Impact of Implementing GASB 75 – Part I

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Purpose

The Governmental Accounting Standards Board (GASB), recently issued two standards related to other postemployment benefits (OPEB), Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans* (OPEB Plan), and Statement No. 75, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* (OPEB Employer). This article presents highlights of the anticipated impact on accounting and financial reporting for state and local government employers relative to the implementation of GASB Statement 75. Information regarding OPEB-related legislation proposed by the New York State Comptroller is also provided in Part II.

Overview

OPEB are benefits other than pensions that governments provide to their retirees. These principally involve health care benefits, but may also include life insurance, disability, legal, and other services when those benefits are provided separately from a pension plan. OPEB does not include termination benefits, or termination payments for sick leave, other than when a terminating employee's unused sick leave credits are converted to provide or enhance defined benefit OPEB. When a terminating employee's unused sick leave credits are converted to provide or enhance defined benefit OPEB, the resulting benefit or increase in benefit should be accounted for in conformity with OPEB.

In an effort to improve the effectiveness of previous standards concerning OPEB, specifically guidance provided by GASB Standard No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, the GASB recently issued two statements that supersede the accounting and financial reporting requirements stipulated by those standards. The first, GASB Standard 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans,* provides reporting guidance for OPEB plans that administer OPEB benefits on behalf of governments. The second, GASB Standard 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions,* provides reporting guidance for governments that provide OPEB to their employees and for governments that are legally required to finance OPEB for employees of other governments. The standards detail how state and local governments should account for and report OPEB, primarily retiree health insurance. The guidance in these statements will change how the long-term obligations associated with OPEB are calculated and reported. The changes largely mirror changes that were recently adopted for pension liabilities and, like the standards for pensions (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 OPEB statements relate only to how costs and liabilities are measured and reported in the financial statements, not how a government should fund its OPEB plan.

The requirements of GASB Statement No. 74 addressing OPEB plans applies to state and local governments for fiscal years beginning after June 15, 2016. The requirements of GASB Statement No. 75 addressing OPEB employers applies to state and local governments for fiscal years beginning after June 15, 2017.

Financial Statement Impact (Employers)

One of the biggest changes to the financial statements of governmental employers that provide OPEB would be the reporting of the OPEB liability on the face of the statements rather than in the footnotes. Governments that do not provide OPEB through a trust would be required to recognize the entire OPEB liability in the financial statements. For governments that provide OPEB through an OPEB plan that is administered through a trust, the government's OPEB liability would be recognized net of the amount of the OPEB plan's fiduciary net position.

Previous guidance allowed governments to amortize the unfunded liability over a period of up to thirty years (approximately equal to a typical public employee's term of employment) and recognize that amount in the financial statements. In the year of implementation, reporting the entire OPEB liability on the face of the financial statements, as required by the new standard, will have a significant impact on the government's net position for governments that previously elected to amortize the liability.

Changes to the Measurement of the Total OPEB Liability

Measurement of the OPEB liability includes discounting future benefit payments for current and former employees and their beneficiaries to present value and allocating the present value over past and future periods of the employee services (total OPEB liability), less the amount of the OPEB plan's fiduciary net position. The calculation would continue to include employee-related events, such as projected salary increases and projected years of service, if they impact the amount of OPEB payments employees will receive, as well as provisions for automatic cost-of-living adjustments (COLAs) and other automatic benefits. Additionally, 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 routinely recur.

Governments are required to discount projected OPEB payments to their present value. Under the new standard, governments would discount the projected OPEB payments to be made in each year and the amount of plan assets (if a government administers the OPEB through a trust) available for providing those benefits to current active and inactive employees and their beneficiaries. Similar to the pension standards, the discount rate that would be used would be based on whether the plan assets are projected to be sufficient to make future payments. If the plan assets are sufficient, governments would discount future payments using the long-term expected rate of return. If plan assets are projected to be insufficient to make future payments to current and inactive employees and their beneficiaries, or if there are no plan assets held in trust, the discount rate would be based on a 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). Under existing standards, governments are allowed to use a discount rate based solely on an assumed long-term rate of return on investments that are expected to be used to pay OPEB.

Finally, benefit payments that are discounted to the present value would be attributed to past and future periods. All governments will be required to use the entry age normal level percentage of payroll cost method to allocate the present value over past and future periods of employee service. This method projects benefits that are discounted to their present value when employees first begin to earn benefits and are attributed to the employees' expected periods of employment. Under current standards, governments are allowed to choose from one of six different cost methods for attributing the present value of benefit payments to specific years.

Calculating OPEB Expense

Factors that impact a government's OPEB liability, such as actual earnings on plan investments when the OPEB plan is administered as a trust, employee compensation changes, interest on the outstanding OPEB liability, contributions from employees and employers, and actual demographic and economic changes that are not in line with assumptions made in the actuarial calculations, will be considered when determining the government's OPEB expense. A government's annual OPEB expense would be calculated with consideration for factors affecting the OPEB liability within the reporting period. Several causes of changes in OPEB liability would immediately be factored into the calculation of OPEB expense for the period, such as benefits earned each year, interest on the total OPEB liability, changes in benefit terms, and projected earnings on plan investments, if administered through a trust.

Governments would be required to recognize deferred outflows of resources or deferred inflows of resources and then introduce into the expense calculation, systematically and rationally over the average remaining years of employment (active employees and inactive employees, including retirees), the impact to the total OPEB liability for differences between assumptions and actual experience. Currently, most governments recognize the change over a period of up to 30 years. This will shorten the period significantly and align the recognition of this part of the expense over the period when employees continue to earn the benefit; therefore, achieving inter-period equity.

For OPEB plans that are administered through a trust, the differences between the expected earnings on plan investments and actual returns 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 period. The intent is to allow the differences between projected and actual investment returns to offset over time (i.e., earnings in excess of projections in some periods will be offset by earnings shortfalls in other periods).

Note Disclosure and Required Supplementary Information (RSI)

In addition to the note disclosures currently required for OPEB, the standard will also require disclosure of:

- A reconciliation of the changes in 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.

Governments with single and agent employers would also be required to disclose for the current period:

- 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.
- The OPEB plan's fiduciary net position, if applicable.

The RSI would have to include the following additional information for each of the past 10 years (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.
- The OPEB plan's fiduciary net position, if applicable.
- The components of the OPEB liability and related ratios, including the covered employee payroll, the OPEB plan's fiduciary net position as a percentage of the total OPEB liability, and a ratio of the OPEB liability as a percentage of the covered employee payroll.
- Schedules of contributions displaying the difference between actuarially determined contributions and employer contributions, covered employee payroll and employer contributions as a percentage of covered payroll.

Governments also would be required to present notes to the RSI schedules regarding factors that significantly affect the trends in the schedules.

For more detailed information on the OPEB Standards, please refer to www.gasb.org.

Author's Bio

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Mr. Traylor serves as the New York State Executive Deputy Comptroller for Operations overseeing the state's accounting, payroll, and financial reporting functions. He has helped lead the push for OPEB trust legislation under State Comptroller Thomas P. DiNapoli.

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Mrs. Baker is the Executive Director for the Bureau of Financial Reporting and Oil Spill Remediation in the Office of the State Comptroller. Suzette has implemented the OPEB standards for New York State and has reviewed the new OPEB standards and the impact the standards have on financial reporting for the State of New York.

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Mrs. Moran is an Associate Accountant in the Bureau of Financial Reporting and Oil Spill Remediation in the Office of the State Comptroller. Maria Elena has reviewed the OPEB standards and will assist in implementing the standard for the State of New York.