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PERiScope
Public Employee Retirement Systems

New accounting rules for public postretirement benefit plans in the United States are set to take effect soon. Successful implementation of the new rules will require an understanding of a variety of technical concepts regarding the various newly required calculations. Two years ago, in a multipart PERiScope series, we explored these technical topics in detail as they related to Governmental Accounting Standards Board (GASB) Statements 67 and 68. We now take a similar approach with GASB Statements 73, 74, and 75. Milliman has established a GASB 73/74/75 Task Force that will publish a detailed series of educational articles regarding various key implementation and technical issues surrounding these new statements. This series will result in numerous articles in the upcoming months.

GASB 73: Implementation and overview

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In June 2015, the Governmental Accounting Standards Board (GASB) released new accounting standards for public sector postretirement benefit programs and the employers that sponsor them.

GASB Statement 73 is for accounting and financial reporting for pensions that are not within the scope of GASB Statement 68. GASB 68 was effective for employer fiscal years beginning after June 15, 2014. GASB 68 applies to pension plans that are administered through trusts in which contributions are irrevocable, trust assets are dedicated to providing pensions to plan members, and trust assets are legally protected from creditors. GASB 73 applies to pension plans (both defined benefit and defined contribution) that either do not have any dedicated assets associated with them or have assets that are not in a trust meeting the requirements specified above. Pensions include retirement income and postemployment benefits other than retirement income such as disability benefits, death benefits, and life insurance that are provided through a pension plan. GASB concluded that these pensions and pensions administered through trusts were no different, except for restrictions on assets; therefore, accounting is essentially the same as GASB 67 and GASB 68. GASB 73 applies for employer fiscal years beginning after June 15, 2016.

Significant differences between GASB 73 and GASB 67/68

- The effective date for GASB 73 is for fiscal years beginning after June 15, 2016. This date is three years later than the effective date for GASB 67 and two years after the effective date for GASB 68.
- There are no assets considered to offset the total pension liability. Under GASB 68, the net pension liability (total pension liability minus fiduciary net position) is what is shown on the employer's balance sheet. With no assets in an irrevocable trust, the entire total pension liability is shown on the employer's balance sheet under GASB 73.
- The discount rate is based solely upon municipal bond yields. This is the yield or index rate for 20-year, tax-exempt general obligation municipal bonds with an average rating of AA/Aa or higher (or equivalent quality on another rating scale). With no assets, there is no need to consider the long-term expected rate of return on assets or to prepare projections to determine a depletion date.

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

Each article will be released through PERiScope. Look for the following articles in coming months:

- **Balance sheet items and projections from valuation date to measurement date**
- **Calculation of OPEB expense**
- **Revised ASOP 6 and Community Rated Plans**
- **Alternative Measurement Method**

Visit milliman.com/GASB-73-74-75 for the latest resources on the new statements.

- Paragraphs 115 and 116 of the statement apply for assets accumulated for purposes of providing pensions through defined benefit pension plans that are not administered through irrevocable trusts.

Fundamental changes to accounting

The new GASB statements require a liability for pension obligations, known as the net pension liability, to be recognized on the balance sheets of the employers. Because the plans that fall under GASB 73 do not have dedicated assets within a trust, the net pension liability is equal to the total pension liability. Similarly, a pension expense will be recognized on the income statement.

Getting started: Determining the plan type

Implementation of this statement should begin with a determination of the GASB plan type, as that will determine which specific requirements must be followed under the standard. There are three types of defined benefit plans covered under GASB 73: insured plans, single-employer pension plans, and multiple-employer pension plans.

An insured plan is defined as a defined benefit pension plan in which pensions are financed through an arrangement whereby premiums are paid to an insurance company while employees are in active service. In return, the insurance company unconditionally undertakes an obligation to pay the pensions as defined under the plan terms. A single-employer plan is a defined benefit pension plan other than an insured plan that provide pensions to the employees of only one employer. If a defined benefit pension plan other than an insured plan is used to provide pensions to the employees of more than one employer, the plan is a multiple-employer plan. Additionally, any of these plan types may also have a special funding situation, which will further impact calculations under GASB 73.

Special funding situations exist when a non-employer entity is legally responsible for making benefit payments directly to the employees of another entity as the pensions come due, and either the non-employer entity is the only entity with a legal obligation to make benefit payments or the amount of benefit payments for which the non-employer entity legally is responsible is not dependent upon one or more events or circumstances unrelated to the pensions. Examples of dependent circumstances include situations where benefit payments are limited by a given revenue source and the amount of benefit payments are dependent on the non-employer entity's ending fund balance exceeding a defined threshold amount.

Calculations for a single-employer plan will generally be straightforward, particularly if no special funding situation applies. For multiple-employer plans, a "proportionate share" of the total pension liability and total pension expense must be calculated for each employer. For insured plans, the plan should recognize a pension expense equal to the amount of premiums or other payments required for the reporting period and a change in the liability to the insurer equal to the difference between amounts recognized as pension expense and amounts paid by the employer to the insurer.

Timing and frequency of actuarial valuations

The total pension liability must be determined by (1) an actuarial valuation as of the measurement date, or (2) using accepted actuarial roll-forward techniques from an actuarial valuation as of a date no more than 30 months and one day earlier than the employer's most recent fiscal year-end. If significant changes occur between the actuarial valuation date and the measurement date, professional judgment should be used to determine the extent of procedures needed to roll-forward the measurement from the actual valuation to the measurement date. For accounting and financial reporting purposes, an actuarial valuation of the total pension liability should be performed biennially. More frequent actuarial valuations are encouraged.

Measurement of total pension liability

The total pension liability is measured as the portion of the actuarial present value of projected benefit payments that is attributed to past periods of employee service. The projected benefit payments should include the effect of automatic postemployment benefit changes, including automatic cost-of-living adjustments (COLAs). In addition, projected benefit payments should include any ad hoc benefit changes to the extent that they are considered to be substantively automatic, projected salary changes, and projected service credits. Administrative costs associated with providing pensions should be excluded from projected benefit payments. It should be measured as of a date (measurement date) no earlier than the end of the employer's prior fiscal year and no later than the end of the employer's current fiscal year, consistently applied from period to period. The entry age actuarial cost method should be used to attribute the actuarial present value of projected benefit payments of each employee to specific periods of employment.

Measurement of pension expense

The inputs into the pension expense that must be recognized immediately are the service cost, interest on the total pension liability, and changes in the terms of pension benefits, such as formula changes. Each employee's service cost should be level as a percentage of that employee's projected pay. Changes in the total pension liability from differences in actual economic and demographic changes, and from actuarial assumptions and changes in economic and demographic assumptions, must be recognized immediately for inactives and amortized over the remaining weighted average service life of the active employees. Contributions to the pension plan from the employer should not be recognized in pension expense.

The basic formula for calculating pension expense is as follows: Service cost + interest on total pension liability + current-period benefit changes – member contributions + administrative expenses + recognition of deferred outflows – recognition of deferred inflows.

The year-to-year pension expense number is likely to be volatile. According to GASB, the pension expense should not be considered a proxy for contribution levels.

Assumptions

Except as specified above with the calculation of the discount rate, the selection of all assumptions used in determining the total pension liability and related measures should be made in conformity with Actuarial Standards of Practice issued by the Actuarial Standards Board. The employer that makes payments for pensions as benefits come due should use the same assumptions when measuring similar or related pension information.

Disclosures: Defined benefit plans

Implementation of GASB 73 will result in required enhancements to financial statement disclosures by establishing a single framework for the presentation of information about pensions, which will enhance the comparability of pension-related information reported by employer and non-employer contributing entities.

The new disclosure items include:

- Descriptions of changes in assumptions and benefit changes
- Discount rate, including the source and sensitivity analysis of the rate
- Total pension liability, deferred inflow and outflows, and pension expense–some of which may be omitted if they are included in a separately available report
- Significant assumptions in measuring total pension liability–including inflation and salary changes
- The fact that there are no assets available in the trust

The continued disclosure items include:

- Description of the plan, the benefits provided, COLAs, plan administrator, and authority establishing plan and requiring contributions
- Policy for determining contributions
- Participant counts separately identifying inactive employees currently receiving benefits, inactive employees entitled to but not yet receiving benefit payments, and active employees

Additional disclosure items include:

- Schedule of changes in total pension liability for the current period
- Revenue from non-employer contributing entities
- Components of the current period pension expense
- Detailed reconciliation of beginning and ending balances of deferred inflow and outflows segregated into various categories
- If applicable, information on measurement date, actuarial valuation date, roll-forward methodology procedures, and special funding situations
- A schedule of the deferred inflow and outflows that will be recognized in pension expense for each of the five subsequent years

Required supplementary information (RSI)

The RSI must contain a 10-year schedule of changes in the total pension liability and the effects of various components on the total pension liability must be shown. If the employer does not have a special funding situation, a 10-year schedule of the total pension liability, covered-employee payroll, and the total pension liability as a percentage of covered-employee payroll also must be included. If the employer does have a special funding situation, a 10-year schedule of the total pension liability, the non-employer contributing entities total proportionate share of the total pension liability, the employer's proportionate share of the total pension liability, covered-employee payroll, and the total pension liability as a percentage of covered-employee payroll must be included.

Special funding situations

For purposes of GASB 73, special funding situations are circumstances in which a non-employer entity is legally responsible for making benefit payments directly to the employees of another entity as the pension comes due and one of the following exists:

- The amount of benefit payments for which the non-employer is legally responsible is not dependent upon one or more circumstances unrelated to the pensions.
- The non-employer entity is the only entity with a legal obligation to make benefit payments as the pensions come due.

The non-employer entity should recognize a liability for the non-employer's proportionate share of the collective total pension liability. The employer's proportionate share of the collective total pension liability should be measured as the collective total pension liability less the non-employer contributing entities' total proportionate share of the collective total pension liability. Proportionate share of pension expense, as well as deferred outflows and deferred inflows related to pensions, should also be recognized.

Assets accumulated for pensions outside of a trust

If a pension plan is not administered through a trust and meets the criteria for GASB 73, any assets accumulated for pension purposes should continue to be reported as assets of the employer or non-employer contributing entity.

If a pension is administered through a trust and meets the criteria for GASB 73, the government that holds these assets in a fiduciary capacity should report the assets in an agency fund. The amount of assets accumulated in excess of liabilities for benefits due to plan members and accrued investment and administrative expenses should be reported as a liability to participating employers or non-employer contributing entities. If the agency fund is included in the financial report of an employer whose employees are provided with benefits through the pension plan or a non-employer contributing entity that pays benefits as the pensions come due, balances reported in the agency fund should exclude amounts that pertain to the employer or non-employer contributing entity that reports the agency fund. These amounts should be reported as required in the first paragraph of this section.

Defined contribution plans

The most significant accounting change from the GASB 73 statement for defined contribution plans is for account forfeitures. The account forfeitures are deducted from pension expense to the extent that they are not reallocated to other accounts. The pension expense is equal to the amount of credits to employees' accounts that are defined by the benefit terms as attributable to employees' services in the period, net of forfeited amounts that are removed from employees' accounts. A change in the pension liability is equal to the difference between amounts recognized as pension expense and amounts paid by the employer as the benefits come due during the fiscal year. The previous accounting and reporting for defined contributions has been carried forward, including the noted disclosure requirements. Liabilities for defined contribution pensions provided through different pension plans may be displayed in aggregate.

Amendments to GASB 67 and 68

Information about investment-related factors that significantly affect trends in the amounts reported for GASB 67 and GASB 68 should be limited to those factors over which the pension plan or participating governments have influence. One example of this would be changes in investment policies. Information about external economic factors, such as changes in market prices, should not be presented.

The contribution-related schedules in the RSI, such as actuarially determined contributions, contractually required contributions, and statutorily required contributions, should exclude amounts, if any, associated with payables to the pension plan that arose in a prior fiscal year and those associated with separately financed specific liabilities of the individual employer or non-employer contributing entity, as applicable, to the pension plan.

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This publication is intended to provide information and analysis of a general nature. Application to specific circumstances should rely on separate professional guidance. Inquiries may be directed to: periscope@milliman.com.

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