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Milliman

PERiScope ALERT

Issues in Public Employee Retirement Systems

GASB Issues Two Other Postemployment Benefit (OPEB) Related Exposure Drafts

SUMMARY

The Governmental Accounting Standards Board (GASB) issued two Exposure Drafts regarding OPEB-related financial reporting by state and local governments. These proposed standards will significantly alter the methods used to account for postemployment OPEBs, similar to the new GASB 67/68 pension standards. Like the pension standards, the unfunded liability will become a balance sheet item rather than a note disclosure. The Exposure Drafts are available on GASB's website, www.gasb.org.

KEY CHANGES INCLUDED IN THE EXPOSURE DRAFTS:

- The most significant effect of the Exposure Draft is to require that governments report a *Net OPEB Liability* in their statement of financial position, the calculation of which differs significantly from the Net OPEB Obligation under the current GASB 45 standard. This amount is the difference between the total OPEB liability (i.e., the Entry Age Normal Accrued Liability) and the plan's fiduciary net position (i.e., the Market Value of Assets) for governments that provide OPEB benefits through a trust meeting specified criteria. If there is no trust or the criteria are not met, the net OPEB liability reported in its statement of financial position is the entire OPEB liability.

- It also proposes significant changes to the calculation of the total OPEB liability and expense, including:

  – Use of a bifurcated discount rate that applies a) the expected long-term rate of return on investments for years in which the plan is projected to have assets, and b) the interest rate on a tax-exempt 20-year AA-or-higher rated municipal bond index for years after the plan is projected to no longer have assets (if such a point is ever expected to occur). The expected long-term rate of return on investments may be used if 1) the trust meets specified criteria and 2) plan assets are invested using a strategy to achieve that return. Otherwise, the interest rate on a tax-exempt 20-year AA-or-higher rated municipal bond index is used as the discount rate for all years.

  – Required use of the Entry Age Normal cost method to determine the total pension liability and the normal cost component of the OPEB expense. The use of the Unit Credit or the Projected Unit Credit cost method is no longer permitted.

  – Immediate recognition of additional components of OPEB expense. This means immediate recognition of changes in the total OPEB liability resulting from plan changes, and significantly accelerated recognition of changes in the total OPEB liability resulting from assumption changes or plan experience.

  – Community-rated plans (i.e., plans where the premium rates are not affected by the claims experience of the group) will be required to measure OPEB liabilities using age adjusted premiums. This means that plan sponsors of community-rated plans will be required to record a financial statement liability to reflect the implicit rate subsidy, even if retirees pay 100% of the premium. Under the current GASB standards, employers who sponsor community-rated plans where retirees pay 100% of the premium recognize no financial statement liability. An implicit rate subsidy takes into account the fact that the cost of healthcare is higher for retirees not eligible for Medicare versus the average premium paid by employers for active employees.

  – A more extensive set of footnote disclosures and required supplementary information.

— An actuarial valuation at least every two years. The current GASB standards required an actuarial valuation every three years for some public employers.

— The Exposure Drafts continue the option to use a specified Alternative Measurement Method in place of an actuarial valuation for purposes of determining the total OPEB liability for benefits provided through OPEB plans in which there are fewer than 100 plan members in order to reduce the administrative costs of complying with the GASB standards for smaller governments.

BACKGROUND

GASB is proposing "major improvements" for accounting and reporting on OPEBs, such as retiree medical benefits, that governments provide to their employees. It also aims to improve information relating to entities that provide financial support to other governments. According to GASB, "Governments have an obligation to pay OPEB based on the level of retirement benefits promised to employees in exchange for their service. The GASB's proposed standards address how to measure the long-term liability and annual costs of OPEB *for the purpose of reporting them in the annual audited financial statements*. The proposals *do not* apply to how a government measures OPEB for the purpose of determining whether to set assets aside to fund future OPEB payments and, if so, how much to set aside."

- The ***Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*** Exposure Draft (OPEB Employer Exposure Draft) relates to reporting by governments that provide OPEB to their employees and for governments that finance OPEB for employees of other governments (amending GASB Statement No. 45). This statement would be effective for fiscal years beginning after December 15, 2016.

- ***The Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*** Exposure Draft (OPEB Plan Exposure Draft) addresses the reporting by the OPEB plans that administer those benefits (amending GASB Statement No. 43). This statement would be effective for fiscal years beginning after December 15, 2015.

The comment period will have two components:

- Written comments are requested from the users of government financial information by August 29

- Public hearings will be held on September 10, 11, and 12

IMPLICATIONS

The proposed changes in OPEB reporting are sweeping in scope, and they will serve to increase the balance sheet liability and may significantly increase the volatility of annual OPEB expense. There are several areas that are significant departures from current practice, and may therefore cause concern for governmental employers, some of which are:

- The recognition of the Net OPEB Liability in the employer's financial statements will likely be a significant increase in the amount of liability than was reported under prior GASB standards.

- The annual OPEB expense, because it includes immediate recognition of liability changes resulting from plan changes and some assumption changes, will be significantly more volatile from year to year than the Annual Required Contribution under GASB 45. It is unlikely that employers will wish to fund their plans based on the annual OPEB expense, so there will likely be two sets of calculations in the future for employers who are funding their benefits, one for financial reporting and one for plan funding.

- For those employers funding their OPEB benefits, the advantage of using a higher discount rate for financial reporting purposes will only apply for the period in which invested assets and projected future contributions are used to cover projected OPEB benefits. This will require a review of current funding policies and the impact under the proposed standards.

- For those employers who participate in community rated plans, the Exposure Drafts will require the reflection of any "implicit rate subsidy." This means that some employers will need to modify current methods for determining the OPEB liability and some employers will now be required to recognize a liability for OPEB where the current standards did not.

ACTION

Every state and local government currently complying with GASB 43 and 45 should review the proposed requirements of the Exposure Drafts and be aware that stakeholders are now being requested to provide commentary to GASB. For more information, please contact your Milliman consultant.