GASB Clarifies How to Report the Cost of Termination Benefits

A well used device as government's attempt to close budget gaps is the offering of early retirement incentives. Early retirement incentives are attempts to encourage employees to retire or end employment earlier than they otherwise would have. In theory, the government is able to reduce the size of its workforce, and thereby cut spending, in return for a cash payment, increase in retirement benefits, or other enticement.

Such incentives are one type of termination benefit. Termination benefits may also be given to employees when a government reduces its workforce through lay-offs (for example, severance pay or continued access to health insurance coverage), and some are given in the normal course of business when an employee decides to end employment.

Until recently, determining the cost of termination benefits has been challenging in the absence of clear guidance on how to do so. However, with the issuance of its Statement 47, the Governmental Accounting Standards Board (GASB) has established standards that specify how the various kinds of termination benefits should be accounted for and reported in audited annual financial reports.

GASB Statement No. 47, *Accounting for Termination Benefits,* essentially answers two questions—*how* should governments measure the costs and liabilities related to termination benefits, and *when* should they be recorded? The answers depend on the type of benefits offered and whether employees leave voluntarily or involuntarily.

Measuring the Cost of Termination Benefits

A typical form of termination benefit is a promise to make one or more future cash payments to a departing employee. Under Statement 47, a government generally would discount these payments to their present value to produce the cost of the termination benefits. If a government's offer to make such payments does not specify when the payments will be made, the government can treat the total future payments as the cost, without discounting. A similar approach generally would be applied to determine the cost of all forms of benefits provided to terminated employees, except for healthcare-related benefits.

If healthcare-related benefits are offered to induce the termination of a significant portion of a government's employees (and the average age of the terminated group differs from the average age of the total covered group), a different measurement method is used. A government generally would discount *projected healthcare claims* for the former employees (based in part on expected trends in healthcare costs), rather than cash payments, in order to determine the cost of the termination benefits. For healthcare-related benefits that do not affect a significant portion of the employees (or for which the age of the affected group does not differ from that of the overall covered group), governments are allowed to measure the termination benefits by projecting future costs based on premiums that have not been adjusted for age.

If a government offers termination benefits that affect the benefits it already provides to former employees through defined benefit retirement plans (such as pensions or retiree healthcare), those effects would be accounted for and reported according to the GASB standards for pensions and other postemployment benefits (Statements 27 and 45, respectively).

When Termination Benefits Should Be Recorded

If an employee can choose whether to stay or leave, the termination offer is *voluntary.* If it can be estimated, the cost of benefits to which an employee is entitled because of a voluntary termination is recorded as an expense *when the offer is accepted by the employee.* Any obligations to make future payments are recorded as a liability.

If the benefits accompany involuntary termination, expenses and liabilities (if the amounts can be estimated) are recorded *when a plan of termination has been approved by the government and communicated to the employees.* A plan of involuntary termination should identify the number of employees to be terminated, the affected job classifications and functions and their locations, and the expected date of termination. The plan should also describe the termination benefits with enough detail to allow the employees to determine what they will receive if they are let go.

In the governmental fund financial statements, which report information on the modified accrual basis of accounting, expenditures for termination benefits are recorded for amounts paid during the year and any additional amounts for which payment is due at year-end.

Required Note Disclosure

Additional information about termination benefits will be found in the notes to the financial statements, including a description of the termination benefit arrangement and the methods and assumptions used to determine any liabilities related to the benefits. If the cost of the termination benefits is not clearly identifiable in the financial statements (for example, if the cost of the termination benefits is reflected as a change in the actuarial accrued liability of a defined benefit pension or OPEB plan, or if it is spread among a variety of functional expense categories, depending on the types of employees involved), then the cost will be disclosed in the note as well.

Implementation Deadline

Governments generally will implement these new standards in fiscal years beginning after June 15, 2005, though earlier implementation is encouraged. However, initial accounting for the effects of termination benefits on employer obligations related to defined benefit other postemployment benefits should coincide with the implementation of Statement 45.