**

Fact: GASB created a new accounting standard for which multiple types of responses could potentially be appropriate. As part of an overall strategy on the new standards, approaches to funding structures and financing should follow, not lead, an analysis of your retiree health benefit needs and options.

Implication: Prefunding could be the best move for your members, but it may not be. Or, some partial prefunding might be what's called for. Watch out for people promoting a particular funding structure or financial product that doesn't factor in the specifics of your retiree health benefit plan, demographic trends, and other locally determined factors.

For Further Information

The NEA Collective Bargaining and Member Advocacy Department has produced a detailed report on the new accounting rules: *Defending Retiree Health Care Benefits: An NEA Guide to Understanding and Preparing for the New GASB Standards*. In addition, the department has prepared other fact sheets on the subject: "Steps for Defending Retiree Health Care Benefits (When You're Not a Technical Expert);" "A Non-Expert's Guide to Actuarial Valuations;" "Plain Talk about New Accounting Standards for Education Employers;" and "Bonds and Benefits: The Impact of Retiree Health Costs on Employers' Credit Ratings." The report and fact sheets are available on the Connect website at http://connect.nea.org/comp/retireehealthcare.htm.

For further information on the GASB standards, please contact the NEA Collective Bargaining and Member Advocacy Department a (202) 822-7080 or mailto:collectivebargaining@nea.org.

[1] For the biggest governments and school districts (with revenues of $100 million or more), the standards are being phased in starting the first fiscal year after December 15, 2006. For them, financial statements for the 2007-2008 school year will be the first to use the new standards. For governments and districts with at least $10 million but less than $100 million in revenue, the standards should be applied during the first fiscal year beginning after December 15, 2007 (school year 2008-2009). For entities with revenues under $10 million, the application date is a year later (school year 2009-2010).

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