August 29, 2014

Director of Research and Technical Activities
Governmental Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

RE: Project No. 34-1E
Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions

Dear Mr. Bean,

We are writing on behalf of Gabriel, Roeder, Smith & Company (GRS) to respond to the GASB’s Exposure Drafts (EDs) related to accounting and financial reporting for postemployment benefits other than pensions (OPEB). GRS is an actuarial and benefit consulting firm that, for over 75 years, has specialized in the benefit plans of state and local governments, including public pension and other postemployment benefit plans.

We would like to thank the GASB for the opportunity to share our comments on the EDs. We would also like to thank the GASB’s Board and staff for their diligent deliberations related to this issue. Generally, we agree with the GASB’s view of the long-term nature of governments and the career-long nature of the employment exchange. With the GASB, we believe this leads logically to a long-term cost of services perspective with regard to OPEB accounting and financial reporting for state and local governments. It follows that the GASB’s financial accounting and reporting measures should reflect the long-term cost of other postemployment benefits.

General Concerns Related to Applying the Pension Standards to OPEB

We are concerned that applying the standards proposed in the EDs would result in substantial volatility in the measures of the net OPEB liability and the OPEB expense, which will be confusing to the users of the financial statements, including the government’s decision-makers and citizens. In many cases this volatility will be due to the use of a discount rate based on municipal bond rates that will change from year to year. These rates strongly influence the value of the total OPEB liability and OPEB expense, but are not directly related to the actual OPEB cost. Given that the volatility related to the discount rate is not directly related to the OPEB cost, the resulting measures could be misleading.

Specific Concerns Related to Applying the Pension Standards to OPEB

In addition, we are concerned that the GASB is applying its recently developed pension accounting and financial reporting standards to benefits that are substantially different from pensions. Key differences between pensions and OPEB include:
Pension benefits are typically defined by formulas and guaranteed while OPEBs are typically subject to the will of the employer. In Concepts Statement No. 4, the GASB defines a liability as a “present obligation to sacrifice resources that a government has little or no discretion to avoid.” However, employers can, and often do, unilaterally change the benefits they provide through OPEB plans. As a result, if a government can reduce or eliminate an OPEB liability by unilaterally changing the benefits, it does have discretion to avoid the obligation and, therefore, may not meet the GASB’s definition of a liability.

Pension funds are typically administered through a trust while OPEB funds are typically not administered through a trust. Generally, under the GASB’s rules, this means that any OPEB assets not held in trust may not be recognized as offsetting the total OPEB liability. Moreover, in such a situation, the discount rate used to value the total OPEB liability must be entirely based on the 20-year tax-exempt municipal bond rate. Our concern is that annual changes in the municipal bond rates would result in significant changes to the total OPEB liability and OPEB expense, even in the absence of changes to the underlying benefits. This would be confusing to users of financial reports and could lead to decisions that are not in the interest of the government or its employees. The volatility inherent in these rates is illustrated in the appendix to this letter.

Other Items

OPEB Normal Cost – Under GASB Statements 67 and 68 for pensions, the period over which a member accrues service (the “attribution period”) generally begins at the date of hire and ends at the date of final decrement. However, if the pension plan includes a deferred retirement option plan (DROP), the attribution period for the pension plan ends at the date of entry into the DROP. This would not be appropriate for members of an OPEB plan, since the OPEB benefits would begin at the end of the DROP period. We recommend that, for an OPEB plan, the “attribution period” should begin at the date of hire and end at the date of final decrement. However, some latitude may be appropriate, since the accrual periods for OPEB are more varied than for pension plans.

Sensitivity of the Net OPEB Liability – The EDs require that the sensitivity of the net OPEB liability to changes in the discount rate and health care cost trend assumptions be measured and disclosed in the annual financial report. This sensitivity would be determined by calculating the net OPEB liability using a plus/minus one percent difference in the discount rate and health care cost trend rate. This results in nine measures of the net OPEB liability, which could do more to confuse users of financial reports than to inform them. We suggest showing three measures, including:

1) The net OPEB liability based on the selected discount rate and selected health care cost trend assumption;
2) The net OPEB liability based on a discount rate that is one percent lower than the selected discount rate and a health care cost trend rate that is one percent higher than the selected health care cost trend assumption; and
3) The net OPEB liability based on discount rate that is one percent higher than the selected discount rate and a health care cost trend that is one percent lower than the selected health care cost trend assumption.

It should also be noted that many governments that sponsor OPEB have biennial cycles for their OPEB valuations. Under the GASB’s proposed rules, all nine sensitivity scenarios would have to be rolled forward in the intervening year. This would result in a substantial amount of work that would give users little new information. Consequently, baring significant OPEB changes, it may be more cost effective to simply show the sensitivity scenarios from the last full valuation. This would still give users useful information about the sensitivities at a lower cost.

- **Contributions for Inactive Members Receiving Benefits** – Contributions for inactive members receiving benefits (e.g., payments for premiums) do not appear to be explicitly included in the 10-year schedule of changes in the net OPEB liability under paragraph 33a8 of the ED related to OPEB plans. However, contributions from employers, nonemployer contributing entities, and active and inactive members not yet receiving benefits are included. Consequently, we recommend either explicitly adding contributions for inactive members receiving benefits to the schedule or allowing them to be included as an offset to benefit payments under paragraph 33a10. We see a similar concern in paragraph 53b of the ED related to OPEBs.

- **Need for Illustrations** – The OPEB rules will be at least as complicated as the pension rules. Consequently, detailed illustrations should be included in the appendices of the final Statements.

**Comments on Effective Date**

It would also be useful for the GASB to postpone the effective date of the OPEB standards until after the pension standards have been fully implemented. Given the issues that have arisen as a result of the GASB’s recent changes to the pension accounting standards, it may be that similar issues will become apparent for the OPEB standards as well. Moreover, if additional modifications become necessary for the pension standards over the next few years, the OPEB standards would also need to be modified. Consequently, it would be prudent to postpone implementing the OPEB standards in order that the significant time and money that governments will spend implementing the new OPEB standards will not be wasted.

In addition, it may be also be appropriate to stagger the effective dates for OPEB sponsors in a manner similar to Statement 45. Currently, the proposed effective date for all OPEB sponsors is for fiscal years beginning after December 15, 2016. It might be better for the larger OPEB sponsors to go first, in part to lead the way. This approach would also help distribute the work load on actuaries, auditors and others who will help implement the standards and provide advice to plan sponsors.
In conclusion, we would again like to thank the GASB for the opportunity to respond to these Exposure Drafts. We hope our comments are helpful in your deliberations.

Sincerely,

Brian B. Murphy, FSA, FCA, MAAA, EA  
President and Senior Consulting Actuary

David T. Kausch, FSA, FCA, MSPA, MAAA, EA  
Chief Actuary

Paul Zorn, MAPPS  
Director of Governmental Research
Appendix – Annual Changes in the 20-Bond Municipal Bond Index

Chart 1 shows the degree to which the 20-Bond Municipal Bond Index has varied from year to year over the period from 1954 to 2013, based on the annual percentage change. The annual percentage change is calculated as the percentage change relative to the prior year rate, rather than as the change in basis points. The percentage change is used (rather than basis points) because of the wide range of bond yields observed during the period. (Note that 25 bps off a 14% yield is very different from 25 bps off a 4% yield.)

For about 40% of the years in the period, the annual changes in the municipal bond rate ranged between -5% and 5% of the prior year value. However, for about 20% of the years, the changes ranged between -10% to -25% of the prior year value, and for the remaining years the changes ranged from 10% to as high as 41% of the prior year value. This indicates substantial volatility in the 20-Bond Municipal Bond Index.

Moreover, the pattern of change is erratic, as shown in Chart 2. A large change in one year may be followed by a large change in the opposite direction during the following year. As a result, pension or OPEB liabilities calculated using these bond rates will likely vary substantially from year-to-year, even in the absence of changes to the underlying benefits.
For comparison, Chart 3 shows the pattern of changes in the 20-Bond Municipal Bond Index based on changes in basis points from one year to the next. Again, the pattern is erratic, although the largest changes occurred in the late 1970s and early 1980s, when the U.S. faced high rates of inflation. However, the chart clearly shows substantial volatility in the bond rates, which would be included in the measures of the pension or OPEB liabilities regardless of any changes in the underlying benefits.

Chart 3: Time Series of Annual Basis Point Changes in 20-Bond Municipal Bond Index from 1954 to 2013

Source: Federal Reserve, State and Local Bonds - Bond Buyer G0 20-Bond Municipal Bond Index, Annual Rates for Calendar Year. Annual basis point changes calculated by author.