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GASB 74/75: Impact on small government employers

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In 2015, the Governmental Accounting Standards Board (GASB) released new accounting standards for public other postemployment benefits (OPEB) plans and participating employers. These standards, GASB Statements No. 74 and 75, have substantially revised the valuation and accounting requirements previously mandated under GASB Statements No. 43 and 45. With implementation required for plan fiscal years beginning after June 15, 2016, for GASB 74 and June 15, 2017, for GASB 75, the time is now for government entities to understand and comply with the new requirements.

In this article, we review the Alternative Measurement Method (AMM), which is used by small government employers in lieu of an actuarial valuation. This AMM review is followed by a discussion of the important changes relevant to small government employers as GASB 74/75 takes effect. This article originally appeared as part of Milliman's PERiScope GASB 73/74/75 miniseries.[1]

Previous articles in this miniseries described the new requirements of GASB 74/75 for government employers as a whole, which broadly apply to small government employers as well. However, some facets of the new Statements are particularly significant for those using the AMM, requiring changes to calculation frequency, methodology, and reporting elements. The AMM requirements in both GASB 74 and 75 are similar. Because most of the plans that use the AMM do not make contributions into an OPEB trust and do not need to report under GASB 74, we will refer to GASB 75 in this article.

Review of the Alternative Measurement Method

The AMM allows small government employers to use a modified approach to calculate their OPEB liabilities. An employer is qualified to use the AMM if fewer than 100 employees (active and inactive) are eligible for OPEB through the plan as of the beginning of the measurement period. The AMM includes the same broad steps as an actuarial valuation, including projecting benefit payments, discounting those payments to a present value, and attributing the present value of projected benefit payments to time periods using an actuarial cost method. However, the AMM permits some simplified methods for setting the assumptions to be used in the calculation. For example, while assumptions for actuarial valuations for large government employers are often set using employer-specific data, the AMM allows assumptions to be established based on combined experience for similar plans. The AMM also allows for simplifications of the following assumptions, described in Paragraph 225 of GASB 75:

- **OPEB benefit commencement** may be modeled according to a single assumed attained age or assumed length of service criterion.
- **Marital status and dependency status** may be based on the present status of active employees and on current or historical data for inactives.
- **The turnover assumption,** i.e., the assumed probability that an active employee will remain employed until that person meets the requirements to receive OPEB, should ideally be based on employer-specific turnover experience. If that data is not available or is not credible, GASB 75 Paragraph 226(b) permits use of publicly available data maintained by the U.S. Office of Personnel Management for employees covered by the Federal Employee Retirement System, or data maintained by another covered entity such as a public employee retirement system that includes the covered group.
- **Healthcare cost trend rates** must be derived from an objective source.
- **Use of health insurance premiums** as the starting basis for per capita benefit projections is permitted under the AMM. If actives and inactives are charged the same premium, age-adjusted premiums must be either obtained from the insurer or calculated using a process specified in Paragraph 226(c) of GASB 75.

Did you know? Milliman's GASB 73/74/75 Task Force has released a miniseries on technical and implementation issues surrounding GASB 73, 74, and 75.

Read more at milliman.com/GASB-73-74-75

1 Milliman PERiScope (2016-2017). GASB 73/74/75: The Series. Retrieved May 3, 2018, from http://www.milliman.com/GASB-73-74-75/.

- **The future selection of coverage options** to inactives may be modeled according to the experience of the covered group by considering differences in options available to pre- or post-Medicare-eligible retirees.

- **Grouping techniques** may be used within a plan or across similar plans to develop reasonable assumptions.

GASB indicated in the Statement's comments that the purpose of the AMM is twofold. First, simplification of the assumption-setting process is designed to allow a nonexpert to complete the liability calculation process. Small government employers may lack the resources or funds to hire an expert consultant to conduct a full actuarial valuation. Second, employer-specific data for a small employer group may lack statistical credibility or sufficient detail to develop actuarial assumptions specific to the group. Allowing for outside data sources and grouping techniques may provide a sounder basis for assessment of the liability.

The AMM is not changing significantly with the advent of GASB 75. However, when comparing the specifics of the AMM methodology described in GASB 75 with those of GASB 45, a few important changes were noted that will be critical for AMM users to understand and implement.

First, the GASB 45 AMM included a standard table of factors representing the expected future working lifetime of each employee in the valuation. In the OPEB liability calculation, two present value (PV) factors are developed: the PV of $1 per year from entry age to expected retirement age and the PV of $1 from current age to retirement age. These PV factors are used to develop the Present Value of Future Service Cost, which is then subtracted from the Present Value of Total Projected Benefit Payments to arrive at the Total OPEB Liability. The expected future working lifetime values are used to represent the number of periods over which to discount the "n" in the discount calculation. In GASB 75, rather than a tabular set of expected future working lifetimes, the values are calculated directly. GASB 75's reference to expected future working lifetime comes in Notes #7 and #9 of Table 2 of the AMM sample calculation (Illustration 5). Note #7 describes the calculation of the PV of $1 per year from entry age to retirement age, in which "the employee's expected future working lifetime [is] calculated as the difference between the employee's entry age and the retirement age." [2] Similarly, in the calculation of the PV of $1 from current age to retirement age, expected future lifetime is calculated as the difference between retirement age and current age. This formulaic approach will produce different results from those based on the GASB 45 standard tables. The tabular factors generally showed future working lifetimes less than what would be derived by simply subtracting retirement age from entry age or current age. As such, this change in approach may result in an increase in OPEB liability, potentially of significant magnitude, for many employer groups using the AMM.

2 GASB Statement No. 75 (June 2015), p. 260.

Second, GASB 45's AMM included a standard, static table of employee turnover factors to be used in the valuation process, developed from the actuarial experience of the Federal Employees Retirement System employees. GASB 75 did not provide such a table, stating that a turnover table should be based on experience from the covered group. If experience data is not available, the turnover table may be created with the most recently available data from the U.S. Office of Personnel or data from another entity, such as a public employee retirement system, of which the covered group is a part. This change puts the onus on the employer group or the actuary completing the AMM valuation to obtain the required data, create a new turnover table, and ensure that it is continually updated as new data becomes available. Additionally, it introduces another source of variation from valuation to valuation to the extent that the turnover experience changes measurably over time.

Important GASB 75 changes for small government employers

The AMM itself has not been altered significantly with the move from GASB 45 to GASB 75. That being said, there are several elements of GASB 75 that will have an impact on small government employers using the AMM.

Valuation frequency: The most significant change is that GASB 75 requires a valuation, or a simplified valuation using the AMM, to be completed every two years. Under GASB 45, valuation frequency was dependent on employer size (the number of employees, terminated employees who have accumulated benefits but are not yet receiving them, and retired employees and beneficiaries currently receiving benefits), with the vast majority of AMM users needing to complete a valuation only triennially. More frequent valuations mean more frequent collection of benefit plan information, census data, and other required inputs, which translates to more work for small employer groups.

Actuarial cost method: The valuation process employs an actuarial cost method to attribute the actuarial present value of benefit payments to periods of employee service. GASB 45 allowed any of six different actuarial cost methods to be used for this purpose. Under GASB 75, the Entry Age Normal actuarial cost method is promulgated as the only allowable method. Additionally, while GASB 45 allowed for each period's cost to be either level as a percentage of service or level as a percentage of pay, GASB 75 requires the latter. Employer groups could see changes in their liability levels under GASB 75 if they are required to change actuarial cost methods.

Discount rate: GASB 45's discount rate was based on the employer's general funds rate for unfunded plans, weighted with the long-term investment return to the extent the plan was funded. GASB 75 replaces the general funds rate with the yield for a 20-year tax-exempt general obligation municipal bond with an average rating of AA/Aa or higher. We believe that most small government employers are not putting assets in a trust to fund their OPEB liabilities; as such, the change in the discount rate

for unfunded plans will affect the magnitude of OPEB liabilities reported by these entities to the extent that the bond rate is different from the employer's general funds rate. The benchmark bond yield is currently over 3%, which we believe is higher than the discount rate used by many AMM users. This could lead to lower OPEB liabilities for those groups.

For plans that do intend to partially or fully fund their OPEB liabilities, GASB 75 describes a depletion date analysis process by which the discount rate should be developed. The discount rate should be the single internal rate of return (IRR) producing a present value of benefits equivalent to those calculated assuming the plan assets' rates of return for the time period over which the plan will be funded, followed by the 20-year municipal bond rate for the remainder of the time period after which assets have been depleted. This analysis is a significant undertaking for employers wishing to use the AMM and it is likely that alternative estimation methods will be needed to derive an appropriate discount rate.

Turnover assumption: For large employers, turnover assumptions, or the probability of an employee staying employed until commencement of OPEB benefits, are often calculated based on group-specific experience. As this was often not feasible for smaller-sized groups, the GASB 45 AMM included a table of standard turnover factors based on experience of the employees covered by the Federal Employees Retirement System at the time. This table is not included in the GASB 75 AMM instructions. Instead, either the most up-to-date experience of the federal employees or the experience of a larger entity such as a public employee retirement system containing the covered group should be used to derive turnover factors.

Community-rated plans: The AMM process allows for premiums to be used in lieu of claims experience for projection of the OPEB liability, but those premiums must be age-adjusted to ensure that the projected retiree premiums accurately reflect the expected cost basis of retirees. If an employer charges the same premiums to actives and retirees, then using that composite premium in the projection would not properly reflect the relatively higher average cost basis for retirees; there is an "implicit subsidy" between actives and retirees. GASB 45 requires an age adjustment to the premiums in this situation to account for the implicit subsidy and to utilize premiums commensurate with the costs of the retiree population insured by that employer group. However, GASB 45 has an exception to this rule for community-rated plans. For employers participating "in a community-rated plan, in which premium rates reflect the projected health claims experience of all participating employers rather than that of any single participating employer, and the insurer or provider organization charges the same unadjusted premiums for both actives and retirees, it is appropriate to use the unadjusted premiums as the basis for projection of retiree benefits, to the extent permitted by actuarial standards."[3] No similar exception is included in GASB 75. Because community-rated plans will have to employ age-adjusted premiums in their projections under GASB 75 rather than unadjusted premiums, those plans may see a significant increase in their OPEB liabilities. For example, most plans in New York are community-rated by law and will likely see changes that are due to this effect.

Sensitivity analysis: GASB 75's required disclosures necessitate sensitivity testing of the calculated OPEB liability that is not required under GASB 45. Two types of scenario testing are required. First, the OPEB liability must be measured and disclosed using a healthcare cost trend rate one percentage point higher than, and also one percentage point lower than, the assumed healthcare cost trend rate. The same type of testing must be done on the discount rate assumption; the OPEB liability must be measured and disclosed using discount rates one percentage point higher than, and also one percentage point lower than, the chosen discount rate. Plans using the AMM must also produce these alternative scenarios, requiring additional time and effort.

Additional reporting: Aside from the sensitivity analysis just described, the reporting requirements under GASB 75 in general are more detailed than those required under GASB 45. A thorough discussion of GASB 75 reporting requirements is beyond the scope of this article and AMM users should familiarize themselves with the full set of required disclosures. As an example, we will focus on one new disclosure: a reconciliation of the net OPEB liability from the prior to the current valuation. Paragraph 55 of GASB 75 states that "for the current reporting period, a schedule of changes in the net OPEB liability should be presented." The schedule starts with the beginning balances of the total OPEB liability, the OPEB plan fiduciary net position, and the net OPEB liability, and indicates the impact of 12 specific items:

1. Service cost
2. Interest on the total OPEB liability
3. Changes in benefit terms
4. Differences between expected and actual experience in the measurement of total OPEB liability
5. Changes of assumptions or other inputs
6. Contributions from the employer
7. Contributions from nonemployer contributing entities
8. Contributions from active employees and inactive employees not yet receiving benefit payments
9. OPEB plan net investment income
10. Benefit payments
11. OPEB plan administrative expense
12. Other changes, separately identified if individually significant

3 GASB Statement No. 45 (June 2004), p. 7.

Application of the financial impact of those 12 items to the beginning balances should result in the ending balances of the total OPEB liability, the OPEB plan fiduciary net position, and the net OPEB liability.

AMM users are not exempt from this detailed reconciliation; the only adjustment made for AMM valuations is that the information in (4) and (5) above may be combined into a single amount. Compliance with this detailed reporting and other reporting elements of GASB 75 will require additional effort from employer groups using the AMM and/or their accountants or auditors.

While the AMM provides for a simplified alternative to a traditional actuarial valuation for small government employers, significant effort is needed to ensure compliance with the GASB rules. As the implementation date for GASB 75 is upon us, small employer groups should familiarize themselves with the new requirements and ensure that subject matter expert consultants such as accountants, actuaries, and auditors are well-versed in the upcoming changes. Milliman consultants can work with you on the actuarial aspects of GASB 75, or Milliman's GASBhelp™ online valuation tool (**www.gasbhelp.com**), which will be updated to fully comply with the GASB 75 AMM liability calculation process, providing a do-it-yourself alternative to hiring an actuary.

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