



401 Merritt 7
 Norwalk, CT 06856-5116
 Phone: (203) 847-0700
 www.gasb.org

GASB Proposals Would Significantly Improve Reporting of Retiree Health Insurance and Other Benefits

In May 2014, the Governmental Accounting Standards Board approved a pair of related proposed Statements designed to bring about substantial improvements to the accounting and financial reporting of other postemployment benefits (OPEB) by state and local governments and financial reporting of OPEB plans. OPEB principally involves retiree health care benefits, but also may include life insurance, disability, legal and other services.

One Exposure Draft, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* (OPEB employer Exposure Draft), proposes guidance for reporting by governments that provide OPEB to their employees and for governments that are legally required to finance OPEB for employees of other employers. The other Exposure Draft, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans* (OPEB plan Exposure Draft), addresses the reporting by OPEB plans that administer those benefits of behalf of the governments.

These proposals are designed to bring about advances in accounting and financial reporting for OPEB similar to those that result from the Board's pension standards established in 2012. The pension standards, specifically, are Statements No. 67, *Financial Reporting for Pension Plans*, which addresses financial reporting for state and local government pension plans, and No. 68, *Accounting and Financial Reporting for Pensions*, which addresses reporting for pensions provided by governments.

The guidance contained in these proposed Statements would change how governments calculate and report the costs and obligations associated with OPEB in important ways. It is designed to improve the effectiveness of the OPEB standards by requiring more useful information and increasing transparency, consistency, and comparability across governments.

The OPEB plan Exposure Draft would supersede the requirements of Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other than Pension Plans*, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, for defined benefit OPEB plans. This proposed Statement also would supersede certain requirements of Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and Statement No. 50, *Pension Disclosures*, for defined contribution OPEB plans.

The OPEB employer Exposure Draft would supersede the accounting and financial reporting requirements of Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, and Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*.

Background

To ensure that GASB pronouncements continue to be of high quality and are in sync with the evolving government environment, the GASB periodically reexamines its standards. Reexamination typically takes place after a Statement has been in place and fully implemented for at least five years. Research on the GASB's OPEB standards indicated the existence of opportunities for significant improvement in light of the changes in pension accounting and financial reporting.

The proposed Statements apply to governments and OPEB plans in which a government makes contributions to a trust used to administer an OPEB plan in which (a) contributions to the trust are irrevocable, (b) OPEB plan assets are restricted to paying OPEB, and (c) OPEB plan assets are beyond the reach of creditors.

The proposed guidance also provides requirements for governments that provide OPEB through an arrangement that is not administered through a trust that meets the above three criteria. Unlike pensions, many governments do not provide OPEB through a trust meeting those criteria. In addition, the proposal contains guidance for governments that are legally responsible for the OPEB of another entity's employees—circumstances referred to as *special funding situations*.

Governments provide OPEB through various types of *defined benefit* OPEB plans, which specify the *amount of benefits* to be provided to the employees after the end of their employment. *Single-employer* OPEB plans provide benefits to the employees of one employer (a *single employer*). *Multiple-employer* OPEB plans provide benefits to the employees of more than one employer. Certain multiple-employer OPEB plans that are administered through a trust that meets the criteria discussed above are also classified separately. Under an *agent* multiple-employer OPEB plan, the assets of a multiple-employer OPEB plan are pooled for investment purposes but separate “accounts” are maintained for each individual *agent employer*, so that each agent employer's share of the pooled assets is legally available to pay the OPEB of only its employees. In a *cost-sharing* multiple-employer OPEB plan, *cost-sharing employers* share their assets *and* their obligations to provide OPEB to their employees—plan assets generally can be used to pay the benefits of the employees of any employer that provides OPEB through the plan. The proposed Statements address all of these types of plans, as well as *defined contribution* plans, which stipulate only the amount to be contributed to employee accounts each year, not the amount of benefits that will be paid in the future.

The proposed Statements relate to *accounting and financial reporting* issues only—how OPEB costs and obligations are measured and reported in audited external financial reports. They do not address how governments approach OPEB plan *funding*—a government's policy regarding how much money it will contribute to its OPEB plan each year. The Board crafted its proposed Statements with the fundamental belief that funding is a policy decision for government officials to determine.

Recognizing a Liability Related to OPEB

State and local government employees often earn two types of compensation in return for their efforts—current compensation and deferred compensation. Salaries and other forms of current compensation reflected in the paycheck are received by employees during their employment. On the other hand, deferred compensation, including OPEB, is not received until after the employee's tenure with the government has concluded. Nevertheless, a government has a present obligation to pay these deferred benefits in the future—a *total OPEB liability*—once they have been earned.

When a government provides OPEB through an OPEB plan that is administered through a trust that meets the criteria discussed above, the GASB concluded that the government's OPEB liability should be recognized net of the amount of the OPEB plan's fiduciary net position because those amounts are the primary resources that will be used to pay the OPEB. This liability would be referred to as the *net OPEB liability*. The OPEB plan's fiduciary net position available for paying benefits is to be measured using the same valuation methods that are used by the OPEB plan for purposes of preparing its financial statements, including measuring investments at fair value.

For governments that do not provide OPEB through a trust that meets the criteria discussed above, the OPEB liability recognized by the government would be the total OPEB liability.

This is an important change that will more clearly depict the government's financial position—but will not alter the economic reality of the government's situation. Reporting the net OPEB liability on the face of the financial statements will more clearly portray the government's financial status because the OPEB liability will be placed on an equal footing with other long-term obligations.

Measuring the Total OPEB Liability

The proposed OPEB standards reflect several potential changes from those currently in place regarding how governments calculate their total OPEB liability. The measurement process detailed in the proposed standards involves three essential 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.

The proposed standards would continue the general existing practice of incorporating expectations of future employment-related events into projections of OPEB payments—like projected salary increases and projected years of service—if they affect the amount of OPEB payments employees will receive. Provisions for automatic cost-of-living adjustments (COLAs) and other automatic benefit changes (which generally are written into the OPEB terms) also will continue to be included in projections. On the other hand, *ad hoc* COLAs and other *ad hoc* benefit changes—which are made at the discretion of the government—will be included in projections as well if they are substantively automatic.

To discount projected OPEB payments to a present value, governments assume a *discount rate*. Under the GASB's proposal, governments would project the OPEB payments expected to be made in each year and the amount of plan

assets available for providing those benefits to current active and inactive employees and their beneficiaries.

As long as plan assets related to current active and inactive employees and their beneficiaries are projected to be sufficient to make the projected benefit payments for those individuals, governments would discount those projected benefit payments using the long-term expected rate of return.

For some governments, however, there will be a point—the *crossover point*—at which the plan assets are projected not to be sufficient for making projected benefit payments to current active and inactive employees and their beneficiaries. The GASB believes that the projected benefit payments that occur at that point and after are similar to other forms of debt. In this circumstance, the discount rate would be based on a tax-exempt, high-quality 20-year tax-exempt general obligation municipal bond yield or index rate. *High-quality* would be defined as being rated AA or higher (or an equivalent rating).

For an OPEB plan with no assets held in trust—which is most common—all projected benefit payments would be discounted using the municipal bond rate.

Finally, benefit payments—discounted to their present value—would be attributed to past and future periods. Under current requirements, governments can choose among six methods for attributing the present value of benefit payments to specific years either in level dollar amounts (similar to a mortgage) or as a level percentage of projected payroll. The proposed standards would require all governments to use the entry age actuarial cost method to allocate present value, and to do so as a level percentage of payroll. Under this method, projected benefits are discounted to their present value when employees first begin to earn benefits and are attributed to employees' expected periods of employment. The GASB believes the attribution pattern that results from use of the entry age actuarial cost method and level percentage of payroll is more representative of how OPEB is earned. In other words, the pattern reflects the ongoing annual exchange of service for benefits over the course of an employee's period of employment in amounts that keep pace with the employee's projected salary over that period.

Calculating OPEB Expense

A government's OPEB liability varies from year to year for a variety of reasons, including actual earnings on plan investments when the OPEB plan is administered through a trust meeting the earlier described criteria, employee compensation changes, interest on the outstanding OPEB liability, contributions from employers and employees, and actual economic or demographic changes that are not in line with assumptions made in the actuarial calculations. When these period-to-period changes should be included

in the calculation of the cost of a government's operations as expenses in the accrual-based financial statements is a key issue.

The proposed standards would provide a more comprehensive measure of OPEB expense. Under the proposed standards, several causes of change in OPEB liability would be factored into the calculation of OPEB expense *immediately* in the period in which the change occurs:

1. Benefits earned each year
2. Interest on the total OPEB liability
3. Changes in benefit terms
4. Projected earnings on plan investments, if administered through a trust that meets the criteria discussed earlier
5. Other changes in the OPEB liability not discussed below.

The effects on the total OPEB liability of (a) changes in assumptions and (b) differences between assumptions and actual experience would be recognized initially as deferred outflows of resources or deferred inflows of resources and then introduced into the expense calculation systematically and rationally over the average remaining years of the employment of employees (active employees and inactive employees, including retirees). This period would likely be significantly shorter than the period of up to 30 years over which governments may now recognize their OPEB expense. The Board believes that bringing these changes in the pension liability into pension expense over the period when employees continue to earn benefits reflects its view that OPEB results from a career-long transaction. The relevant assumptions are about events that will take place during the employees' future years of service; recognizing this part of pension expense over that period is appropriate for assessing whether governments have lived within their means each year—whether they have achieved interperiod equity.

If the OPEB plan is administered through a trust that meets the criteria discussed earlier, the effect of differences between the expected earnings on plan investments and actual experience would be recognized as deferred outflows of resources or deferred inflows of resources and included in expense in a systematic and rational manner over a five-year closed period. The Board believes that differences between projected and actual investment experience generally will offset over time; earnings in excess of projections in some periods will be offset by earnings shortfalls in other periods, and vice versa. Incorporating OPEB liability changes related to investment earnings experience into OPEB expense over five years provides an opportunity for short-term, market-cycle fluctuations to be offset and dampens the volatility of OPEB expense that would otherwise occur as a result of such fluctuations.

Reporting by Governments in Cost-Sharing Multiple-Employer Plans

Under the OPEB standards now in effect, cost-sharing employers have not been required to present actuarial information about the plan. Instead, information has been required to be presented in the OPEB plan's own financial statements for all of the participating governments combined. In addition, the recognition of expense by a cost-sharing employer has been equal to its contractually required contribution to the OPEB plan.

Through its research, the GASB concluded that the needs of users of information regarding cost-sharing employers are quite similar to those interested in single and agent employers. Therefore, the GASB believes it is important to give users of the financial statements of cost-sharing employers access to better, more transparent financial information. Consequently, the GASB is proposing that cost-sharing governments report net OPEB liability, OPEB expense, and OPEB-related deferred inflows and outflows of resources based on their proportionate share of the collective amounts for all the governments in the plan.

Note Disclosures and Required Supplementary Information (RSI)

The proposed standards contain requirements for disclosing information in the notes to the financial statements and presenting required supplementary information (RSI) following the notes. Due to the complexity of the array of OPEB plan features, the Board concluded it was critical that financial statement users have access to certain basic plan information through governments' own financial statements. The Board believes that including this information will strengthen the usefulness of financial reports for both decision making and assessing accountability.

The GASB is proposing that all governments participating in a defined benefit OPEB plan would include the following information in their note disclosures:

- ◆ Descriptions of the plan and benefits provided
- ◆ Significant assumptions employed in the measurement of the OPEB liability, including the discount rate and the healthcare cost trend rate
- ◆ Descriptions of benefit changes and changes in assumptions
- ◆ The OPEB liability and deferred outflows of resources and deferred inflows of resources related to OPEB
- ◆ The impact on the OPEB liability of a 1-percentage-point increase and decrease in the discount rate and a 1-percentage-point increase and decrease in the healthcare cost trend rate.

Single and agent employers also would be required to disclose, for the current period, the beginning and ending

balances of the OPEB liability, and the effects of changes during the period (such as the effects of service cost, benefit changes, and, if applicable, investment earnings) on the total OPEB liability and the OPEB plan's fiduciary net position, if applicable.

In addition, single and agent employers would present RSI schedules with the following information for each of the past 10 years (generally on a prospective basis):

- ◆ The beginning and ending balances of the OPEB liability and the effects of changes during the period on the total OPEB liability and the OPEB plan's fiduciary net position, if applicable
- ◆ The OPEB liability, the covered-employee payroll, and a ratio of the OPEB liability as a percentage of the covered-employee payroll. If the OPEB is provided through an OPEB plan that is administered as a trust that meets the criteria discussed previously, the OPEB plan fiduciary net position and a ratio of the OPEB liability to the OPEB plan's fiduciary net position would also be presented. If there is a special funding situation, as discussed on the next page, the OPEB liability of the plan will be reported along with the amounts of that net OPEB liability associated with the employer and associated with the nonemployer entity.

If a single or agent employer that provides OPEB through an OPEB plan that is administered as a trust that meets the criteria discussed previously has an actuarially determined OPEB contribution (or, if not actuarially determined, then the statutorily or contractually established contribution), it would also be required to present an RSI schedule with the following information for each of the past 10 years (generally on a prospective basis): (1) the actuarially determined OPEB contribution (or, if not actuarially determined, then the statutorily or contractually established contribution), (2) the amount of employer contribution actually made, (3) the difference between 1 and 2, (4) the payroll of employees covered by the plan, and (5) a ratio of 2 divided by 4. Cost-sharing employers would be required to present this same information if it has a statutorily or contractually established contribution requirement.

Governments also would be required to present notes to the RSI schedules regarding factors that significantly affect the trends in the schedules. For employers with actuarially determined contributions, significant assumptions also would be disclosed.

Special Funding Situations

Special funding situations are circumstances in which a *nonemployer contributing entity* (such as a state government) is legally responsible for contributions directly to an OPEB plan of another employer, including payments for OPEB as the benefits come due. For example, a state might be legally required to make contributions for the employees of

school districts located within that state. Furthermore, *one or both* of the following also must be true:

1. The nonemployer is the only entity with a legal obligation to make contributions directly to the OPEB plan, including payments for OPEB as the benefits come due
2. The amount of the contributions (or payments for OPEB as the benefits come due) for which the nonemployer is legally responsible is not dependent upon one or more events unrelated to the OPEB.

In a special funding situation, the nonemployer has essentially assumed a portion of the employer entity's OPEB obligation as its own. Consequently, if the nonemployer is a government, it would recognize its proportionate share of the net OPEB liability, OPEB expense, and deferred outflows of resources and deferred inflows of resources related to OPEB in its own financial statements.

The government benefitting from the nonemployer's contributions in a special funding situation would calculate its OPEB liability, OPEB expense, and deferred outflows of resources and deferred inflows of resources related to OPEB prior to the nonemployer government's support, but would *recognize* in the financial statements only its proportionate share. It also would recognize a revenue and an expense equal to the nonemployer entity's OPEB expense, as it would account for an intergovernmental grant.

Reporting by Governments in Defined Contribution Plans

Governments would recognize an expense for the amount of contributions to employees' accounts that are defined by the benefit terms as attributable to employees' services in the period, net of forfeited amounts that are removed from employees' accounts. A change in the OPEB liability would be required to be recognized for the difference between amounts recognized in expense and amounts paid by the employer to a defined contribution OPEB plan, including amounts paid by the employer for OPEB as the benefits come due.

Governments also would make descriptive disclosures about the defined contribution OPEB plan and benefit terms, contribution rates and the method by which they are determined, and amounts attributed to employee service and forfeitures in the current period.

Reporting by OPEB Plans

The proposed Statement on plan reporting details guidance for financial reporting by *defined benefit OPEB plans* administered through trusts that meet the criteria described earlier. The OPEB plan document also addresses how assets that are accumulated for purposes of providing OPEB through defined benefit OPEB plans that are *not* administered through trusts meeting the criteria should be reported. The proposal also details note disclosure

requirements for *defined contribution OPEB plans* administered through trusts that meet the criteria.

Proposed Effective Dates

The proposed requirements of the OPEB plan Exposure Draft would be effective for periods beginning after December 15, 2015. The proposed requirements of the OPEB employer Exposure Draft would be effective for periods beginning after December 15, 2016. Early application would be encouraged in both cases.

How Can You Help the GASB Complete This Project?

You can assist the GASB by reading the Exposure Drafts and providing feedback. The documents are available to download free from the GASB website, www.gasb.org. (See the links below). It is most helpful if you respond to not only the aspects of the proposal you disagree with, but also those that you support. In addition, it is most valuable to the GASB when respondents explain *why* they support or oppose a particular facet of a proposal. You can submit comments by email (director@gasb.org) or traditional mail. The comment deadline is August 29, 2014.

The GASB also encourages you to participate in the series of public hearings scheduled for September 2014. Additional information about how to provide written comments and participate in the public hearings is available in the opening pages of the Exposure Drafts.

The GASB will be conducting two webinars about the proposals:

- ◆ A CPE webinar on July 30, 2014 at 1:00 pm EDT
- ◆ A webinar for financial statement users on August 8, 2014, beginning at 1:00 pm EDT, that will be followed by a survey to collect feedback from users.

Registration for both events will be announced on the GASB website in the coming weeks.

Additional related resources can be downloaded free from the GASB website or by clicking on the links below.

Obtaining the Proposals

The proposed Statements can be downloaded free from the GASB website (www.gasb.org).

- ◆ Read the news release (issued upon release)
- ◆ Read the Q&A
- ◆ Read the article for financial statement users

© Copyright 2014 by Financial Accounting Foundation, Norwalk, CT. Reproduction of these materials, in whole or part, shall only be as permitted by Financial Accounting Foundation. This Copyright Notice must be prominently displayed on any such reproduction.