



Bryan, Pendleton, Swats & McAllister, LLC
A Wells Fargo Company

Accounting for the OPEB Obligation

Tom Swain, F.S.A.

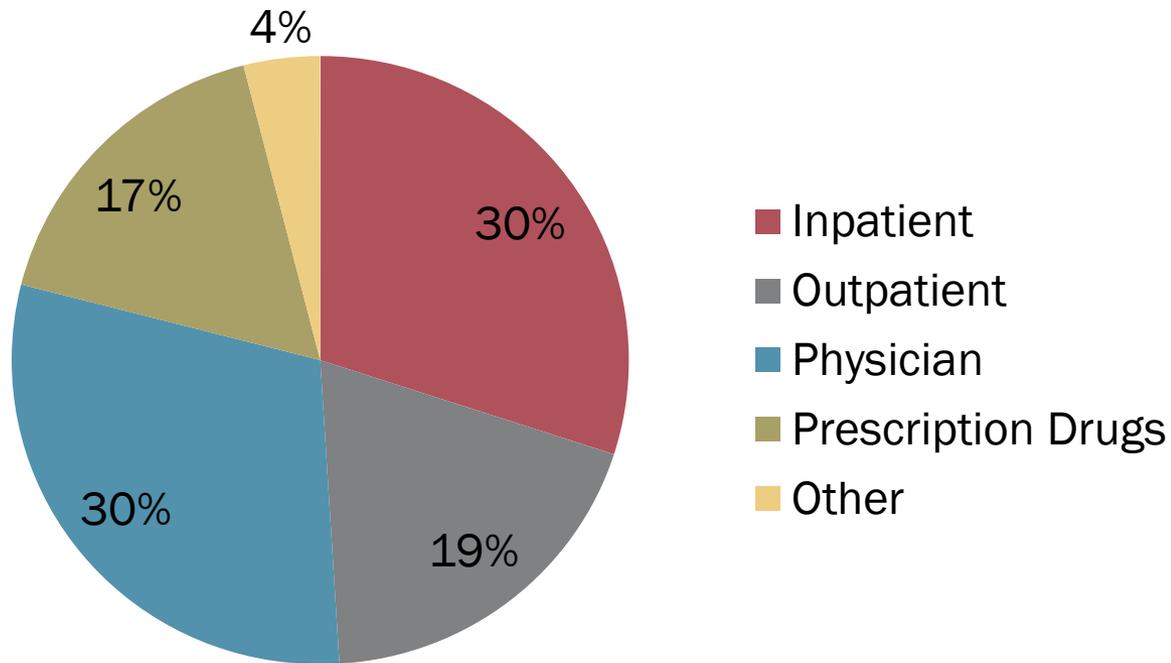
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Agenda

- Overview and effective dates
- Significant changes
- Sample balance sheet pre/post changes
- Plan sponsor implications
- Planning steps to take now
- Questions

Healthcare Statistics

Employer healthcare benefits cost increases are projected to continue at 6.5% in 2017



Why update GASB 43/45?

- More consistency and transparency
 - Robust disclosure of key assumptions
 - Single actuarial method, fixed amortization periods
 - Full recognition of net liability on balance sheet
 - Reporting consistent with pension obligations under GASB 67/68

Who is subject to these new standards?

Government Entities

- State and local governments
- Government-chartered entities
- Non-employer contributing entities

Government OPEB Plans

- OPEB plans administered through a trust that meets the following criteria:
 - Contributions are irrevocable
 - Assets are set aside specifically to pay for OPEB
 - OPEB plan assets are legally protected from creditors
- Single-employer and cost-sharing multiple employer plans

Effective dates

- Plan Reporting–GASB No. 74 (replaces No. 43)
 - Effective for fiscal years beginning after **June 15, 2016**
 - Significant additional plan financial disclosure requirements
 - Most of GASB 74 does not apply if plan is not funded through an irrevocable trust
- Employer Reporting–GASB No. 75 (replaces No. 45)
 - Effective for fiscal years beginning after **June 15, 2017**
 - Applies to employer that report under *Generally Accepted Accounting Principles*
 - Changes to the recognition and measurement of OPEB obligations, as well as disclosure for employers

Early adoption is encouraged.

Important GASB Terms

GASB Term	Definition
Total OPEB Liability	Actuarial Accrued Liability: Liability attributable to prior service
Net Fiduciary Position	Fair Market Value of Plan Assets
Net OPEB Liability (NOL)	Unfunded Actuarial Accrued Liability
Service Cost	Normal Cost : Estimated cost of future participant benefits expected to accrue due to service this year
Actuarially Required Contribution or Actuarially Determined Contribution	Recommended Funding
Annual OPEB Expense	Standardized measurement of OPEB expense, unrelated to recommended or actual funding

Significant changes

	GASB 43/45	GASB 74/75
Approach	Accounting = Funding	Accounting and funding no longer linked
Annual Cost	Annual Required Contribution Defined as service cost plus amortization of all unfunded liabilities over a period not to exceed 30 years	OPEB Expense Defined as accounting expense plus unrecognized items, so that the total equals the annual change in funded status
Balance Sheet Recognition	Net OPEB Obligation or Asset (measure of actual contributions vs Annual Required Contributions)	Net OPEB Liability (standardized measure of funded position of plan)
Assets	Asset smoothing allowed	Fair market value of assets
Discount Rate	If plan is unfunded, expected long-term general account portfolio return	If plan is projected to be underfunded, a combination of long-term portfolio return and tax-free municipal bond return
Funding Methods	6 major funding methods allowed with discretion on amortization methods and periods	Single funding method, fixed amortization periods

The separation of funding and accounting

GASB 43/45

- Most sponsors use the same or similar assumptions for both funding and disclosure calculations

GASB 74/75

- Funding and accounting are officially separated
- Annual expense is a standard measure of actuarial cost
- Plans that currently fund benefits on a pay-as-you-go basis can reduce their unfunded balance sheet liability by establishing a trust and developing a funding policy

Change to annual expense

- The *Annual OPEB Expense* replaces the *Actuarially Required Contribution (ARC)*
- Annual OPEB Expense =
 - Service Cost
 - + Interest Cost
 - + Immediate recognition of benefit change
 - Member contributions
 - Expected Return on Assets
 - +/- Amortization Items (known as deferred inflows and outflows):
 - Asset gains or losses over 5 years
 - Liability experience over average future working lifetime of active employees (0 for retirees)
 - Assumption changes over average future working lifetime of active employees (0 for retirees)

OPEB Liability Reporting

GASB 43/45

- Net OPEB Obligation (NOO) is the accumulation of contributions in excess of the Annual Required Contribution (ARC)

GASB 74/75

- Net OPEB Liability (NOL) is the *Entry Age Normal Level Percent of Salary (EAN%) Accrued Liability* less the Market Value of Assets (MVA).
- The new NOL could be much larger and more volatile than the NOO.

Funded Plans

- Report a Net OPEB Liability on their balance sheet
- Net OPEB Liability = Total OPEB Liability – the plan's fiduciary net position

Unfunded Plans

- Report the Total OPEB Liability on the face of their financial statements
- The entire Unfunded Actuarial Accrued liability (UAAL) will move from the notes of the financial statements to the balance sheet

Calculating the discount rate

Funded Plans

- If assets are sufficient, rate may be calculated as the single rate reflecting the long-term expected rate of return on plan assets
- If assets are insufficient, rate may be calculated using a mixed method.

Unfunded Plans

- Required to use a yield or index rate for 20-year, tax-exempt general obligation municipal bonds with an average rating of AA/Aa or higher

Tax Exempt High Quality Municipal Bond Rates

Year	20 Bond GO (Aa2)	11 Bond GO (Aa1)
2011	5.08%	4.84%
2012	3.83	3.51
2013	3.68	3.43
2014	4.75	4.46
2015	3.42	3.27
2016 YTD	2.85	2.43

*For illustration purposes only
Source: www.bondbuyer.com*

Single actuarial cost method

GASB 43/45

- Employers with fewer than 200 employees had the option of having valuations every three years
- 6 major cost allocation methods available

GASB 74/75

- Employers must use the *Entry Age Normal Level Percent of Salary (EAN%)* actuarial cost method
- Required to be used at least every two years in conducting actuarial valuations
- Applies to employer with fewer than 200 employees¹

¹ The alternative measurement method is available for employers with fewer than 100 employees

GASB 75 Timing of Results

Actuarial Valuation Date (no more than 30 months and 1 day earlier than the employer's FYE)		
		Measurement Date (any date in this FY)
FYE 6/30/2016	FYE 6/30/2017	FYE 6/30/2018

Measurement Date must be consistently applied

Valuation results must be determined at least once every 2 years,
more frequently with material plan changes

Valuation results are projected from valuation date to measurement date,
incorporating plan and assumption changes

Note disclosures or RSI

Note disclosures

Notes to financial statements should include:

- descriptions of OPEB benefits provided,
- the number of employees in each class in the OPEB plan, and
- the source of gains/losses in the Net OPEB Liability for the current fiscal year

Required Supplementary Information

RSI should include:

- Schedule showing each of the following over the most recent 10 years:
 - The sources of changes in the Net OPEB Liability
 - Differences between the actual and required contributions
 - Components of the Net OPEB Liability and related ratios
- NOL sensitivity to changes in medical trend (+/- 1%) and discount rate (+/- 1%), resulting in 5 different NOL measures

Fully funded general government balance sheet (amounts in thousands)

	As Reported GASB 43/45	Adjusted GASB 74/75
Current Assets	\$437,487	\$437,487
Capital Assets	1,098,366	1,098,366
OPEB Assets	0	80,688
Total Assets	1,535,853	1,616,541
Long-term Liabilities Outstanding	635,303	635,303
Other Liabilities	239,389	239,389
OPEB Liabilities	0	168,523
Total Liabilities	\$874,692	\$1,043,215
Net Assets		
Net Investments	\$259,378	\$259,378
Restricted	62,979	62,979
Unrestricted	338,804	338,804
OPEB Funded (Unfunded)	0	(87,835)
Total Net Assets	\$661,161	\$573,326

Change in Net Assets

	As Reported GASB 43/45	Adjusted GASB 74/75
Revenues		
Charges for Services	\$1,241,434	\$1,241,434
Operating Grants and Contributions	(926,575)	(926,575)
Capital Grants and Contributions	0	0
General Revenues		
Property Taxes	0	0
Sales Taxes	0	0
Other Taxes	0	0
Miscellaneous	295	295
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	\$315,154	\$315,154
Expenses		
All Departments	\$232,011	\$232,011
OPEB Expense	17,302	12,337
Community Support	0	0
Interest on Long-Term Debt	22,236	22,236
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	\$271,549	\$266,584
Transfer from Business – Type	0	0
Increase in Net Assets	\$43,605	\$48,570

Implications for plan sponsors

Immediate	GASB 74/75
Greater transparency of plan assumptions	Greater scrutiny of the financing of the plan. Larger contributions, lower benefits, perhaps a combination of the two.
Volatility of unfunded OPEB obligations and annual accounting expense. Some may experience a significant increase in the balance sheet liability.	Fund managers will migrate toward a risk adjusted return approach. Possible adoption of more conservative investment policies, reducing expected long term portfolio returns.
Those switching to the EAN% cost method may experience a one-time increase in NOL. An increase in administrative expense associated with gathering the salary data for the actuary may occur.	Some may aggregate costs associated with conducting actuarial valuations more frequently.
Lowering of discount rate for valuing OPEB obligations	OPEB liabilities grow, causing unfunded pension obligations to increase
More conservative investment policy and lower discount rates	Higher contributions over time, more security for plan participants, higher costs for governments
Expected long-term portfolio return	If plan is projected to be underfunded, a combination of long-term portfolio return and tax-free municipal bond return
Benefit design for government OPEB plans	Reduction in future retirement benefits for workers or more cost and risk sharing with workers

Planning Steps

Understand the impact of GASB 74/75

- Prepare for communication challenges regarding disclosure of funded status and expense
- Begin discussions with actuaries, plan auditors and other stakeholders
- Develop a timeline for implementation. Understand which actuarial valuation will be used at upcoming measurement and reporting dates
- Compare balance sheet recognition and annual expense to current standards. Understand differences and expected volatility
- If community-rated, contact the pool administrators to determine if pool-wide demographic data and expected claims costs will be made available
- Start collecting the historical data needed for the new footnote requirements
- Read the statements and plain-language explanations on gasb.org



Questions