OPEB – Preparing for Your Audit

Civic Federation and the Federal Reserve Bank of Chicago

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OPEB – Preparing for your audit

- Objectives of GASB 45
- Misconceptions about GASB 45
- Preparing for the audit
- Actuaries and what they do
- Practical Issues/Challenges
- Questions

Objectives of GASB 45

- Recognize OPEB costs systematically over employee's years of service

- Provide relevant information on:
  - Accrued OPEB obligation
  - Cost of services including cost of OPEB
  - Progress made in funding the plan
  - Report OPEB and pensions consistently

5 Myths of GASB 45 – from GFOA’s “Government Finance Review,” June 2006

- GASB 45 will result in booking the entire OPEB liability in the financial statements.
- Districts have no choice – Districts have to change how they fund OPEB if they want to keep getting a clean opinion from the auditors.
- OPEB will wipe out fund balance in the general fund overnight.
- No written agreement means no OPEB.
- As long as the retirees pay the full amount of their healthcare premium, there is no OPEB for the district to report.

Preparing for the audit

What do the financial preparers need?

- Actuarial reports
- Plan documents
- Adjusting journal entries
- Financial statements
- Footnote disclosures

Preparing for the audit

What do the auditors need?

- Actuarial reports
- Plan documents
- Adjusting journal entries documentation
- Financial statements
- Footnote disclosures
- Format of information
- Implicit rate subsidy information

What the Actuary Does and Why?

- Why – required by S45 for employers with more than 100 members (members are benefit eligible employees plus retirees)
- Actuaries use statistical models to estimate future benefit costs
- Set assumptions appropriate for the employer and plan
  - demographics – rates of termination, retirement, mortality, disability
  - economic – investment return (discount rate), salary increases, medical inflation
  - implicit rate subsidy – age-adjusted medical costs vs. blended costs
- Establish Funding Method to allocate retirement costs over employees' working careers (accrual basis)

Selecting an Actuary

- Qualifications
  - Training – Associate (A.S.A.) or Fellow (F.S.A.) of the Society of Actuaries
  - Certification – Member of the American Academy of Actuaries (M.A.A.A.)
  - Expertise
    - Short-term Aspect – Health Care Pricing
    - Long-Term Aspect – Pension Models

Actuarial Valuation Process and Timing

- Collect census, plan, and medical cost information from employer
- Set actuarial assumptions and methods
- Project future cash flows for benefits and allocate their value to employees' working careers
- Report preparation and contents
- Communication to administration, board, public, employees
- Timing – usually at least 4 to 12 weeks after actuary receives all data

Typical Actuarial Data Request

- Employee Census (in electronic format)
  - Name
  - Social Security Number or Employee Number
  - Date of Birth
  - Date of Hire
  - Gender
  - Employee Class
  - Accumulated Sick Leave
  - Salary

Typical Actuarial Data Request

(continued)

- Medical Plan Information
  - Current premiums (or claims) for medical plans
  - Historical premiums (or claims) for three to five year period, including description of significant changes in plans over that period of time

Typical Actuarial Data Request

(continued)

- **Retiree Census** (in electronic format), including any on direct bill basis with insurer

  - Name
  - Social Security Number or Employee Number
  - Date of Birth
  - Date of Retirement
  - Gender
  - Spouse Covered (yes or no)
  - Spouse's Date of Birth
  - Employee Class
  - Remaining Months of Retiree Medical Insurance
  - District Contribution Toward Retiree Medical Insurance
  - Remaining Stipend/Pension
  - Remaining Accumulated Sick Leave

Typical Actuarial Data Request

(continued)

- Plan Documents
  - Collective bargaining agreements or labor contracts for each employee group eligible for Retiree Benefits

Key Actuarial Assumptions

- Investment Return (Discount Rate) – based on the estimated long-term investment yield on the investments used to finance the payment of benefits

- Health Care Cost Trend Rate (Medical Inflation) – change in per capita health claims costs over time as a result of medical inflation, utilization, plan design, and technological developments

- Implicit Rate Subsidy – Age-adjusted premiums vs. blended premiums

- Demographic Assumptions – rates of termination, retirement, mortality, and disability

Key Actuarial Methods

- Six acceptable actuarial funding methods
  - Consistent with accrual accounting
  - Allocate costs to prior and future service periods
  - Recognition of actuarial gains and losses
- Asset Methods
  - Market Value of Assets
  - Smoothing of asset gains and losses

Actuarial Report Contents

- Actuarial Accrued Liability – value of retirement benefits attributable to employees prior service
- Normal Cost – value of retirement benefits attributable to current year’s service
- Annual Required Contribution (ARC) – Normal cost plus Amortization of Unfunded Actuarial Accrued Liability
- Plan assets set aside into Irrevocable Trust
- Cash flows for benefits vs. ARC
- Implicit Rate Subsidy
- Accounting Disclosures

When the Actuarial Report is needed

- GASB Requirements
  - separate reporting for Employer (S45) and Irrevocable Trust (S43)
  - actuarial certification required for employers with 100+ members
  - alternative calculation method in lieu of actuarial certification
    - allowed for smaller employers
    - requires the same actuarial principles and methods
    - simplifies setting of assumptions
  - Biennial (200+ members) or Triennial (less than 200 members) valuations

When the Actuarial Report is needed

(continued)

- Lead time
  - report usually takes 4 to 12 weeks to complete after all data received
  - will find a rush of valuations around fiscal year end
- Date of valuation
  - best if valuation date aligns with fiscal year
  - use same valuation date for subsequent valuations
- Consider doing a valuation now to plan for the increase in costs

Practical Issues

Implicit Rate Subsidy

- Applies if retiree premium is not age adjusted
- Difference in amount paid on behalf of retirees and active employees
- The true value of the retiree benefit
- Usually applies only to retirees under age 65 (pre-Medicare)

Practical Issues

Complex Issues That Could Arise with OPEB Plans

- Collectively bargained fixed employer contributions to a trust
- Other mixed funded plans (explicit subsidies funded separately from implicit subsidies) and partially funded plans
- Pension plans and other vehicles providing health subsidies
- Life insurance and other types of OPEBs
- Issuance of OPEB obligation bonds to finance OPEB

Challenges

- ➢ Pensions not previously recognized
- ➢ Using Accumulated Sick Leave to pay retiree medical
- ➢ Forced into implicit rate subsidy by state law
- ➢ Quality of substantive plan
  - memoranda of understanding
  - past practice differs from documents
- ➢ Plan Documents may not fully describe benefits
  - retirees on direct bill basis with insurer

Questions and Answers