

PERiSCOPE

Public Employee Retirement Systems

New accounting rules for public postretirement benefit plans in the United States are set to take effect soon. Successful implementation of the new rules will require an understanding of a variety of technical concepts regarding the various newly required calculations. Two years ago, in a multipart PERiScope series, we explored these technical topics in detail as they related to Governmental Accounting Standards Board (GASB) Statements 67 and 68. We now take a similar approach with GASB Statements 73, 74, and 75. Milliman has established a task force for GASB 73/74/75 that will publish a detailed series of educational articles regarding various key implementation and technical issues surrounding these new statements. This series will result in numerous articles in the upcoming months.

Overview of GASB Statements 73, 74, and 75

Daniel Wade, FSA, EA, MAAA

In June 2015, the Governmental Accounting Standards Board (GASB) released new accounting standards for public sector postretirement benefit programs and the employers that sponsor them.

GASB Statement 73 is for accounting and financial reporting for pensions that are not within the scope of GASB Statement 68, the pension standard that was effective for employer fiscal years beginning after June 15, 2014. GASB 68 applies to employers for pension plans that are administered through trusts in which contributions are irrevocable, trust assets are dedicated to providing pensions to plan members, and trust assets are legally protected from creditors. GASB 73 will apply for pension plans that either do not have any dedicated assets associated with them or have assets that are not in a trust meeting the requirements specified above. GASB 73 will apply for employer fiscal years beginning after June 15, 2016.

GASB Statements 74 and 75 reflect a fundamental overhaul in the standards for accounting and financial reporting for postemployment benefits other than pensions (OPEB). They will replace the current statements, GASB 43 and 45. GASB 74 is for OPEB plans and is effective for plan fiscal years beginning after June 15, 2016. GASB 75 is for employers that sponsor OPEB plans and is effective for employer fiscal years beginning after June 15, 2017. Note that if there are no assets in a dedicated trust, most of GASB 74 does not apply, but GASB 75 does apply. If there are assets, but not in a dedicated trust meeting the criteria specified, paragraphs 58 and 59 of GASB 74 apply and GASB 75 applies for employers.

Many of the provisions of GASB Statements 74 and 75 for OPEB are parallel to the provisions of GASB 67 and 68 for pensions. The current OPEB statements 43 and 45 are very similar to GASB 25 and 27, the former statements for pensions. Pension accounting and financial reporting were overhauled with GASB 67 and 68 and the changes made for OPEB mostly follow the same guidelines.

Did you know? Milliman's GASB 73/74/75 Task Force is releasing a miniseries on technical and implementation issues surrounding GASB 73, 74, and 75. Each article will be released through PERiScope. Look for the following articles in coming months:

- Relationship between valuation date, measurement date, and reporting date
- Depletion Date Projections
- Calculation specifics on individual entry age normal actuarial cost method
- Balance sheet items and projections from valuation date to measurement date
- Calculation of OPEB expense
- GASB 73
- Revised ASOP 6 and Community Rated Plans
- Alternative Measurement Method

The new GASB statements will require a liability for OPEB obligations, known as the net OPEB liability (NOL), to be recognized on the balance sheet of the plan and the participating employers. In addition, an OPEB expense will be recognized in the income statement of the participating employers. This is very similar to what happened with GASB 67 and 68 for pensions. An overview of the NOL and the expense calculations can be found later in this article.

Under GASB 43 and 45, the unfunded actuarial accrued liability (UAAL) for OPEB was reported in the notes for the plan. There are some technical differences between the UAAL and the NOL, but the most significant impact of the new accounting standards is the move from the notes for the plan to the balance sheet of individual employers. In the current GASB OPEB Statements 43 and 45, no liability or expense was calculated for the individual employer's financial reporting for cost-sharing multiple-employer plans. Single-employer and multiple-employer agent plans were required to show the net OPEB obligation on the balance sheet. Note that the net OPEB obligation under GASB 43 and 45 was a fundamentally different measure than the NOL under GASB 74 and 75. It was more of a funding calculation and, for plans with small assets relative to the measured liabilities, the net OPEB obligation tended to be much smaller than the NOL that will appear under GASB 74 and 75.

GASB 73: Accounting and financial reporting for pension plans not within the scope of GASB 68

The primary reason that a pension plan would not fall within the scope of GASB 68 is that not all pension plans are administered through irrevocable trusts. Most of Statement 73 is very similar to GASB Statements 67 and 68. Please see <http://www.milliman.com/gasb6768/> for Milliman's comprehensive coverage of those statements. While much of GASB 73 is taken directly from GASB 67 and 68, there are a few significant differences, including:

- The effective date is for fiscal years beginning after June 15, 2016. This date is three years later than the effective date for GASB 67 and two years after the effective date for GASB 68.
- There are no assets considered to offset the total pension liability. Under GASB 68, the net pension liability (total pension liability minus fiduciary net position) is what is shown on the employer's balance sheet. With no assets in an irrevocable trust, the entire total pension liability is shown on the employer's balance sheet under GASB 73.
- The discount rate is based solely upon municipal bond yields. With no assets, there is no need to consider the long-term expected rate of return on assets or to prepare projections to determine a depletion date.
- Paragraphs 115 and 116 of the statement apply for assets accumulated for purposes of providing pensions through defined benefit pension plans that are not administered through irrevocable trusts.

GASB 74 and 75: Accounting and financial reporting for OPEB plans and the employers that sponsor them

Effective dates, applicability, and frequency of valuations

GASB Statement 74 replaces GASB Statement 43 and will be the first of the two new OPEB statements to be implemented, with an effective date for *plan* fiscal years beginning after June 15, 2016. Therefore, plan financial statements for fiscal years ending (FYE) in the latter half of 2017 will be the first required to reflect GASB 74 (most commonly FYE June 30, 2017, or December 31, 2017). GASB Statement 75 replaces GASB Statement 45 and will be effective for *employer* fiscal years beginning after June 15, 2017. Note that the plan's fiscal year will not always match that of the employer(s) sponsoring the plan.

GASB 43 and 45 were implemented on a phased basis from plan years beginning after December 15, 2005, through plan years beginning after December 15, 2008, based on the size of the revenue of the government sponsoring the plan. No such phasing will be done for GASB 74 and 75. Prior to GASB 43 and 45, there typically was no financial reporting for public sector OPEB plans.

Most of GASB 74 only applies for plans administered through trusts in which contributions are irrevocable, trust assets are dedicated to providing OPEB to plan members, and trust assets are legally protected from creditors. If there are assets accumulated, but not through trusts meeting the above criteria, only paragraphs 58 and 59 apply. Those paragraphs indicate that any such assets should continue to be reported as assets of the employer or non-employer contributing entity. Note that those paragraphs are very similar to paragraphs 115 and 116 in GASB 73.

GASB 75 applies even if there is no trust, which is often the case for OPEB plans. Note that this is different from GASB 68, which did not apply unless the plan was administered through a trust meeting the criteria above.

Biennial actuarial valuations are now required for all plans. Under GASB 45, triennial valuations were permitted for plans with fewer than 200 members (active employees, terminated employees who have accumulated benefits but are not yet receiving them, retirees, and beneficiaries). More frequent valuations were encouraged under GASB 43 and 45 and continue to be encouraged under GASB 74 and 75. The alternative measurement method continues to be available for plans with less than 100 members.

Total OPEB liability and net OPEB liability

There is new terminology with GASB 74 and 75, which is consistent with GASB 67 and 68. The total OPEB liability (TOL) under the new GASB standards will be equal to the actuarial accrued liability for the plan, calculated under the GASB-specified individual entry age actuarial cost method. Under GASB 43 and 45, there were six acceptable actuarial cost methods and many plans used the projected unit credit actuarial cost method. These plans will be required to change the actuarial cost method under new GASB standards.

The NOL is simply equal to the TOL minus the fiduciary net position (FNP). The FNP is the same as the market value of assets. For unfunded plans, the net OPEB liability (NOL) will equal the TOL.

Measurement date and actuarial valuation date

Under GASB 74, the measurement date must be the same as the plan’s fiscal year-end. This is parallel to the requirement under GASB 67 for pension plans and it means that there is no distinction between the date on which reporting is done and the measurement date (in contrast with GASB 75—see below for more on this).

The actuarial valuation date may be any date up to 24 months prior to the measurement date. Note that the FNP is measured as of the measurement date. For the TOL, if the valuation date is before the measurement date, the results must be projected forward from the valuation date to the measurement date using standard actuarial roll-forward techniques. The projection must reflect any source of material impact, including changes of the discount rate that are due to changing bond yields or index rates between the valuation and measurement date and changes in the FNP. If any benefit provisions change and are adopted prior to the measurement date, the measured liabilities must reflect them, even if the effective date is after the measurement date.

Under GASB 75, there can be a lag of 12 months between the measurement date and the reporting date, with no adjustment or roll-forward between the measurement date and the reporting date. The reporting date can be a maximum of 30 months (and a day) after the actuarial valuation date upon which the reporting is based. A roll-forward of the actuarial valuation to the measurement date is required, but not to the reporting date, if different. Similarly, the FNP should be based on the measurement date and not the reporting date. This timing is the same as the timing for GASB 68 for pensions.

Discount rate

The discount rate is the rate used to discount future benefit payments to a present value. Under GASB 74 and 75, there are different approaches for determining the discount rate, based on the funding of the plan.

For plans that are unfunded or have assets insufficient to cover the projected benefit payments, a discount rate reflecting a 20-year tax-exempt municipal bond yield or index rate must be used. As of December 31, 2015, the Bond Buyer 20-Bond General Obligation Index, one of the indices sometimes used for this determination, is at 3.57%. As can be seen in Figure 1, the bond indices have been volatile over time and this will be an additional source of volatility in the measured liabilities.

For plans with assets that meet the GASB 74 requirements, a projection of the benefit payments and future FNP is performed based on the funding policy and assumptions of the plan, along with the methodology specified by GASB. If the assets are anticipated to always be sufficient to cover the projected benefit payments, GASB indicates that the discount rate should be based on an estimated long-term rate of future investment return on the assets that are expected to be used to finance the payment of benefits.

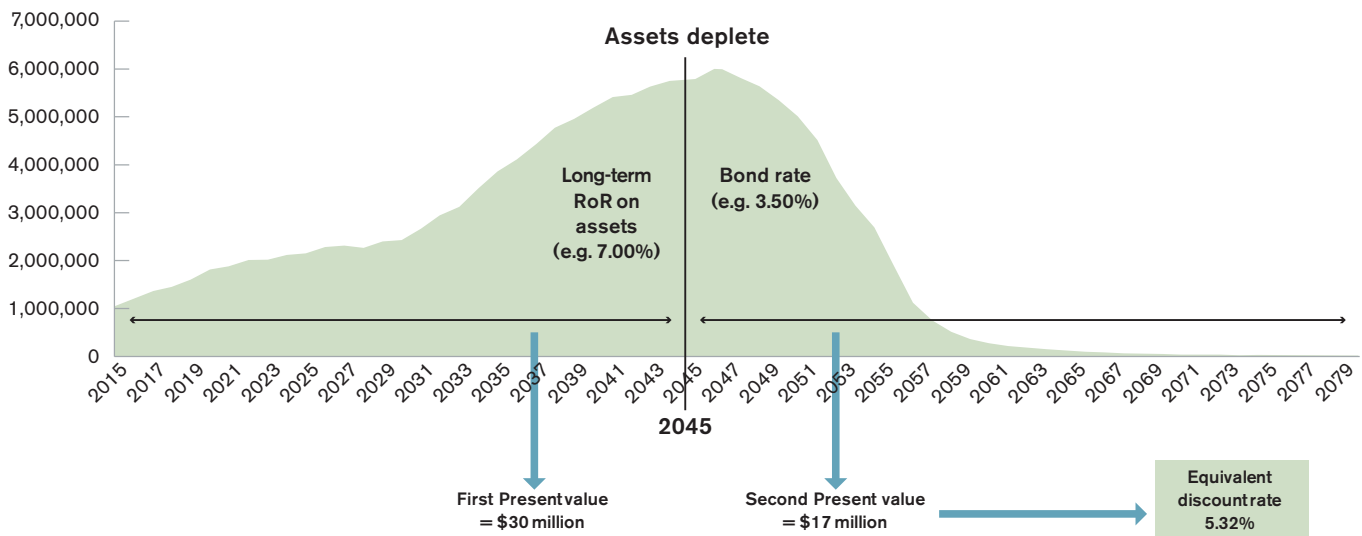
If the plan has some assets, but is projected to be inadequate to pay benefit payments at some point in the future, also known as a depletion date, a blended discount rate is used. For years in which assets are anticipated to be sufficient to cover projected benefit payments, the assumed long-term rate of future investment return is used to discount benefit payments to the present. For years in which benefit payments are not covered by the assets, the bond yield or index is used. This dual method results in an actuarial present value of benefits and that is used to calculate the single equivalent blended discount rate for all years that produces the same present value as the bifurcated dual discount rate. Please see Figure 2 on page 4 for an example of how the bifurcated discount rates are calculated. This single equivalent blended discount rate is then used for the TOL and service cost calculations.

Note that blended discount rates were applicable under GASB 43 and 45 for plans that contributed some amounts, but less than the annual required contribution. The calculation of the blended discount rate under GASB 74 and 75 is fundamentally different.

FIGURE 1: HISTORICAL BOND BUYER 20-BOND GENERAL OBLIGATION INDEX



FIGURE 2: EXAMPLE OF BIFURCATED DUAL DISCOUNT RATES: PLAN IS PROJECTED TO RUN OUT OF ASSETS IN 2045



A future article in this series will provide more details about the asset projection and various indices for 20-year tax-free municipal bond yields or index rates.

Disclosures

Implementation of GASB 74 and 75 will result in significantly more financial statement disclosures compared with GASB 43 and 45. The notes to the financial statements will need to include information regarding the year-over-year change in the NOL among other disclosures. It will also include sensitivity calculations for the NOL. The NOL will be displayed with medical trend 1% higher and 1% lower than assumed each year. The NOL is also calculated with a discount rate 1% higher and lower than assumed.

The required supplementary information (RSI) will necessitate production of a number of 10-year schedules of various results. There is also a schedule of money-weighted rate of return, which will require consideration of monthly cash flows. Another item that must be disclosed is the actuarially determined contribution, if such an item is calculated. This amount is compared with the actual contributions year-by-year.

ASOP 6 and community-rated plans

The new statements require assumptions to be selected in conformity with Actuarial Standards of Practice (ASOP) issued by the Actuarial Standards Board. ASOP No. 6, which covers retiree medical programs and was recently updated, with a significant difference in the treatment of “community-rated plans” among other changes. These are plans in which the same premium is paid for everyone across an insured pool, regardless of age, sex, or health status, and the characteristics of the group valued have little impact on the premiums charged by the larger pool. Under GASB 43 and 45, the pool’s unadjusted premiums could be used for community-rated plans. Under GASB 74 and 75, age-specific claims costs must be used for each individual regardless of whether the individual’s age has an influence on the premiums paid by the employer.

Note that for plans that charge the same premiums for active and retired employees for people not yet eligible for Medicare, there will likely be an implicit rate subsidy that requires calculation and inclusion in the NOL. Claims costs for retirees are expected to be higher than those of active employees, which is primarily due to the differences in the average age between the two groups.

For employers who purchase insurance from a large pool, the actuary may need to gather the total age distribution and total expected claims cost for the entire pool, not just for the group being valued.

A future article in this series will provide more information on this issue.

GASB 75: Accounting and financial reporting for employers sponsoring OPEB plans

Recall that GASB 75 is for the accounting and financial reporting of the employers, as opposed to the plans themselves. GASB 74 does not apply for plans that are not administered through trusts meeting the criteria listed in the statement. Two concepts that apply for GASB 75, but not GASB 74, are OPEB expense and, for cost-sharing multiple-employer plans, the employer proportionate share.

Expense

The OPEB expense in GASB 75 is an accounting item designed to recognize in the current period income statement certain changes to the NOL. Additionally, changes to the NOL not fully recognized in a given year’s OPEB expense will be tracked as deferred inflows and outflows, and recognized incrementally in the OPEB expense over time. Differences between actual and assumed investment return will be recognized over a closed five-year period. Differences between actual and assumed experience, and the impact of any changes in assumptions or inputs, will be recognized over a closed period equal to the average remaining service life of all active and inactive members. Note that this includes zero future service life for inactive members. Benefit changes will be recognized immediately in the year of adoption.

The basic formula for calculating OPEB expense is as follows:

Service cost plus interest on total OPEB liability plus current-period benefit changes minus member contributions minus assumed earnings on plan investments plus administrative expenses plus recognition of deferred outflows minus recognition of deferred inflows.

The details and implications of this calculation will be discussed in a future article in this series.

Proportionate share

Proportionate share calculations apply for cost-sharing multiple-employer plans. The purpose of the proportionate share calculation is to determine the amount of the total NOL and OPEB expense that should be recognized by each employer. GASB 75 states that the “projected long-term future contribution effort” of the employer is considered in the determination of an employer’s proportionate share.

Note that the proportionate share of the NOL will be included with the individual employer’s balance sheet and the proportionate share of the OPEB expense will be on the individual employer’s income statement. This is a significant change from GASB 43 and 45. In those statements, no liability or expense was calculated for the individual employer’s financial reporting.

However, GASB has allowed flexibility with respect to this definition. In particular, the current contribution effort of an employer may be used if this is deemed to be a reasonable method of determining the future contribution effort for a given plan.

Actions to prepare for implementation of these statements

- Begin communications with staff, plan and employer’s actuaries, plan auditors, employers, and other stakeholders.
- Develop a timeline for implementation. Be aware of which actuarial valuation will be used for the measurement date and reporting dates required.
- For community-rated plans, plan sponsors and actuaries should contact the administrators of the entire applicable pool to determine if pool-wide demographic data and expected claims costs information will be made available.
- Educate yourself by reading the statements and other information available on www.gasb.org.
- Contact your Milliman consultant with questions and look for future articles in this series.

Daniel Wade, FSA, EA, MAAA, is a principal and consulting actuary in the Seattle office of Milliman. Contact him at daniel.wade@milliman.com.