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Article for *Minnesota Cities*

An Alternative Approach to Implicit Rate Subsidy

By Rebecca Otto, Minnesota State Auditor

As I travel throughout the state I find a great deal of frustration among local government finance people as they prepare for the OPEB disclosures going into effect over the next three years. OPEB, of course, stands for "other post employment benefits." New standards adopted by the Governmental Accounting Standards Board (GASB) require disclosure of these benefits as a liability in the city's audited financial statements. The OPEB provision causing the most concern is the inclusion of "implicit rate subsidy" in the OPEB liability calculation.

For those unfamiliar with the term "implicit rate subsidy", it refers to the additional cost of including retired employees in the same health insurance plan used by current employees. The additional cost is included in OPEB as an employee liability based on this rationale:

- Cost of health care increases with increasing age;
- In general, cost of health care is higher for retirees than active employees of the same age (retirees generally have more time to take advantage of health care); and
- If retirees pay the same premium rate as an active employee, there is an implicit employer subsidy due to blending of claims experience.

Based on this reasoning, GASB maintains that implicit rate subsidy exists and must be included in the city's OPEB liability even if retirees pay 100 percent of the blended premium rate.

In Minnesota, cities are required to make employee health insurance available to retired employees. For most cities the only OPEB liability will be implicit rate subsidy.

Under GASB Statement 45, cities with 100 or less plan participants do not have to obtain an actuary report to determine their OPEB liability. Instead, they can use a do-it-yourself actuary calculation found in the Statement known as the Alternative Methods of Evaluation. Though this method provides some relief to small cities, there are a number of large cities that have very little OPEB liability, certainly not enough to justify the expense of an actuary report. If your city's OPEB liability consists of implicit rate subsidy and there are few retirees participating in your plan, use the Alternative Methods of Evaluation to establish the “immateriality” of your city’s OPEB liability. If the estimated liability is demonstrably immaterial you can avoid the costs of an actuary report.

The key to using this approach will be the reasonableness of your assumptions in applying the Alternative Methods of Evaluation. Therefore, you should work with your auditor early in the process to ensure that he or she will accept your reasonable conclusion that your OPEB liability is immaterial to the presentation of your financial statements at the time of your annual audit. Engaging your auditor in the process as soon as possible is essential. This approach will not be available to all cities, but for those that are eligible, it can provide significant savings.

If you have any questions please call my staff, David Kenney at 651-297-3671 or Tom Karlson, at 651-296-4715.