OTHER POSTEMPLOYMENT BENEFITS
STATEMENTS 74 AND 75

Key Takeaways From This Presentation

- Healthcare pricing in the U.S. is broken and we as finance professionals must focus on controlling costs for both active and retirees.
- For those who created a "irrevocable trust", your first GASB 74/75 valuation is next year and you may want to re-think the plan FYE,
- OPEB is an "overlay" benefit that takes an active employee benefit and applies it to retirees-**Finance and HR will have to talk to each other to properly implement these standards**
- While GASB Pension (67/68) and OPEB (74/75) requirements are extremely similar the underlying transactions that drive the numbers are completely different -a salary/time based pension benefit vs. a claims based retiree health benefit
- Unlike Pensions, the majority of the implementation burden will fall on the employer
- Expect volatility

Did You Know…

- That in 1960, healthcare was 5% of Gross Domestic Product (GDP)
- By 2014, it had grown to 17.5% of GDP or $9,523 per capita
- It is predicted to exceed 20% by 2021
- The 2012 average for the 35 nation OECD is 9.3%
- Individuals in OECD nations on average live 1.5 years longer than those born in U.S.
- After ACA removed life time maximums, various stop loss reinsurers reported dramatic increases in $1 million and over claims

Impact to Cities

- It is not unusual for the average employer cost to provide healthcare per employee to exceed $12,000
- Employer costs can range from $7,000 for employee only coverage all the way to $20,000 for family coverage.
- While reporting and disclosure focuses on retiree benefits, active healthcare is typically the most expensive benefit provided.
- Employers must take a holistic approach to managing OPEB as cutting access to retiree coverage can simply result in employees staying on the plan as actives

OPEB OVERVIEW

OPEB in Brief

- GASB 74 (Plans) & 75 (Employers) are almost identical to their pension siblings GASB 67 (Plans) and 68 (Employers) except for:
  - *Pension lessons learned have been built into the base standards (for example-GASB 71-transition guidance for contributions after the measurement date and GASB 73-non trusted plans have been incorporated into the base standards, subsections of the standard have also been labeled at the corner of each page to promote easy navigation)*
  - *Minor tweaking to better fit retiree healthcare have been made (for example, recognizing implicit rate subsidies or requiring sensitivity analysis for healthcare trend rate)*
  - *Alternative method for very small plans (100 or fewer **total** participants) is still included in the new guidance.*

OPEB in Brief

- OPEB is divided into two categories:
  - *Postemployment health care benefits always accounted for separately*
  - *Other forms of OPEB--such as death benefits, life insurance and disability benefits-only accounted for separately when provided separately from a pension plan*
- GASB defines a pension plan as all assets are available to pay all liabilities. Using Texas Municipal Retirement System as an example:
  - *Disability is blended in with pensions as all disability assets and liabilities are accounted for in the pension trust fund*
  - *Supplemental Death is accounted for separately as related assets and liabilities have their own trust fund and cannot be used for any other purpose*

OPEB in Brief

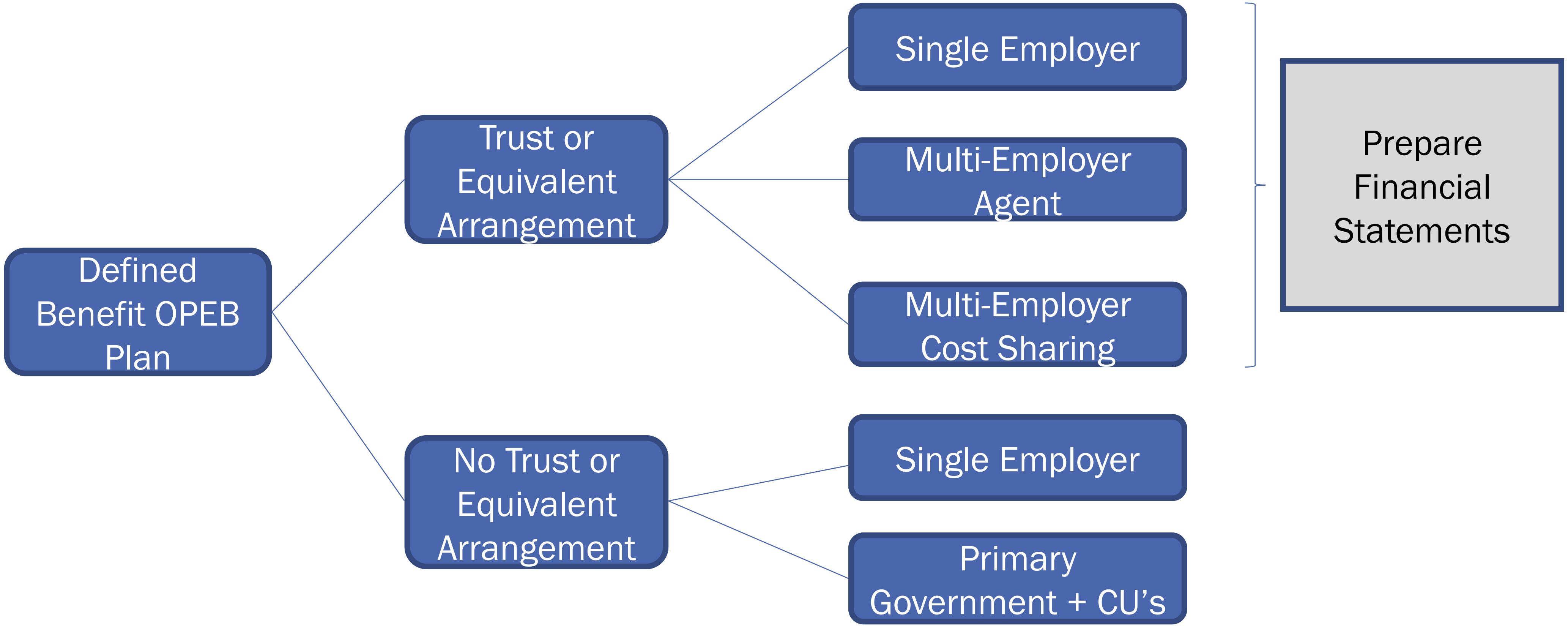
- Major impacts of GASB 75 vs. GASB 45
  - *Net or total OPEB liability is now recorded in SNP*
  - *Inflexible actuarial methodology and discounting guidance will produce a different (often higher) OPEB liability than GASB 45*
  - *Annual measurement dates are now required using either annual or biennial valuations*
  - *Triennial valuations no longer allowed*
  - *Expense volatility likely due to claims volatility, discount rate volatility and more frequent plan changes*
  - *Much more robust note and RSI is required*

PLAN REPORTING

Plan Standard

- Statement No. 74, Financial Reporting for Postemployment Benefit Plans Other Than Pensions
  - *Effective for June 30, 2017 plan year-ends and later*
- Plan accounting and reporting required when a trust or equivalent arrangement exists
  - *Plan financial statements may be either issued separately or as a fiduciary fund in the financial statements of the sponsoring government*
- Apply changes retroactively by restating financial statements for all periods presented, if practical
  - *10-year RSI schedule of employer contributions should be presented in year of transition*
  - *Other 10-year RSI schedules present information that is available until 10-years has been accumulated*
- GASB 74 par 34 requires that the OPEB liability be measured as of the most recent plan year end making plans with the same year-end as the employer that are reported in the employer's CAFR problematic from a timely issuance perspective.
  - *Choose the measurement date you want as an employer and then switch plan's FYE to that date*

Types of Plans



Overview of Plan Standard

- Recognition, measurement, and presentation of financial statement amounts generally similar to current guidance.
- Note disclosures and required supplementary information
  - *Similar to nature of disclosures for employers, with the addition of information on investment policies and actual rates of return on plan assets.*
  - *Certain actuarial information only required for single-employer and cost-sharing plans (not for multiple employer agent plans).*
- Requirements regarding the measurement of net OPEB liability (asset) are similar to the requirements for employers.
  - *Net OPEB liability (asset) is disclosure only (not recognized in plan financial statements)*

Plan vs. Non-Plan Asset Reporting

- Scope includes defined benefit and defined contribution OPEB plans administered through trusts that meet specified criteria
- Also addresses assets accumulated for purposes of providing OPEB through defined benefit OPEB plans that are *not* administered through trusts that meet the criteria
  - *Assets reported as assets in employer's governmental/ proprietary funds*
  - *Assets held for other government reported in an agency fund*

EMPLOYER REPORTING

Employer Standard

- Statement No. 75, Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions
  - *Effective for June 30, 2018 employer year-ends and later*
- Apply changes retroactively by restating financial statements for all periods presented, if practical
  - *May not be practical to present balances all deferred outflows and inflows of resources at beginning of period*
  - *Should report beginning deferred outflow of resources for transactions subsequent to measurement date*
- Divided into two primary sections:
  - *OPEB provided through plans administered as trusts or equivalent arrangements (meeting paragraph 4 requirements)*
  - *OPEB provided through plans that are **NOT** administered as trusts or equivalent arrangements (does not meet paragraph 4)*

OPEB Liability

Total OPEB Liability

Less: Plan's fiduciary net position

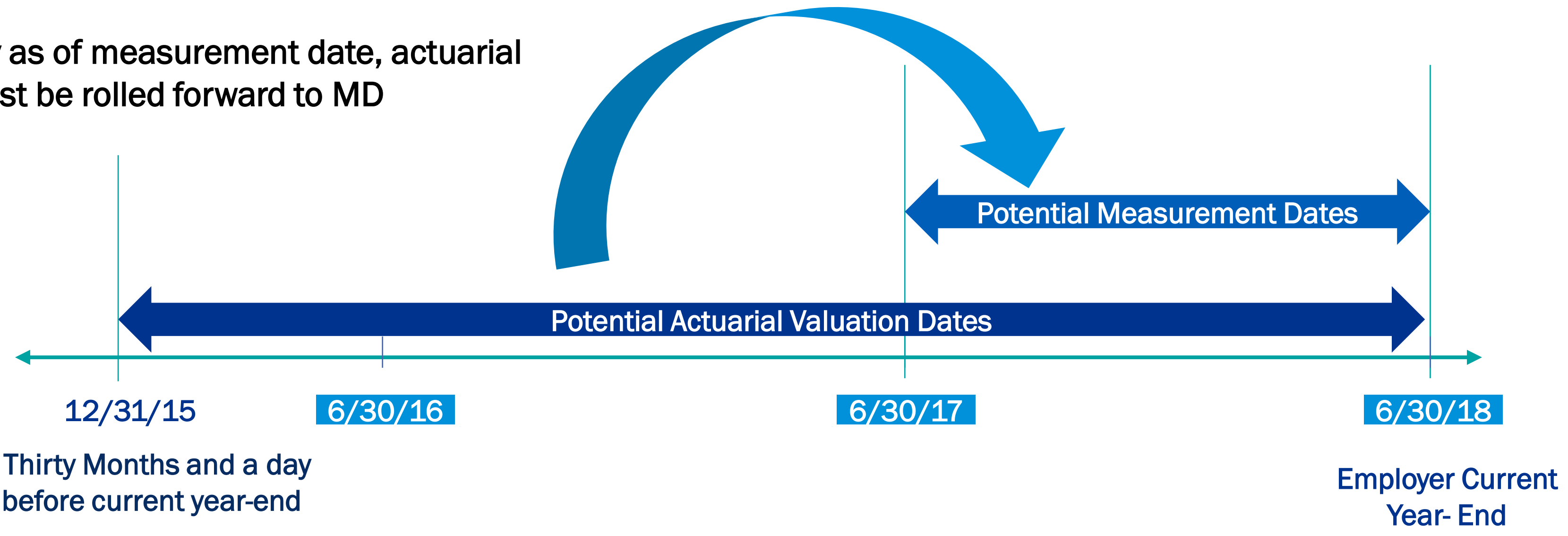
Net OPEB Liability

- Plan administered as a trust or equivalent arrangement:
  - *Employer reports a net OPEB liability in their financial statements*
- Plan **NOT** administered as a trust or equivalent arrangement:
  - *Employer reports a total OPEB liability in their financial statements*

Plans with fewer than 100 members (active and inactive) may use the alternative measurement method to determine the liability.

Measurement Date

If not already as of measurement date, actuarial valuation must be rolled forward to MD



Measurement of the total OPEB liability in employer’s financial statements must be as of a date no earlier than the end of the employer’s prior fiscal year. Measurement must be based on an actuarial valuation performed within 30 months plus 1 day of the employer’s year-end. If actuarial valuation not performed as of measurement date, update procedures must be performed to roll forward amounts to measurement date.

Projecting Future Benefit Payments

Projecting benefit payments for OPEB plans will be significantly different than for pensions:

- Pension benefits are typically based on salary and years of service and are often statutorily or constitutionally guaranteed based on a detailed plan document.
- Retiree health care OPEB are typically not salary or time based not statutorily guaranteed and often not well documented.
- As diverse as pension plan design may be, OPEB is much more so with virtually endless variants that are constantly evolving.
- OPEB valuations will require use of many assumptions that do not exist in a pension valuation such as participation rate, participation of dependents, health care trend rate, healthcare utilization by age etc.
- Even common assumptions such as mortality or rate of return, will have different impacts for pensions vs. OPEB valuations.

It is critical for the employer to truly understand the retiree health plan, verify that design and practice are one in the same and to accurately communicate that information to the actuary performing the valuation.

Discounting Future Benefit Payments to Present Value

Plans administered as a trust or equivalent arrangement:

— A single blended rate should be used to discount projected future benefit payments, based on:

- The long-term expected rate of return on plan investments (net of investment expenses) that are expected to be used to finance the payment of OPEB benefits for the periods that the plan's fiduciary net position is projected to be sufficient to make projected benefit payments and is expected to be invested, using a strategy to achieve that return; ***and***
- A yield or index rate for ***20-year***, tax-exempt general obligation municipal bonds with average rating of AA/Aa or higher for all periods that fiduciary net position is not available (also known as the crossover point).

The farther into the future the crossover point the closer the rate will be to the long-term rate of return, the higher the single blended rate and the lower the present value of the liabilities.

Discounting Future Benefit Payments to Present Value

Plans *NOT* administered as a trust or equivalent arrangement:

- A yield or index rate for ***20-year***, tax-exempt general obligation municipal bonds with average rating of AA/Aa or higher (or equivalent quality on another rating scale)
- This rate is easily verifiable and will change every valuation. It may be higher or lower than the rate previously used for GASB 45.
- GASB 45 requires non-trust plans to use the return on employer assets using the same inflation assumption as that used for a long-term rate of return. This requirement resulted in wide variations in practice but once chosen, the rate rarely changed from valuation to valuation.

Attribution

- Only one actuarial cost method is allowed-Entry Age.
- Many OPEB valuations under GASB 45 were conducted using Projected Unit Credit. Entry Age will generally produced a higher accrued actuarial liability at any point in time compared to Projected Unit Credit. While dependent on plan structure and participant demographics these higher liabilities under Entry Age could be as much as 30% more.
- The impact will be less for plans which have a significant retiree liability relative to the active employee liability or those with older workforces.

The resulting OPEB liability under the new standard will be different than previously reported and could be significantly higher.

Employer note disclosures - descriptions

Plan Description	A	B	C	D
Name of plan, administrator of plan, and type of plan	✓	✓	✓	✓
Benefit terms, including (1) classes of employees covered, (2) types of benefits, (3) key elements of OPEB formula, (4) terms or policies with respect to automatic benefit changes, including ad hoc colas, (5) legal authority	✓	✓	✓	✓
Number of employees covered	✓		✓	
Fact that no assets accumulated in a trust			✓	✓
Contribution requirements, including (1) authority under which contributions made, (2) legal or maximum contributions rates, (3) contribution rates, and (4) contributions made	✓	✓		
Authority under which to pay OPEB benefits as they come due and amount			✓	✓
Availability of audited plan financial statements	✓	✓		

A = Trusted: Single/Agent

B = Trusted: Cost-sharing

C = Non-trusted: Single

D = Non-trusted: PG + CU

Employer note disclosures - assumptions

Assumptions and Other Inputs	A	B	C	D
Significant assumptions, including inflation, healthcare cost trend rates, salary changes, postemployment benefit changes	✓	✓	✓	✓
Source of mortality assumptions	✓	✓	✓	✓
Dates of experience studies	✓	✓	✓	✓
Fact that projections of sharing of benefit costs based on established pattern of practice	✓	✓	✓	✓
Net OPEB liability sensitivity to healthcare cost trend rate (+/- 1%)	✓	✓		
Total OPEB liability sensitivity to healthcare cost trend rate (+/- 1%)			✓	✓

A = Trusted: Single/Agent

B = Trusted: Cost-sharing

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Employer Note Disclosures – Discount Rates

Discount Rate	A	B	C	D
Discount rate used	✓	✓	✓	✓
Assumptions about projected cash flows	✓	✓		
Long-term expected rate of return on plan investments and how determined	✓	✓		
Municipal bond rate used	✓	✓	✓	✓
Periods of projected benefit payments applied to long-term rate of return and municipal bond rate, if applicable	✓	✓		
Assumed asset allocation and long-term expected real rate of return for each major asset class	✓	✓		
Net OPEB liability sensitivity to discount rate (+/- 1%)	✓	✓		
Total OPEB liability sensitivity to municipal bond rate (+/- 1%)			✓	✓

A = Trusted: Single/Agent

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Employer Note Disclosures –Additional Disclosures

Additional Disclosures	A	B	C	D
Information about plan's fiduciary net position if report not publicly available	✓	✓		
Schedule of changes in ***net*** OPEB liability	✓			
Schedule of changes in ***total*** OPEB liability			✓	
Measurement date	✓	✓	✓	✓
Actuarial valuation date	✓	✓	✓	✓
Employers proportionate share of net (total) OPEB liability and basis for allocation		✓		✓
Changes in assumptions and benefit terms	✓	✓	✓	✓
Changes subsequent to measurement date	✓	✓	✓	✓
OPEB expense in current period	✓	✓	✓	✓
Balance of deferred outflows/inflows by source and aggregate impact on OPEB expense in each of next 5 years and thereafter	✓	✓	✓	✓

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Employer Required Supplementary Information

10-Year Schedules	A	B	C	D
Changes in net OPEB liability by source	✓			
Components of net OPEB liability and related ratios	✓			
Proportionate share of net OPEB liability		✓		
Employer contributions	✓	✓		
Changes in total OPEB liability by source			✓	
Total OPEB liability as a percentage of covered employee payroll			✓	
Proportionate share of total OPEB liability				✓

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Transition

- Beginning deferred outflow of resources for contributions if any, subsequent to the measurement date of the beginning OPEB liability
- All other deferred outflows/deferred inflows of resources balances—all or nothing at initial implementation
- RSI schedules are prospective if information not initially available. Information on contributions will generally be available for all periods in which the trusted plan was in existence.

IMPLEMENTATION ISSUES

GASB Implementation Guides

- Implementation Guides
  - *Plan—February 2017 (Exposure Draft—October 2016)*
  - *Employer—November 2017 (Exposure Draft—June 2017)*
- Webinars and other implementation assistance
  - *What worked and what did not work*

Implementation Responsibility

- BEGIN IMPLEMENTATION PLANNING NOW!
  - *Unlike Pensions, OPEB plan management and employer management are typically one in the same –**YOU!***
    - In pensions someone else typically hires the actuary and approves the assumptions (employers have to agree that assumptions are reasonable for financial reporting purposes)
    - In OPEB the employer hires the actuary and approves/choose the assumptions.
    - In Pensions the employer has ultimate responsibility but in OPEB employer's have <u>both</u> primary and ultimate responsibility.
  - *In spite of the similarities in standards there are huge differences between OPEB and Pension valuations that must be considered in producing an OPEB liability that is both fairly stated and auditable.*

Implementation-Assumptions

Pensions	OPEB	Difference
Long-Term Rate of Return	Long-Term Rate of Return	Usually the main driver for Pension; often immaterial for OPEB due to limited funding or non-trusted plans
Mortality Rate	Mortality Rate	Crucial for Pension because it determines the payment period; less so for OPEB since much of the liability is pre-65
Inflation/Salary Progression	Inflation/Salary Progression	For Pension this is usually the basis for the benefit; for OPEB it is usually important only for amortization purposes only
Retirement Age/Rates	Retirement Age/Rates	For Pension this can be an age point if payment forms are actuarially equivalent; for OPEB retirement rates are crucial to determine cash-flows and liabilities
Inflation-COLAs	Health Care Trend Rate	For Pension this only matters if the Plan has a post-retirement COLA; for OPEB this is the main driver for liabilities
Retirement Options-Retiree only, beneficiary receives 100%, 75%, 50% of annuity after death of retiree	Retiree Options-Plan Choice; Number of dependents /beneficiaries;	For Pension the options offered are often actuarially equivalent and do not impact plan liability; For OPEB there are multiple choices all of which significantly impact plan liabilities

Implementation-Assumptions

Pensions	OPEB	Difference
None	Utilization by Age	Individuals require more health care as they age. Actuarial tables exists showing the expected healthcare utilization of plan participants are various ages
None	Participation Rate	Unlike pension in which the payments flow only one way (to the retiree), retirees are most commonly expected to pay sometimes significant monthly premiums to continue receiving benefits. As expected, higher premiums typically result in lower participation as retirees may find less expensive options. Post 65 provisions also greatly impact participation rate.
None	Cadillac Tax	This tax for “luxury” level of benefits is likely to affect many plans and will significantly add to the costs.

Implementation Issues for Cost-Sharing Arrangements in Non-Trusted Plans

- Employers that have component units that provide the same retiree health care benefits as the primary government and issue separate financial statements will need to record their proportionate share of the Total OPEB Liability.
- GASB 75 paragraphs 172-192 specifically addresses this situation providing two options:
  - *In a manner consistent with how benefits are paid as they come due*
  - *Use of projected payments for all participating entities as benefits come due over the long-term. (This method is encouraged but will probably require the use of an actuary).*

IMPLEMENTATION STRATEGIES

Planning the Implementation

- Healthcare Plans
- Retiree Provisions
- Actuarial Considerations
- Audit Considerations
- Communicating Results

Healthcare Plans

- Obtain documentation regarding healthcare plans.
  - *Ensure that documentation is up to date.*
  - *Ensure that documentation reflects actual practice.*
- Evaluate internal controls over health care plans
  - *Enrollment Controls*
  - *Dependent verification and audit*
  - *SOC 1 Type 2 reports for third party administrators*
- Identify and document controls over internal tracking of healthcare costs including splitting of costs between plans and between retirees and actives.
- Review key service providers or systems such as TPA, health insurer, healthcare software so that you will not be making key changes in the year of implementation.

Retiree Provisions

- Obtain documentation regarding key retiree health provisions and ensure that documentation reflects actual practice for:
  - *Retiree eligibility including premiums paid and ability to leave and return to the plan*
  - *Dependent eligibility including premiums paid and ability to leave and return to the plan and ability to stay on plan after retiree has turned 65 and dependent has not*
  - *Specific plans retirees are eligible to participate in.*
  - *Ancillary benefits such as health care clinic*
  - *Post 65 provisions including:*
    - Ability to stay on the plan
    - Plan becoming secondary to Medicare
    - Premium adjustments

Actuarial Considerations

- OPEB valuations require two distinct actuarial skill sets 1) health clams development and 2) attribution, discounting and accruing to specific periods. As a practical matter many OPEB actuaries start as pension actuaries and acquire the required qualifications for claims development or have a healthcare actuary perform and certify that portion of the valuation. Actuaries should state affirmatively in their valuation that they meet the Actuarial Qualification Standards for OPEB.
- If biennial valuations are used, will the year of implementation be an off year or new valuation. If off year, will actuary be willing to rerun the valuation for GASB 75 and update to the measurement date?
- What measurement date will work best for reporting purposes?
- Are any overlapping assumptions consistent between the OPEB and the pension plans for the same employee groups?
- What are the key assumptions that drive the valuation and are they appropriate?

Actuarial Considerations

- Has the actuary been provided all related documentation to ensure an accurate understanding of the retiree benefits?
- Does the actuary’s projection methodology take into consideration key plan provisions?
- Will timing of the valuation work within the constraints of the financial reporting deadlines?
- Will the actuarial report be as “turnkey” as possible by providing all GASB 74/75 required reporting disclosure and RSI including current year and amortization of prior year deferred inflows and outflows of resources?

Audit Considerations

- Whether total or net, the materiality of the OPEB liability mandate specific audit guidance.
- The AICPA's State and Local Government Expert Panel (SLGEP) plans to provide this guidance in the 2017 edition of the Audit and Accounting Guide for State and Local Governments.
- While no specific decisions have yet been made regarding contents of the guidance, certain general approaches are likely:
  - *For trusted plans with independent governing structures, guidance for data maintained by the plan will be similar to pensions for the same plan type (single employer, multiple employer agent or cost-sharing)*
  - *Auditing for investments held by the plan will also be similar*
  - *Guidance regarding use of a specialist (management specialist-AU-C 500, Audit Evidence or Auditor Specialist AU-C 620) will remain applicable with explanations likely regarding the specific skill sets needed for OPEB valuations*

Audit Considerations (continued)

- *Testing of census data will continue to be a point of focus, but guidance to assist the auditor in determining the relevant census data, the sources of that data and the best testing approaches is likely.*
- *The importance of understanding plan provisions and ensuring the plan provisions as documented is the plan that is being administered including specific testing approaches is likely.*
- *Understanding how specific plan provisions affect the valuation including the relative importance of various assumptions (especially those assumptions that do not exist for pensions) and various testing approaches for specific assumptions such as participation rates is likely to be a component of census data testing*

Communicating Results

- Use modified pension checklists for booking of the liability and deferred inflows and outflows
- Use the applicable section of GASB 75 for note disclosures and RSI as your checklist to ensure completeness of notes
- Using the recent pension implementation as a guide, gauge media and elected body interest in the OPEB implementation
- Discuss with actuary the likely results of the GASB 75 valuation (higher or lower liability etc.). If warranted, consider having actuary rerun most recent GASB 45 valuation using GASB 75 methodology.
- Using the GASB 68 implementation as a “lesson learned” evaluate presentation material for adaptability to OPEB.

Summary Steps for a Successful Implementation

- Familiarize yourself with both the health plan and retiree provisions
- Ensure that the provisions as written are how the plan is being administered and adopt any needed policy changes or clarifications
- Determine that actuary has adequate qualifications and knowledge. Agree in advance on format and contents of actuarial report
- Determine timing and frequency of valuations and how they will interface with implementation and year-end reporting including implications of trusted plan reporting
- Develop communication plan for elected officials and other stakeholders.
- If plan is trusted, implement June 30, 2017 or later and be sure to check for late breaking guidance in the GASB Plan implementation guide (IG).
- Employer's implement June 30, 2018 and later. Check for new developments in employer IG. Actual financial reporting including required PPA, deferred I/O, notes and RSI will be very similar to pensions.

NCTCOG Actuarial Shared Services

- First bid in 2008, it currently has over 100 governments participating
- Plans are to rebid the contract to comply with the requirements of GASB 74/75 late 2016/early 2017
- We need:
  - *For those not participating, the names of actuarial firms currently doing your GASB 45 valuation*
  - *For those who are participating, willingness to serve on selection committee (looking for 6-8 spread throughout the state with 1 or 2 reserved for counties)*


QUESTIONS
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