

To the Mayor and Members of the City Council

November 1, 2016

Page 1 of 2



SUBJECT: IMPLEMENTATION OF GOVERNMENTAL ACCOUNTING STANDARDS BOARD (GASB) STATEMENTS FOR REPORTING AND ACCOUNTING RELATED TO NON-PENSION OTHER POSTEMPLOYMENT BENEFITS

This informal report outlines the implementation of two new Governmental Accounting Standards Board (GASB) statements that affect how the City accounts for and reports obligations related to Other Postemployment Benefits ("OPEB").

The two pronouncements are Statement 74, which is effective for the City beginning in the current fiscal year, and Statement 75, which is effective for the City beginning in Fiscal Year 2018. These statements impose standards on the accounting and reporting for OPEB benefits that are similar to standards that were enacted for pension benefits under GASB 67 and 68.

Key elements of GASB 74 and 75 include:

- Replacement of GASB Statements No. 43 and No. 45 with these new standards
- Requirement that unfunded OPEB liabilities be recognized on the face of financial statements
- Use of a 20-year Municipal Bond rate as the discount rate for determining present value equivalent of future benefit payment obligations
- Use of the actual long term return rate on plan investments as the discount rate for determining present value equivalent of plan assets available to meet future benefit payment obligations
- Requirement to include extensive note disclosures and supplementary information about OPEB obligations in financial reporting

There are two important notes to make regarding application of these GASB standards. First, use of the specified discount rates will result in an **increase in the unfunded OPEB obligations being reported** for any entity that is not pre-funding OPEB benefits. Secondly, while these statements govern how OPEB benefits are accounted for and reported, they do not require OPEB obligations be funded or affect the City's ability to change the structure of the underlying benefits in the future. The City retains discretion to change or discontinue health benefits for current employees and retirees at any time.

Overall Effect on the Financial Reporting

GASB 74 and 75 will change the way the City is required to account for OPEB related liability. A summary of these changes is highlighted below:

- A. Implementation of the standards will result in a more immediate recognition of OPEB related obligations in the City's financial statements
 - Under GASB No. 45 the present value equivalent of the City's OPEB liability was \$534,629,000. Calculated using the discount rates mandated by GASB No. 75, the present value of the City's total OPEB liability is approximately \$840,000,000.
- B. The OPEB Statements require more robust disclosures of assumptions and methodology.

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- Compliance will involve presentation of more comprehensive schedules, reconciliation of liabilities and greater detail in general.
- C. Since the City is minimally pre-funding its Net OPEB Liability (“NOL”), GASB 75 requires the use of a lower rate of return.
 - Using an estimated 3.5% interest rate will increase the NOL by approximately 11% (application of this interest rate is reflected in the \$840M figure identified above).

Measurement Period:

The actuarial valuation for OPEB liabilities has, in the past, occurred on a calendar year basis. To simplify recognition and accounting for the NOL, the City will now calculate valuation on a fiscal year basis (10/1 – 9/30). This evaluation is consistent with the City’s application of GASB 68 regarding Pension obligations.

Impact on City

From the most recent valuation, the Actuarial Accrued Liability (“AAL”) and Unfunded Actuarial Accrued Liability (“UAAL”) for the City’s OPEB obligations were \$750 million and \$684 million, respectively. Under GASB No. 74/75, staff expects the reportable amount for these liabilities to each increase by \$157 million, with revised AAL being approximately \$907 million and revised UAAL coming in at approximately \$840 million. While the City’s actual payment obligations are not impacted by implementation of the GASB standards, the total *reported* liability is expected to increase at least 21%. As with all projections of valuations, these projections are only estimates and can change as changes occur in market conditions, plan benefits, beneficiary demographics, and underlying assumptions.

The additional reportable OPEB liability will be recognized on the Statement of Net Position and Statement of Activities in the City’s Fiscal Year 2017 Comprehensive Annual Financial Report, which will issue in Spring 2018.

If you have any questions, please call Aaron Bovos, Chief Financial Officer, at 817-392-8517

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