Segal Consulting

update

Public Sector Benefits Compliance News

April 15, 2016

GASB's Updated Accounting Standards for Other Postemployment Benefits (OPEB)

The effective date of Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, is fast approaching. Statement No. 74, the first of two updated Governmental Accounting Standards Board (GASB) standards that address accounting and financial reporting by state and local governments for retiree health insurance and postemployment benefits other than pensions (OPEB), takes effect for fiscal years beginning after June 15, 2016. It applies to OPEB plans that administer benefits on behalf of governments. The other updated OPEB standard, Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, which addresses reporting by governments that provide OPEB to their employees and for governments that finance OPEB for employees of other governments, takes effect one year later (for fiscal years beginning after June 15, 2017).[1]

This publication summarizes the key requirements in the updated statements, which are intended to provide a more comprehensive picture of the costs associated with state and local governments' OPEB benefits. It also notes some of the implications. As a result of the changes, which are generally very similar to the changes GASB proposed in Exposure Drafts published in 2014,[2] sponsors of public sector plans will face significant additional work in order to prepare their financial statements.

Accounting Guidance Highlights:

- The effective date for plan reporting, Statement No. 74 is for fiscal years beginning after June 15, 2016 (later than the December 15, 2015 effective date proposed in the Exposure Draft).
- The effective date for plan sponsor reporting, Statement No. 75 is for fiscal years beginning after June 15, 2017 (later than the December 15, 2016 effective date proposed in the Exposure Draft.)

The Changes

Frequency of Actuarial Valuations

At least every two years, actuarial valuations will be required for plans with 100 or more participants.[3] Current standards require plans with fewer than 200 participants to perform triennial valuations. Plans with fewer than 100 participants will be offered an alternative measurement method to do their calculations.

Calculation and Recognition of OPEB Liabilities

GASB introduces the following changes for plans and sponsoring employers:

- The net OPEB liability, defined as the actuarial accrued liability offset by the OPEB plan's net fiduciary position (if assets exist), will have to be recognized.

[1] Both statements, which GASB approved unanimously on June 2, 2015, can be accessed from GASB's website.

[2] For a summary of what GASB proposed, see Segal Consulting's September 2014 *Bulletin*, "GASB Exposure Drafts Propose New Disclosures for Other Postemployment Benefits (OPEB)."

[3] These include employees and retirees.

- The actuarial accrued liability will have to be determined using the entry age actuarial cost method with a level percentage of pay. (Under current accounting standards, plans and employers can choose among six different actuarial cost methods for determining their accrued OPEB liability.)
- The discount rate for pay-as-you-go plans will be based on a 20-year tax-exempt high-quality general obligation bond index. For funded plans, this bond rate may be blended in with the trust fund's expected rate of return on assets depending on the structure of the funding policy compared to benefit payment projections.
- The Affordable Care Act's excise tax on high-cost health plans[4] will have to be taken into consideration in calculating the net OPEB liability.

"The discount rate for pay-as-you-go plans will be based on a 20-year tax-exempt high-quality general obligation bond index."

New Definition of OPEB Expense

The OPEB expense will be defined as the change in the net OPEB liability from year to year with some limited deferrals allowed.

There is a special requirement for employers that provide insured benefits through an arrangement where premiums are paid to an insurance company while employees are in active service and the insurance company takes on the obligation to pay OPEB in retirement. Statement No. 75 requires those employers to recognize OPEB expense equal to the amount of annual contributions or premiums required by the agreement with the insurance company. In addition to the amount of OPEB expense/expenditures recognized in the current period, a brief description of the benefits provided through the arrangement is required to be disclosed.

New Disclosures for Cost-Sharing Employers

Cost-sharing employers[5] will be required to disclose their proportionate share of the collective net OPEB liability and expense and their contributions to the plan. Cost-sharing employers must also disclose all of the items listed in the next section for their proportionate share.

Financial Statements

Financial statements will be required to include:

- A description of the OPEB plan,
- Significant assumptions and other inputs, including sources of assumptions and dates of different experience studies,
- Information about assets (*i.e.*, investments, investment policy, and methods to determine fair value of assets),
- Information about the selection of the discount rate and how it was determined,
- The net OPEB liability under five possible combinations of discount rate, the discount rate plus/minus 1 percent, the health care trend rate, and the health care trend rate plus/minus 1 percent,
- The OPEB plan's net fiduciary position (if the plan has assets),
- A schedule of changes in net OPEB liability in which plan changes are recognized immediately and other gains/losses are amortized,

[4] Beginning in 2020, the Affordable Care Act imposes a 40 percent excise tax on the cost of high-cost health plans above a certain threshold. The base thresholds for 2018 are $10,200 for self-only coverage and $27,500 for all other coverage tiers, with higher thresholds available for certain participants. These thresholds will be indexed to 2020 and beyond.

[5] Cost-sharing employers are those whose employees are provided a defined benefit OPEB plan through a multiple-employer plan in which the OPEB obligations to the employees of more than one employer are pooled and plan assets can be used to pay the benefits of the employees of any employer that provides OPEB through the OPEB plan.

- The measurement date,
- A narrative about the actuarial measurement process and changes, and
- A schedule showing the subsequent five years of amounts currently deferred to be recognized in expense and the aggregate amount thereafter.

Additionally, the net OPEB liability will be required to be recognized in the footnotes of the financial statements for plans and on the balance sheets for employers. GASB Statement No. 43, for plans, and Statement No. 45, for governments, which will be superseded by the new standards, require the unfunded liability to be reported in the notes for the plan. Under GASB Statement No. 74 and Statement No. 75, the OPEB expense will need to be recognized in the income statement for participating employers.

Required Supplementary Information

Required Supplementary Information will have to include the following information, determined as of the measurement date, for each of the 10 most recent fiscal years:

- The sources of changes in the net OPEB liability,
- The components of the net OPEB liability and related ratios, including the OPEB plan's net fiduciary position as a percentage of the total OPEB liability, and the net OPEB liability as a percentage of covered employee payroll, and
- A schedule of contributions, if actuarially determined, statutorily or contractually required, and the amounts recognized by the OPEB plan and covered employee payroll.

Implications

Statement No. 75 will bring the net OPEB liability front and center on the reporting entity's balance sheet. (Statement No. 74 requires that the net OPEB liability be reported in the footnotes to the financial statement.) Though total OPEB liabilities may be smaller than the entity's total pension liability, the *net* OPEB liability will often be larger than the *net* pension liability because OPEB is usually less well funded than pensions. With the size and risk of these obligations more prominently displayed, there is likely to be increased pressure to improve the funding of these obligations or redesign the plans to limit the obligations.

> "Statement No. 75 will bring the net OPEB liability front and center on the reporting entity's balance sheet."

Recordkeeping issues could arise because of new requirements to allocate the net OPEB liability among employers participating in cost-sharing multiple-employer plans.

The standards are not funding standards and the calculations will not be appropriate for funding purposes. Employers that wish to begin prefunding OPEB on an actuarial basis, as well as those that are already prefunding, will need to ask for additional calculations of an actuarially determined contribution consistent with a funding policy that the employer will need to establish.

After all the recent changes in pension accounting, the new OPEB standards will bring a similar new focus to the management of the employer's other postemployment benefits.

What's Next?

GASB intends to publish Implementation Guides for Statements 74 and 75, one for each Statement. The proposed first guide, which will focus on implementation issues for plans, is scheduled to be released for a 60-day comment period in November 2016.

GASB's goal is to publish the final Implementation Guide in February 2017. Work on the second Implementation Guides, which will focus on issues related to employer-specific requirements, will begin at that time.[6]

Questions?

For more information about how these new accounting rules may affect your plan, please contact your Segal consultant or the Segal office nearest you.

How Segal Can Help

Segal works with public plans and employers and their auditors to determine the potential immediate and longer-term impact of GASB's OPEB requirements on plans and practices. We help public plans and employers reassess their retiree health strategies for both Medicare-eligible and pre-age-65 retirees, including evaluating alternative options for medical and prescription drug coverage that balance plan design, costs and liabilities. In addition, we can run funding and long-term solvency projections on either a deterministic or stochastic basis[7] to help public plans and employers develop a sustainable financing approach to OPEB.

"Public plans and employers…[need to] determine the potential immediate and longer-term impact of GASB's OPEB requirements on plans and practices."

For assistance, contact your Segal benefits consultant or one of the following experts:

- Mary P. Kirby, FSA, MAAA, FCA
  212.251.5489
  mkirby@segalco.com

- Kim Nicholl, FSA, MAAA, FCA, EA
  312.984.8527
  knicholl@segalco.com

- Richard Ward, FSA, MAAA, FCA
  818.956.6714
  rward@segalco.com

- J. Richard Johnson
  202.833.6470
  rjohnson@segalco.com

Future Segal communications will focus on plan design and funding options to better manage liabilities.

[6] For additional details, see the project page on GASB's website.

[7] Deterministic projections assume a fixed rate of return. Stochastic projections provide a spectrum of possible returns through many repeated simulations of deterministic projections.