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GASB 74/75

The Accounting and Reporting of OPEBs Is Undergoing a Major Change

December 17, 2018

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What is an OPEB?

Other Postemployment Benefits (or OPEB) are benefits (other than pensions) that U.S. state and local governments provide to their retired employees.

These benefits principally involve health care benefits, but also may include life insurance, disability, legal, and other services.

Source: GASB

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The Elephant in the Room

- In 2007, **$1.5 trillion** was the estimate of unfunded OPEB liabilities throughout the United States
- Of that amount, Pennsylvania governments' estimate was greater than **$10 billion**

Source: CreditSuisse

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The Problem…

- Many OPEB plans are not funded through a trust, like pension plans
- "Pay-as-you-go"

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Déjà vu?

- Governments were required to implement GASB Standards #43 and #45 beginning in 2006
  - These set up a liability (asset) for just the difference between the annual required contribution and the amount contributed
- Governments were required to implement GASB Standards #67 and #68 beginning in 2015
  - These set up a liability for the unfunded portion of **pension** plans

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So Now GASB 74/75

Establishes standards of accounting and financial reporting for defined benefit OPEB and defined contribution OPEB provided to employees of state and local governmental employers

GASB 74 sets the requirements for financial statements of the *plan*

(if it issues separate financial statements)

GASB 75 sets the requirements for financial statements of the *government*

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How the Changes in This Statement Will Improve Financial Reporting

- More robust disclosures of assumptions
- Improved transparency
- Better indication of the extent to which the total OPEB liability is covered by resources held by the OPEB plan, if any
- Enhanced measures to evaluate decisions related to contributions
- More consistent and conservative discount rates

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How the Changes in This Statement Will Improve Financial Reporting (continued)

- Streamlined calculation of actuarial present value
- Immediate recognition in OPEB expense for some items, rather than a choice of recognition periods
- Deferral of other items over a defined, closed period, rather than a choice of open or closed periods
- Shift of focus of the OPEB measures from the employer's **OPEB cost** to the employer's **OPEB liability**

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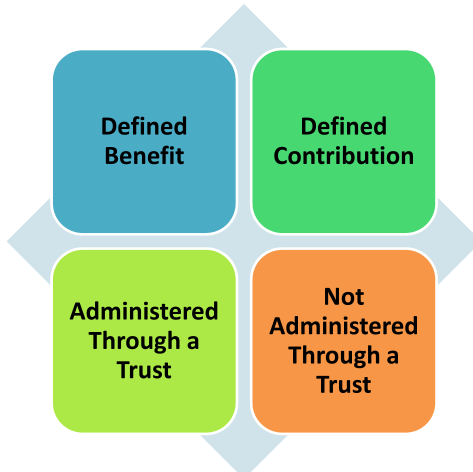
Types of OPEBs



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OPEB Plans Administered Through Trusts

To qualify as a trust:

- Contributions from employers and nonemployer contributing entities to the OPEB plan and earnings on those contributions are irrevocable
- OPEB plan assets are dedicated to providing OPEB to plan members in accordance with the benefit terms
- OPEB plan assets are legally protected from creditors of employers, nonemployer contributing entities, the OPEB plan administrator, and the plan members

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OPEB Plans Administered Through Trusts (continued)

The assets held in trust are subtracted from the total OPEB liability to determine the net OPEB liability

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OPEB Plans Not Administered Through Trusts

Any assets earmarked to pay OPEB would be treated as assets of the employer and the OPEB liability would remain the total OPEB liability

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Defined Benefit (DB) OPEB Plan Types

Single

- OPEBS provided to employees of only ONE employer
- Primary government and component units reported together are considered one employer
- Stand-alone financials will have to account as if cost-sharing

Agent

- Assets are pooled in a trust for investment purposes
- Separate accounts are maintained for each employer
- Each employer's assets are legally available to pay only for their own employees

Cost-Sharing

- Assets are pooled in a trust for investment purposes
- Assets can pay the benefits for any employers in the plan

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Total OPEB Liability

Governments will measure total OPEB liability in three steps:

1. Projecting future benefit payments for current and former employees and their beneficiaries
2. Discounting those payments to their present value
3. Allocating the present value over past and future periods of employee service

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Actuarial Valuation

- The total OPEB liability generally is required to be determined through an actuarial valuation
  - Actuarial valuation must occur no less frequently than every two years
  - Actuarial valuation date is not required to have same relationship to the measurement date in each reporting period
- However, if fewer than 100 employees (active and inactive) are provided with OPEB through the plan, use of a specified alternative measurement method in place of an actuarial valuation is permitted

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Actuarial Valuation (continued)

- The actuarial valuation is performed as of:
  - The measurement date
    - No earlier than the employer's prior fiscal year-end and not later than the current fiscal year-end
    - Must remain consistent from period to period
  - A date other than the measurement date
    - No earlier than 30 months and one day before the employer's most recent fiscal year-end
    - Rollforward procedures to the measurement date

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Actuarial Valuation (continued)

Date of Adoption	12/31/18	6/30/18
Earliest Measurement Date	12/31/17	6/30/17
Earliest Valuation Date (would require rollforward to measurement date)	6/30/16	12/31/15
=====================	=====================	=====================
So…If Next Valuation Date Is Earlier Than	1/1/18	7/1/17

Discuss With Your Actuary & Auditor

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Actuarial Valuation (continued)

- Timing may require valuations in consecutive years
- Potential Options:
  - Two consecutive valuation years (full valuation under GASB 45, full valuation under GASB 75)
  - Two consecutive valuation years (full valuation under GASB 75, interim calculation to recognize transition)
  - Early adoption (full valuation under GASB 75)

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Projections of Benefit Payments Incorporate the Effects of:

- Projected salary changes (if the OPEB formula incorporates future compensation levels)
- Service credits (if the OPEB formula incorporates periods of service)
- Automatic postemployment benefit changes, including automatic cost-of-living adjustments (COLAs)

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Projections of Benefit Payments Incorporate the Effects of: (continued)

- (NEW) ad hoc postemployment benefit changes (including ad hoc COLAs), if they are considered to be substantively automatic
- Certain taxes or other assessments expected to be imposed on the benefit payments

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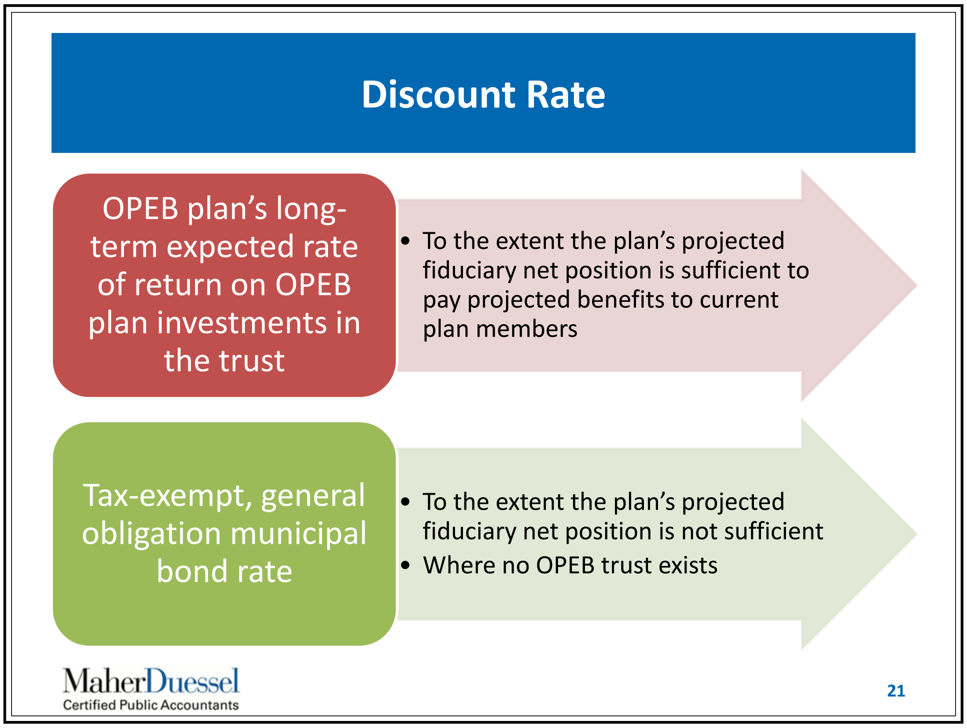

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Discount Rate (continued)

Accordingly, underfunded plans will result in an increased total OPEB liability compared to well-funded plans.

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Allocation

- Entry age actuarial cost method is required
- Level percentage of pay

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Items Immediately Recognized in Expense

- Increases
  - Service cost
  - Interest on the total OPEB liability as of the beginning of the year
  - Administrative expenses
  - Changes in the total OPEB liability due to changes in plan benefits
- Decreases
  - Projected investment returns over the year
  - Current employee contributions for OPEB
  - Changes in the total OPEB liability due to changes in plan benefits

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Items with Deferred Recognition

- Must use a closed 5-year period, starting with the current reporting period
  - Differences between projected investment earnings and actual investment earnings

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Items with Deferred Recognition (continued)

- Must use a closed period equal to the average expected remaining service lives of employees, retirees, and vested deferred members, starting with the current reporting period
  - Changes in actuarial assumptions
  - Differences between expected actuarial experience and actual experience

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Items with Deferred Recognition (continued)

- Reduction of liability in subsequent year
  - Employer contributions to the OPEB plan (if any) that are made subsequent to the measurement date of the net OPEB liability and before the end of the reporting period

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Items with Deferred Recognition (continued)

- Reported as “deferred inflows of resources” or “deferred outflows of resources” related to OPEB

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Cost-Sharing Employers

- A cost-sharing employer's net OPEB liability is its "proportionate share" of the cost-sharing plan's collective net OPEB liability
- The cost-sharing plan would calculate the collective net OPEB liability for all participating cost-sharing employers using the same methods as for single-employer and agent OPEB plans
- The plan would calculate the collective OPEB expense, and collective deferred inflows/outflows of resources

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First, and foremost…

Consult Your Actuary and Your Auditor

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Your OPEB is going to be a substantial long-term liability. What can you do?

- Create a qualified trust fund to prefund OPEB obligations

PROS	CONS
Dedicated source of funding	Irrevocable
Eliminates/reduces contributions required in future years	Fees can be costly
Can use a more favorable discount rate for valuation	

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If you decide to set up a trust, understand…

- Your legal authority to establish a trust and the forms of trust allowed
- How to design trust documents effectively
- The fiduciary roles needed to administer the trust
  - Trust administrator
  - Custodian
  - Investment advisor
- Your investment policy
- Your spending policy

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Your OPEB is going to be a substantial long-term liability. What can you do?

- Commit/assign fund balance for payment of future OPEB obligations

PROS	CONS
Excesses from prior years can be set aside to offset future costs	Doesn't qualify as a trust and can't be used to reduce the NOL
Can "uncommit" funds should another need arise	Must use a less favorable discount rate for valuation

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If you decide to commit/assign fund balance, understand…

- Your policy for setting committed/assigned fund balance
- Your plan for utilizing the committed/assigned fund balance
- The balance of the committed/assigned fund balance must be disclosed in your financial statements
- Your policy for setting committed/assigned fund balance must be described in your financial statements

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Your OPEB is going to be a substantial long-term liability. What can you do?

- Redesign/renegotiate benefits structure

PROS	CONS
Can eliminate/reduce obligation	Hard to get all necessary parties to agree

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If you decide to redesign/renegotiate benefits structure, understand…

- Options include:
  - Eliminating the benefit for new entrants
  - Offering current employees to switch to a defined contribution plan
  - Changing co-payments, health plans, coverages, etc.
  - Others as can be agreed upon

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Your OPEB is going to be a substantial long-term liability. What can you do?

- Do nothing – continue to pay as you go

PROS	CONS
No changes to current practice	Liability will remain substantial

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If you decide to do nothing, understand…

- General Fund budget for pay-as-you-go may fluctuate year over year
- Bond rating agencies may inquire about the liability
- You may minimize your exposure to fluctuating financial markets

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Questions?

Implementation

- Effective for plan financial statements for fiscal years beginning after June 15, 2016
  - 6/30/17
  - 12/31/17
- Effective for employer financial statements for fiscal years beginning after June 15, 2017
  - 6/30/18
  - 12/31/18

Implementation (continued)

- Changes adopted should be applied retroactively by restating financial statements, if practical, for all prior periods presented

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GASB Implementation Guide (cont.)

- Q4.2 – If the Plan issues a stand-alone financial report in accordance with Statement #74, the Employer does not need to include detailed disclosure and RSI requirements of Statement #74 as part of its presentation of the OPEB trust fund in the Employer's financial report. The Employer's financial report needs to include information on how to obtain the stand-alone financial report. However, upon adoption of Statement #75, detailed disclosure and RSI requirements will be required for the Employer's financial report.

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GASB Implementation Guide (cont.)

- Q4.69 – If the Plan does not issue a stand-alone financial report in accordance with Statement #74, the Employer must include detailed disclosure and RSI requirements of Statement #74 as part of its presentation of the OPEB trust fund in the Employer’s financial report. The Employer’s financial report needs to include this information from two perspectives (the employer and the plan). The Employer can take care to avoid unnecessary duplication of information.

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GASB Implementation Guide (cont.)

- Q4.35 – A primary government and its component units should be considered to be one employer for purposes of classifying a defined benefit OPEB plan. Therefore, a government who administers a defined benefit OPEB plan through a trust for its employees and the employees of its component units is considered to have a single-employer plan.

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Questions? Contact Us!

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