Response to Questions on the FY 2007 Advertised Budget Plan

Request By: Supervisor Gross

Question: What are the current and future requirements for funding future liabilities as related to post-employment benefits under GASB 45?

Response:

Background

Beginning in FY 2008, the County's financial statements will be required to implement Governmental Accounting Standards Board (GASB) Statement No. 45 for other post-employment benefits (OPEBs) including health care, life insurance, and other non-retirement benefits offered to retirees. The new standard addresses how local governments should account for and report their costs related to post-employment health care and other non-pension benefits, including the County's "explicit" retiree health benefit subsidy, as well as the "implicit" benefits that the County provides for health, dental, and life insurance by allowing retirees to pay a premium based on the blended experience of active employees and retirees.

Currently, the County funds the "explicit" retiree health benefit subsidy on a pay-as-you-go basis. GASB 45 will require that the County accrue the cost of both the "explicit" retiree health subsidy and other post-employment "implicit" benefits during the period of employees' active employment, while the benefits are being earned, and disclose the unfunded actuarial accrued liability in order to accurately account for the total future cost of post-employment benefits and the financial impact on the County. This funding methodology mirrors the funding approach used for pension/retirement benefits.

Upon careful examination of GASB 45, the County plans on establishing an OPEB trust fund in FY 2007 to begin to pre-fund the cost of post-employment health care and other non-pension benefits. Establishing such a trust fund will allow the County to capture long-term investment returns and make progress towards reducing the unfunded liability. In addition, it will allow the County to save millions of dollars in the long-run as these investment gains will be able to offset what would otherwise be required County contributions. Moreover, establishing a trust fund will be received by the bond rating agencies as being the financially responsible course whereas continuing with pay-as-you-go funding will not be viewed as favorably.

Issue Discussion

A preliminary actuarial valuation as of January 1, 2005 calculated the County's actuarial accrued liability (AAL) at approximately $191.5 million (excluding the Schools portion) for the explicit and implicit components of the other post-employment benefits. The AAL represents the present value of other post-employment benefits earned to date by active and retired County employees as determined by an appropriate actuarial cost method. Of the $191.5 million total, approximately $74.8 million is due to the explicit retiree health benefit subsidy provided to County retirees on a monthly basis, $106.3 million is due to the implicit benefit to retirees of participating in the County's health plans, and $10.4 million is due to the implicit benefit to retirees of participating in the County's life insurance plan. It should be noted that the implicit subsidy must be included in the AAL even if retirees pay 100 percent of the blended premium rate. The annual required contribution (ARC) was estimated at $16.1 million as of the January 1, 2005 valuation. The ARC consists of the normal cost, which is the portion of future benefits attributed to service during the year, plus the amortization of past service liability amortized over 30 years. After 30 years, assuming the County has fully funded the AAL, only the normal cost will have to be funded each year. It should be noted that a 30 year amortization period is the maximum allowed by GASB.

As the County is currently funding the explicit retiree health benefit subsidy on a pay-as-you-go basis we would be credited for these payments and the net fiscal impact to the County would be less than the full annual required contribution. Based on preliminary assumptions provided to the actuary in January 2006, the additional amount required to fully fund the ARC is $10.2 million. Correspondingly, this amount has been set aside as part of the FY 2007 Advertised Budget Plan to begin to fund the County's accrued actuarial liability. This is approximately two-thirds of the annual required contribution, as the remainder is already funded through pay-as-you-go contributions.

It should also be noted that as GASB 45 does not go into effect until FY 2008, the liability that will be shown on the County's financial statements will use valuation results as of January 1, 2008. This valuation will be performed based on the data at that time and impacted by all funds already in place in the OPEB trust fund, which would include the amounts noted above and any balances which might accumulate in Fund 506, Health Benefits Trust Fund.

Fairfax County Public Schools

It should be noted that the GASB liability noted above and the associated funding requirements do not include the GASB liability for the Schools, which is estimated to be approximately $278 million if the Schools pre-fund and set aside funding in a trust fund in order to capture long term investment returns and begin to make progress towards funding the liability. By pre-funding, the liability will be calculated using a high discount rate, which is equal to the expected long-term yield on assets. If the benefits are not pre-funded, a lower discount rate is used, resulting in a higher liability. If the Schools do not pre-fund, their unfunded AAL that will have to be disclosed on the County's financial statements would be approximately $430 million. It should be noted that no action has been taken by the School Board on funding this liability.