

Author: David W. Powell

If you have questions, please contact your regular Groom attorney or one of the attorneys listed below:

Kimberly M. Boberg
kboberg@groom.com
(202) 861-2606

Ian D. Lanoff
ilanoff@groom.com
(202) 861-6638

David N. Levine
dlevine@groom.com
(202) 861-5436

Louis T. Mazawey
lmazawey@groom.com
(202) 861-6608

David W. Powell
dpowell@groom.com
(202) 861-6600

Changing Retiree Medical Plan Benefits to Reduce OPEB Liabilities Under Governmental Accounting Rules

In 2015, the Governmental Accounting Standards Board (“GASB”) issued Statement No. 74 (“GASB 74”) to replace Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other than Pension Plans*, and establish new uniform standards of financial reporting for state and local governmental post-employment benefits other than pension benefits, (known as “OPEB”), which includes post-employment healthcare benefits (i.e., retiree medical) as well as other types of post-employment benefits (e.g., death benefits, life insurance, and disability).

Generally, the new statement, together with its corollary Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pension*, regarding accounting by the governmental employers, require that net OPEB liabilities be calculated and reported on each employer’s financial statements. This is similar to the treatment GASB had promulgated several years earlier for governmental pension plan liabilities in GASB Statements. Nos. 67 (effective for plan fiscal years beginning after June 15, 2013) and 68 (effective for employer fiscal years beginning after June 15, 2014). For more information on that pension accounting treatment, see our prior Groom article here:

http://www.groom.com/media/publication/1194_Net_Pension_Liability_of_State_Retirement_Systems.pdf.

GASB 74 became effective for financial statements for fiscal years beginning after June 15, 2016. As governmental employers have begun to determine and report OPEB liabilities, a question has arisen similar to a question that had earlier arisen in the context of reporting pension liabilities - whether the governmental employer can make changes to the plan to reduce the amount of liabilities.

In this regard, paragraph 43 of GASB 74 provides that, in determining total OPEB liabilities, projected benefit payments should include all benefits in accordance with the benefit terms and any additional legal agreements to provide benefits that are in force that are in force at the OPEB plan’s fiscal year-end. Until the benefit terms are changed, the employer has constructive liability under the current benefit terms and the measurement of that liability is sufficiently reliable to be recognized for financial reporting purposes. Thus, while a state statute may, for example, authorize or require a change in the benefit terms to make benefits affordable, such a change is not taken into account unless and until the benefit change has been adopted prior to the relevant fiscal year end.

Because governmental entities generally have more leeway to change OPEB benefits than pension benefits, this way in which the accounting statement works may present an opportunity to modify the net OPEB liabilities. For example, assume a state statute provides that a board is required to make changes to a retiree health plan so that it is not to be

underfunded. From time to time, in compliance with that statute, the pension board adopts changes to benefits payable under the health plan, lowering them in satisfaction of the statutory requirement (or perhaps raising them again after a prior reduction). How and when do such changes affect the total and net OPEB liabilities with respect to that plan?

In late 2016, GASB also issued related guidance in the form of a proposed Implementation Guide that was recently finalized at the April GASB meeting. The proposed and now final Implementation Guide addresses these questions. Three question and answer sets in particular answer these questions by indicating that, to be recognized, the change must be actually adopted, but it is only taken into account with the plan year in which it is adopted. In addition, though, the guide adds an anti-abuse rule that indicates that, if a periodic change to the formula is made but is not really enforced (e.g., a cap on benefits has a history of being waived), it perhaps should not be taken into account. But assuming, under the facts and circumstances, that a benefits cap is specific and real, once it is enacted it would be taken into account, even if benefits are not capped until a later year.

The three questions are as follows, with particularly relevant parts highlighted:

4.109. Q—A state statute provides that the administrator of the state’s retiree healthcare plan is required to make changes to the plan to maintain a specified minimum funded level. From time to time, in compliance with that statute, the OPEB plan administrator adopts changes to the OPEB plan’s benefit terms. At what point in time should anticipated changes to the OPEB plan’s benefit terms be included in the projection of benefit payments for purposes of Statement 74?

A—Paragraph 43 of Statement 74 requires that **projected benefit payments** include all benefits in accordance with the benefit terms and any additional legal agreements to provide **benefits that are in force at the OPEB plan’s fiscal year-end**. In addition, that paragraph requires that the projection include consideration of the established pattern of the sharing of benefit-related costs between the employer and inactive plan members. To the extent that the effects of the anticipated benefit changes are determined to be part of an established pattern of the sharing of benefit-related costs with inactive plan members, those effects should be considered in the projection of benefit payments beginning in the period in which that determination is made. Any portion of the expected effects of the anticipated benefit changes that is not determined to be part of the pattern of sharing of benefit-related costs with inactive plan members is not part of the substantive plan until the benefit change has been adopted. Therefore, although the state statute requires a change in benefit terms **in the future** if certain conditions arise, those effects of anticipated changes should not be incorporated into the projection of benefit payments for purposes of Statement 74 **until the OPEB plan’s fiscal year-end in which the benefit change has been adopted, that is, the benefit change is part of the substantive plan.**

...

4.121. Q—Under what conditions should a legal or contractual cap on benefit payments to be provided in the current year be taken into consideration in projecting the benefit payments to be provided in future periods?

A—A legal or contractual cap on benefit payments that is established to limit an employer’s obligation for OPEB should be factored into the projection of benefit payments if both of the following conditions apply:

a. The cap sets an upper limit on the benefit payments to be provided to inactive plan members each period, as distinguished from a cap on the employer's contributions to a defined benefit OPEB plan. (See also Question 4.120.)

b. The cap is assumed to be effective, taking into consideration all relevant facts and circumstances, including the employer's record of enforcing the cap in the past. (For example, has the employer ever previously increased the benefit cap when the original capped amount was reached?)

4.122. Q—If a legal or contractual cap on benefit payments meets the two conditions identified in the answer in Question 4.121, what is the assumed effect on benefits that are projected to be paid at or after the point that the benefit payments reach an effective benefit cap?

A—If a legal or contractual cap on benefit payments meets the two conditions identified in the answer in Question 4.121, the benefit payments for OPEB each period should be projected to increase based on continuation of the historical pattern of sharing of benefit-related costs between the employer and the inactive plan members up to the point at which the benefit payments reach the capped amount. From that point forward, the benefit should be projected to not exceed the capped amount. [emphasis added]

In summary, if a governmental employer wishes to modify the amount of liabilities reported on its financial statements, the Implementation Guide indicates what legal steps need to be taken to do so. If you would like more information on GASB 74, please contact David Powell or your usual Groom lawyer.