NORTH CAROLINA
DEPARTMENT OF STATE TREASURER
STATE AND LOCAL GOVERNMENT FINANCE DIVISION
AND THE LOCAL GOVERNMENT COMMISSION

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Memorandum #1126

TO: **Local Government Officials and their Independent Auditors**

FROM: **Sharon Edmundson, Director, Fiscal Management**

DATE: **June 26, 2009**

SUBJECT: **GASB Statement No. 47- *Accounting for Termination Benefits***

GASB Statement No. 47, *Accounting for Termination Benefits,* establishes standards on how to account for and report the various types of termination benefits. Termination benefits are incentives or settlements for early termination of an employee's employment. It is not compensation based on service provided or to be provided by the employee. Please note, this Statement does not cover accounting for unemployment compensation, pensions or other post-employment benefits (OPEB) and became effective for periods beginning after June 15, 2005.

During the current economic environment, our office understands the difficult choices and decisions that our North Carolina local governments are forced to make, including staffing. We are aware that a few local governments are now forced to examine their payrolls (the largest component of a local government's expenditures) for potential cuts to balance their budgets. This memorandum will give guidance on how to account for termination benefits if offered. Common termination benefits offered include payments for early retirement packages, severance pay, and continued access to health insurance coverage when none otherwise would be permitted.

This statement essentially answers the following two questions: (1) How should governmental units measure the costs and liabilities related to termination benefits; and (2) When should they be recorded?

Measuring the Cost and Liabilities Related to Termination Benefits

Healthcare Related Termination Benefits

- If the termination benefits relate to a large-scale, age-related group of employees (e.g., offered to those with ten or more years of service), then calculate the cost by:

    1. Segregating the benefits provided to terminated employees from those provided to active employees for measurement purposes;

    2. Projecting employer's future termination payments based on the projected total claims costs or age-adjusted premiums that approximate claim costs;

       In determining the expected termination benefit for each year, any amounts that are to be paid by the terminated employees should be deducted from the projected total claims costs or the age-adjusted premiums, whichever is applicable; and

3. Measuring at the employer's discounted present value using an assumption regarding healthcare cost trends and a discount rate equivalent to the rate of return the employer would receive on the investments that are used to finance the future termination payments.

- All other groups (e.g., 3% reduction in force across the board), cost is calculated by:

1. Segregating the benefits provided to terminated employees from those provided to active employees;

2. Projecting the employer's future termination payments based on unadjusted premiums;

   In determining the expected termination benefit for each year, any amounts that are to be paid by the terminated employee should be deducted from the unadjusted premium costs; and

3. Measuring at the employer's discounted present value using an assumption regarding healthcare cost trends and a discount rate equivalent to the rate of return the employer would receive on the investments that are used to finance the future termination payments.

Non-Healthcare Related Termination Benefits

- If the benefits to be paid are set at specific amounts on a fixed or determinable basis, the cost should be calculated as the discounted present value of expected future benefit payments. An assumption should be made regarding changes in future cost levels during the time period covered.

- If the benefits to be paid are not fixed or determinable, the cost of the benefits should be calculated as either: a) the undiscounted total of estimated future payments at current cost levels or b) the discounted present value of expected future benefit payments with an assumption regarding changes in future cost levels during the time period covered. If the payments are discounted, the discount rate should be determined by giving consideration to the estimated yield over the time period the benefits are to be provided and consideration should be given to the investments that will be used to finance the payment of these benefits.

<u>Recording the Cost of Termination Benefits</u>

Full Accrual Basis of Accounting

- If an employee can choose whether to stay or leave, the termination offer is *voluntary*. In this case, the liability and expense should be recognized when the employee accepts the offer and the amount of benefits can be estimated. Any incremental changes should be recognized at the end of each reporting period.

- For *involuntary* terminations, the liability and expense should be recognized when a plan of termination has been approved by the governing board, has been communicated to employees, and the amounts can be estimated. At a minimum, an involuntary plan should identify the number of employees to be terminated, the job classifications that will be affected and when the terminations are expected to occur. It should establish the terms of the termination benefits in enough detail so that employees can determine the type and amount of benefits they will receive.

For involuntary terminations with the requirement of the employee to render future service in order to receive termination benefits, the liability and expense should be prorated over the employee's required future service period. Any incremental changes should be recognized at the end of each reporting period.

Modified Accrual Basis of Accounting

- Expenditures for termination benefits (voluntary or involuntary) should only be recorded for amounts paid during the year and any additional amounts for which payment is due at year-end.

If termination benefits effect defined benefit retirement plans (such as pension assumptions or retiree healthcare members), these effects would be accounted for and reported according to the applicable paragraphs in the GASB standards for pensions and OPEB benefits for significant changes to plan terms. A disclosure in the notes of the financial statements should provide the change in actuarial accrued liability for the pension or OPEB plan attributable to termination benefits for which the employer becomes obligated that period

Note Disclosures for the Audited Financial Statements

Note disclosures for termination benefits should include the following elements in the year of obligation and any applicable subsequent periods (year in which benefits are provided and/or unit becomes obligated):

a) Information about the type(s) of benefits provided,
b) Number of employees affected,
c) The period of time over which benefits are expected to be provided,
d) The cost of the benefits if not identifiable on the face of the financial statements, and
e) Significant elements and assumptions used to determine liability.

If you have any questions please contact Manasa Cooper at (919) 803-2390 or via e-mail at Manasa.Cooper@nctreasurer.com.