Maryland GFOA Spring Conference:

Hot Topics in Government Accounting

April 28, 2017

Agenda

- New GASB Standards Effective in 2017
- Challenges with Tax Abatement Disclosures
- Investments in Government Investment Pools
- Top Ten OPEB implementation Issues
- New AICPA OPEB Chapter
- Responsibility for Establishing Actuarial Assumptions

GASB statements effective in 2017

December 31, 2016

- No. 77, *Tax Abatement Disclosures*
- No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*

June 30, 2017

- No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*
- No. 80, *Blending Requirements for Certain Component Units – an amendment of GASB Statement No. 14*
- No. 82, *Pension Issues – an amendment of GASB Statements No. 67, No. 68, and No. 73*

December 31, 2017

- No. 81, *Irrevocable Split-Interest Agreements*

Challenges with Tax Abatement Disclosures

What is a tax abatement?

— A reduction in tax revenues that results from an agreement between one or more governments and an individual or entity in which:

- (a) one or more governments promise to forgo tax revenues to which they are otherwise entitled <u>and,</u>
- (b) the individual or entity promises to take a specific action after the agreement has been entered into that contributes to economic development or otherwise benefits the governments or the citizens of those governments.

Exercise – Is this a tax abatement?

A local government enters into an agreement with a real estate developer for the purpose of stimulating economic growth. Under the terms of the agreement, the developer will construct a building. The government will <u>rebate</u> to the developer incremental property tax revenues generated above a baseline established prior to the agreement, based on certain costs incurred by the developer related to the new building. The rebate to the developer is limited to no more than the amount of the incremental tax revenues. Does this agreement meet the definition of a tax abatement in Statement 77?

✓ Yes   X No

Answer - Substance over form

Yes.

The developer is promising to take a specific action of constructing a building for purposes of economic development, and the government is forgoing tax revenues to which it is otherwise entitled by returning some or all of the incremental property tax revenues to the developer.

Although many tax abatements directly reduce the amount of taxes paid and do not involve the actual collection and return of taxes, the mechanism used to transact the abatement is not relevant to determining whether a transaction meets the definition of an abatement. Therefore, the fact that the government receives property taxes and subsequently rebates those tax receipts to the developer means that the government did, in substance, forgo tax revenues.

Investments in Government Investment Pools

Investments in government investment pools

- Valuation
  - Value per share of underlying portfolio
  - NAV based measurement under GASB 31
- Disclosure
  - NOT part of leveling disclosure
  - NOT subject to NAV as a practical expedient disclosure

Top Ten OPEB Implementation Issues

OPEB Implementation Issues

1. Evaluating whether there is a qualifying trust
2. Determining the type of plan
3. Selecting the measurement date for the employer
4. Selecting the timing and frequency of actuarial valuations
5. Evaluating and documenting process for selecting key actuarial assumptions
6. Determining whether Medicare Part D should be included in measurement of total/net OPEB liability

OPEB Implementation Issues, cont.

7. Verifying what constitutes the substantive plan
8. If qualifying trust, determining methodology for projecting future contributions in the discount rate calculation
9. Determining whether IBNR should be accrued for self-insured health plans
10. Determining who will calculate deferred outflows/inflows of resources and OPEB expense

Qualifying trusts or equivalent arrangements

1. Contributions from employers and nonemployer contributing entities to OPEB plan and earnings on those contributions are irrevocable

2. OPEB plan assets dedicated to providing OPEB to plan members in accordance with benefit terms

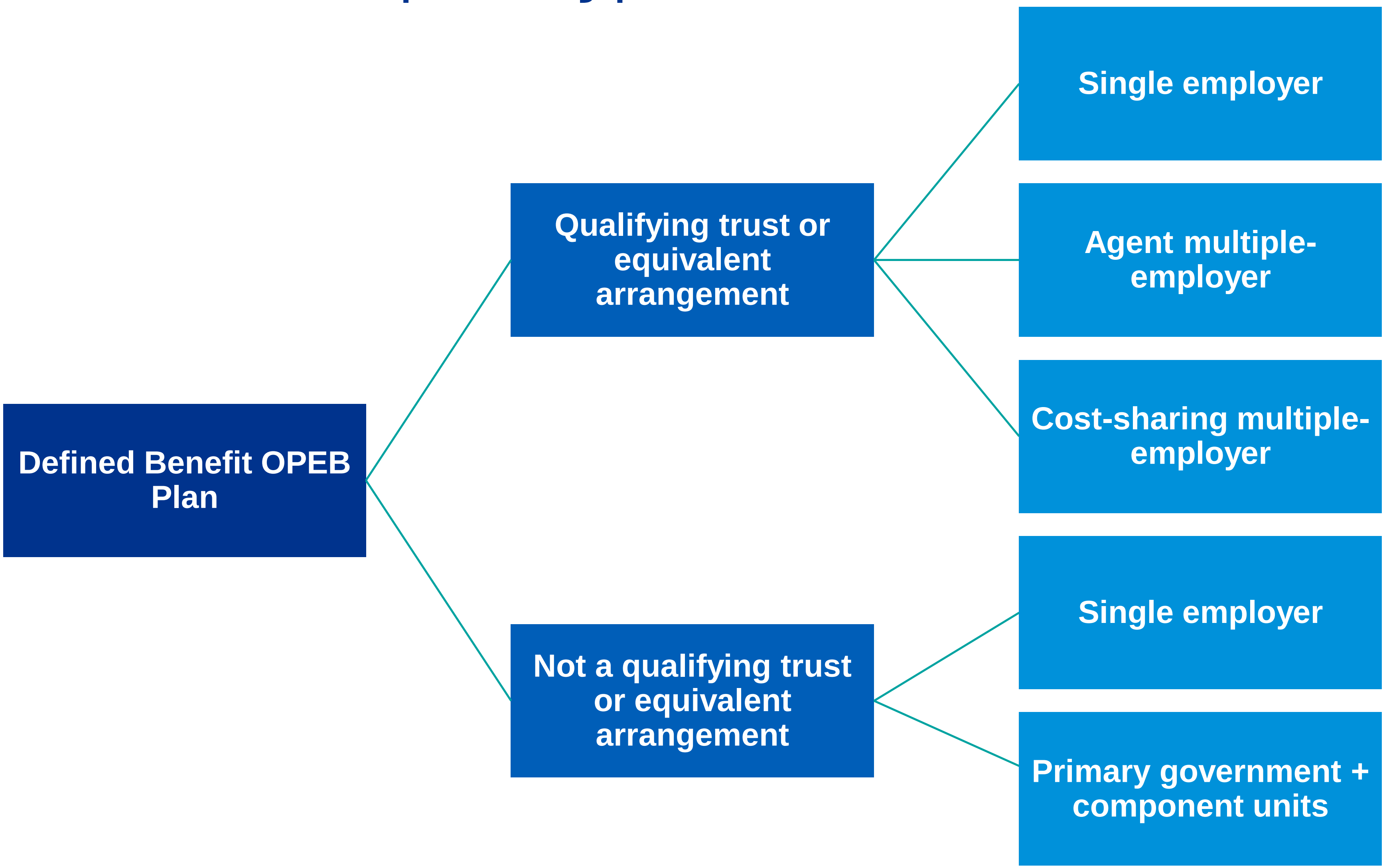
3. OPEB plan assets are legally protected from creditors of employer(s), nonemployer contributing entities, plan administrator, and plan members

Recognition and measurement on employer financial statements dependent upon whether plan is administered through a qualifying trust or not.

Qualifying trust considerations

- Qualifying trust vs. not a qualifying trust designation drives recognition and measurement on employer financial statements
  - Incorrect designation dooms accounting from the start!
- Implementation of GASB 74 is good time to revisit qualifying trust criteria to ensure compliance
- OPEB benefits and non-OPEB benefits (i.e., active employee healthcare) administered through a single trust
  - Partition between OPEB and non-OPEB
  - OPEB portion meets definition of qualifying trust only if assets are dedicated solely to providing OPEB

Overview of plan types



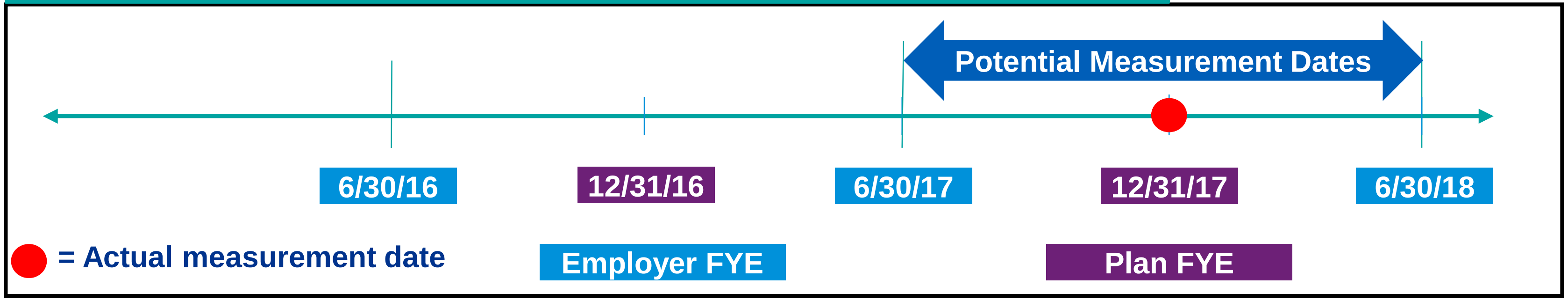
Types of defined benefit OPEB plans

Single Employer	Agent Multiple-employer	Cost-sharing Multiple-employer
— Provides OPEB to employees of one employer — Primary government and component units collectively considered to be one employer	— Provides OPEB to employees of more than one employer — Assets are pooled for investment purposes, but separate accounts maintained for each employer — Employer’s share of pooled assets is legally available only for its employees	— Provides OPEB to employees of more than one employer — Employers pool or share obligations — Plan assets can be used to pay the benefits of retirees from any employer

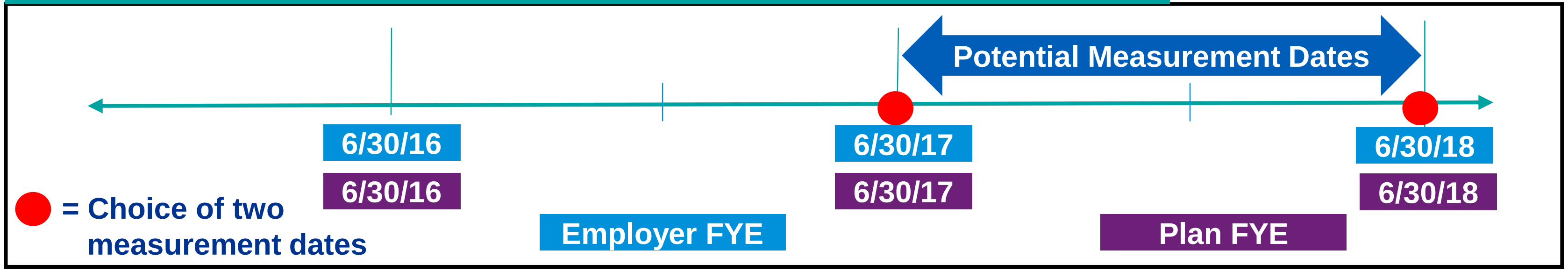
Measurement date for employers – Qualifying trust

- As of a date no earlier than employer's prior fiscal year-end
  - Likely will coincide with plan's year-end
  - Consistently apply from period to period

Example: Plan and employer have different year-ends

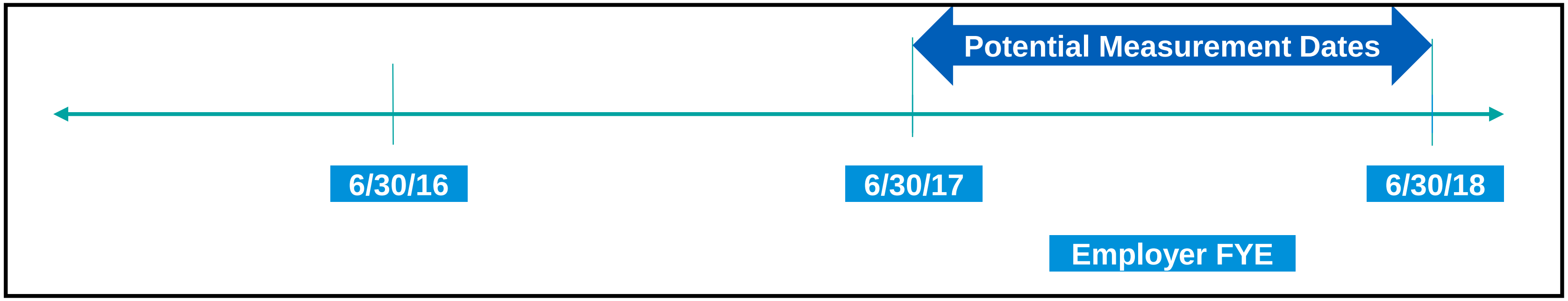


Example: Plan and employer have the same year-ends



Measurement date for employers - Not a qualifying trust

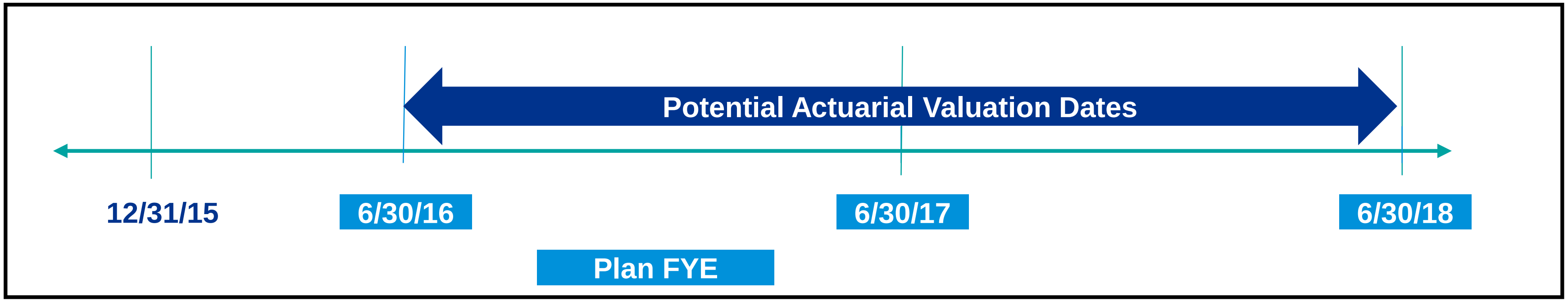
— As of a date no earlier than employer's prior fiscal year-end
  - No plan year-end – measurement date can be any day in fiscal year
  - Availability of information from plan is not a challenge
  - Consider whether plan will be administered through a qualifying trust in future
  - Consistently apply from period to period



Actuarial valuation date - Plan

— Measurement of the total OPEB liability is determined through:
  - An actuarial valuation performed as of plan year-end, or
  - The use of update procedures to roll forward amounts from an actuarial valuation as of a date no more than 24 months from the plan's year-end

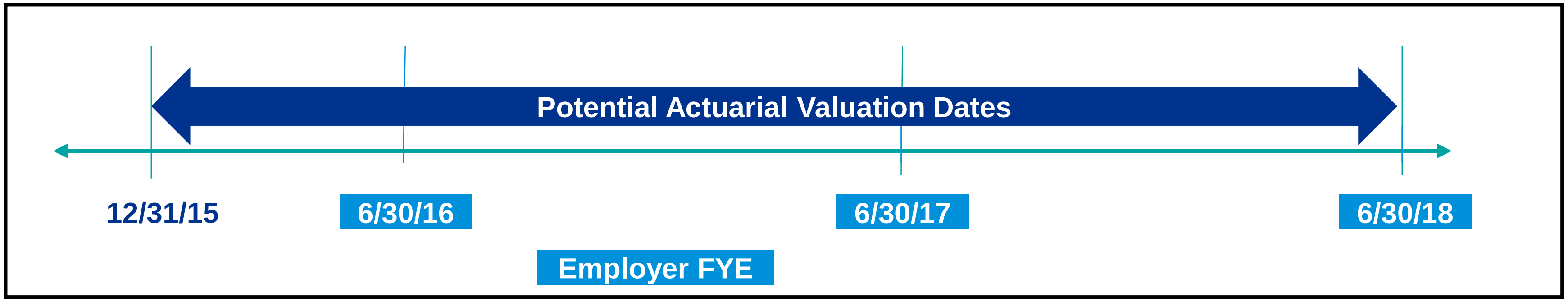
— Use professional judgment in determining extent of update procedures when changes occur between last valuation date and measurement date



Actuarial valuation date - Employer

— Measurement of the total OPEB liability is determined through:
  - An actuarial valuation performed as of the measurement date, or
  - The use of update procedures to roll forward amounts from an actuarial valuation as of a date no more than 30 months and 1 day earlier than the employer's year-end

— Use professional judgment in determining extent of update procedures when changes occur between last valuation date and measurement date

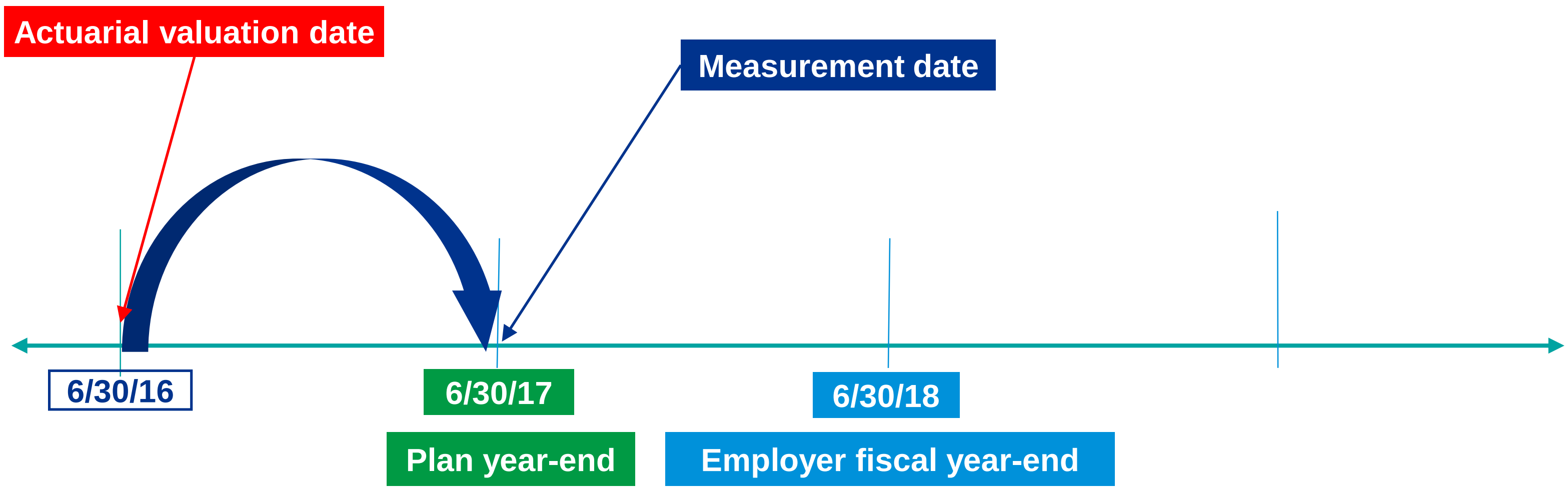


Frequency of actuarial valuations

- Consider whether actuarial valuations will be performed on an annual or biennial basis
- Regardless of timing or frequency of actuarial valuations, amounts must be rolled forward to plan’s year-end or measurement date of employer, as applicable
- Consider employer’s measurement date when selecting frequency and timing of the plan’s actuarial valuation

Actuarial valuation date - Biennial valuations

Employer chooses beginning of the year measurement date – 2018



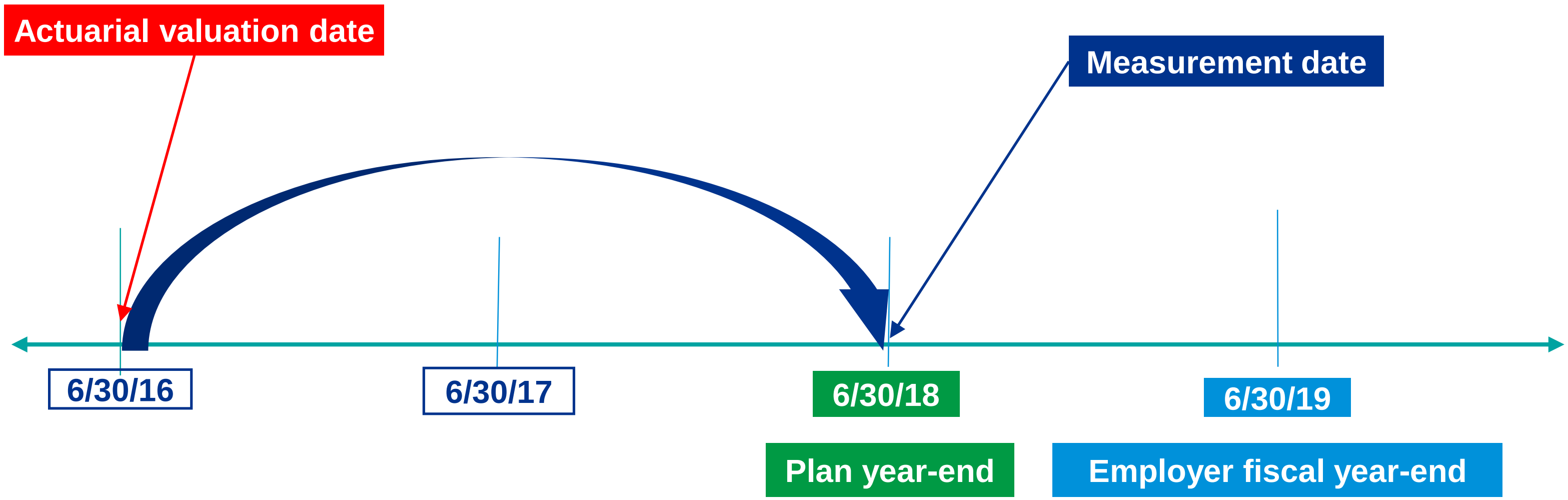
Date Check:

✓ = Actuarial valuation within 30 months and 1 day of employer year-end

✓ = Actuarial valuation within 24 months of plan year-end

Actuarial valuation date - Biennial valuations

Employer chooses beginning of the year measurement date – 2019



Date Check:

X = Actuarial valuation within 30 months and 1 day of employer year-end

✓ = Actuarial valuation within 24 months of plan year-end

Key actuarial assumptions

Pension	OPEB
Long-term expected rate of return on plan investments (plans administered through qualifying trusts)	Long-term expected rate of return (plans administered through qualifying trusts)
Mortality	Mortality
Compensation increases	Healthcare cost trend rate
	Participation/acceptance rate of benefits

- Assumptions represent management's best estimate at measurement date
- Assumptions are unique to each plan
- New assumptions take effect when known (i.e., experience study completed or new information is known)
- Must reconsider appropriateness of assumptions each year

Medicare Part D

- Employer provides prescription drug benefits through employer plan and receives a federal retiree drug subsidy (RDS)
  - Technical Bulletin 2006-01 - Requires plans administered through a qualifying trust include the prescription drug benefit funded by the RDS in projection of future benefit payments when measuring the total OPEB liability
  - Apply same concept to plans not administered through a qualifying trust
- Medicare benefits an employer is providing as a conduit to the federal government are not part of substantive OPEB plan
  - Example, Employer Group Waiver Plan in which eligible employees are enrolled directly in Medicare Part D
  - Core Medicare Part D benefits not part of projection of future benefit payments because the federal government is primarily responsible for and has assumed risks associated with providing benefits (GASB 75 ¶B47)
  - Benefits provided through a "wrap" to enhance Medicare Part D are part of projection of future benefit payments

Substantive OPEB plan

- Benefits of the OPEB plan as understood by employer and plan members
- May or may not be based on a written plan document
  - May differ from written documents
- Typically not one comprehensive plan document
- May include several written documents
  - Healthcare plan
  - Administrative policies
  - Collective bargaining agreements
  - Ordinances or state statutes
  - OPEB trust document
  - Other communications between employer and plan members
- Substantive plan provisions change frequently compared to pensions

Discounting future benefit payments

— When a qualifying trust, a single blended rate, based on:
  - The long-term expected rate of return on plan investments (net of investment expenses) to the extent that the plan's fiduciary net position is projected to be sufficient to make projected benefit payments and is expected to be invested, using a strategy to achieve that return; and
  - A yield or index rate for 20-year, tax-exempt general obligation municipal bonds with average rating of AA/Aa or higher, to the extent that the conditions above are not met

— When not a qualifying trust, a yield or index rate for 20-year, tax-exempt general obligation municipal bonds with average rating of AA/Aa or higher, to the extent that the conditions above are not met

Discount rate calculation – Qualifying trust

- Most OPEB plan trusts are thinly funded
- Many employer's administer benefits outside of trust on pay-as-you-go basis
- Caution should be used in projecting future contributions to plan (including benefit payments outside of trust) in future periods
- Projection of future employer contributions should consider:
  - Formal written policy
  - No formal written policy – Limited to average of contributions over most recent 5-year period
  - Apply professional judgment in all cases
- Projected employer contributions on pay-go basis will not equal benefit payments in the future
  - Portion of future pay-go contributions will fund future plan members

New OPEB Chapter in the AICPA State and Local Government Accounting and Auditing Guide

New OPEB chapter in AICPA SLG Guide

- Part I – Plans Administered through a Qualifying Trust
- Part II – Employer: Single and Agent Employers Administered through a Qualifying Trust
- Part III – Employer: Cost-Sharing Employers Administered through a Qualifying Trust
- Part IV – Employer: Plans That Are Not Administered through a Qualifying Trust

Responsibility for Establishing Actuarial Assumptions

Actuarial reports

Accounting Valuation

- Used to calculate total pension liability of plan
- Assumptions driven by GASB 67/68
- Designed to measure total pension liability as of measurement date
- Plan Net Position is used to determine Net Pension Liability

Funding Valuation

- Used to calculate actuarially determined contribution
- Assumptions driven by Plan's board and/or State law
- Designed to fully fund plan by a certain date
- Actuarial value of assets are used to determine unfunded actuarial accrued liability

Employer responsibilities

- Establishing financial reporting processes and controls over measurement of pension and OPEB amounts
  - Reporting processes and controls will be different depending on type of plan (single-employer, agent, or cost-sharing)
- Supporting assumptions with appropriate, reliable, and verifiable information
  - Not sufficient to rely solely on assumptions provided by plan or plan actuary
  - Significantly higher level of responsibility for single-employer and agent plans

Key actuarial assumptions

Pension	OPEB
Long-term expected rate of return on plan investments (plans administered through qualifying trusts)	Long-term expected rate of return (plans administered through qualifying trusts)
Mortality	Mortality
Compensation increases	Healthcare cost trend rate
	Participation/acceptance rate of benefits

- Assumptions represent management's best estimate at measurement date
- Assumptions are unique to each plan
- New assumptions take effect when known (i.e., experience study completed or new information is known)
- Must reconsider appropriateness of assumptions each year

Practice challenges related to accounting valuations

— Accounting valuations not including necessary information, such as discount rate calculation

— Lack of employer involvement in establishment of assumptions

— Lack of documentation supporting actuarial assumptions

— Not updating reviewing assumptions each year

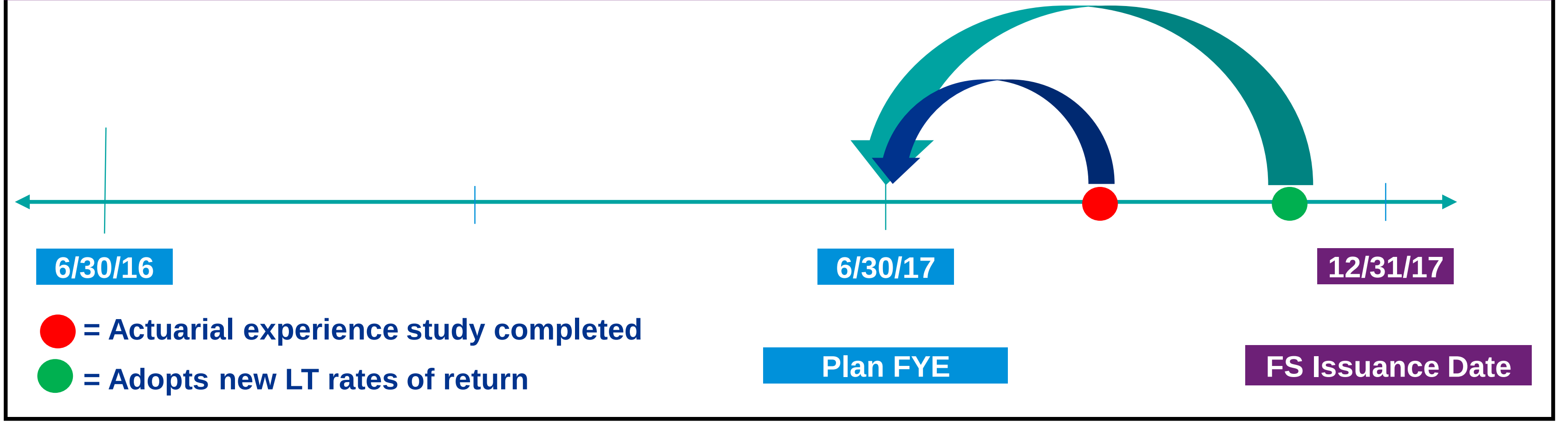
— Misunderstanding of relationship of assumptions used for “best estimate” measurement of net pension liability under GASB 68 vs. assumptions used for funding valuations that affect current measurement period

— Assumptions being changed for subsequent funding valuation but not for measurement of net pension liability as of current measurement date

Changes to actuarial assumptions

- Changes to assumptions effective when information is available
  - Not when incorporated into next accounting valuation
- Audits of plan financial statements – Subsequent events
  - Completion of actuarial experience studies
  - Changes to long-term rates of return
  - Condition likely existed as of year-end – Reflect changes in assumptions in current year FS and GASB 68 schedules

Example: Changes to assumptions after year-end but before FS issued



Changes to actuarial assumptions

- Audits of employer financial statements – Timing of changes to actuarial assumptions
  - Timing of issuance of plan financial statements key in determining how to reflect in employer financial statements
  - No plan financial statements – follow principals discussed on prior slide

After plan financials issued, before employer financials issued	After plan financials issued, before GASB 68 schedules and employer financials issued	Before plan financials, GASB 68 schedules, and employer financials issued
• Changes in assumptions not reflected in employer financials	• Changes in assumptions not reflected in employer financials	• Changes likely necessary to plan and employer financial statements

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