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June 30, 2008

The Honorable Kimberly D. Bose
Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426

Re: California Independent System Operator Corporation
Docket Nos. AC08-41-___ and AC08-54-___

Dear Secretary Bose:

Attached please find the Request for Rehearing of the California Independent System Operator Corporation and all attachments thereto, submitted in the above-referenced proceedings.

Thank you for your assistance in this matter. Please contact the undersigned with any questions.

Respectfully submitted,

/s/ Kenneth G. Jaffe
Kenneth G. Jaffe
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Counsel for the California Independent System Operator Corporation

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corporation	))	**Docket Nos. AC08-41-___ and AC08-54-___**

REQUEST FOR REHEARING OF THE
CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION

Pursuant to Section 313(a) of the Federal Power Act ("FPA"), 16 U.S.C. § 825l(a), and Rule 713 of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission ("FERC" or "Commission"), 18 C.F.R. § 385.713, the California Independent System Operator Corporation ("CAISO") respectfully submits this request for rehearing ("Request for Rehearing") of the letter order issued on May 30, 2008 in the above-referenced proceedings ("May 30 Order").[1] The May 30 Order addressed the CAISO's request for approval of its proposed accounting treatment of the costs of post-employment benefits other than pensions ("PBOPs") in accordance with the requirements of the Statement of Governmental Accounting Standards No. 45 ("SGAS 45").[2] As explained below, the May 30 Order erroneously denied the CAISO's proposal to use SGAS 45, which is the standard that the CAISO is required to employ for financial accounting purposes. Instead, the May 30 Order directed the CAISO to continue to account for PBOP costs using an accounting standard that is similar but not

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1 Capitalized terms not otherwise defined herein are used in the sense given the Master Definitions Supplement, Appendix A to the CAISO Tariff.

2 SGAS 45 is entitled "Accounting and Financial Reporting by Employers for Post-Employment Benefits Other than Pensions."

identical to SGAS 45, the Statement of Financial Accounting Standards No. 106 ("SFAS 106").[3] The Commission should correct this error on rehearing.

I. BACKGROUND AND SUMMARY

A. FASB and GASB, and the Commission's Statement of Policy Concerning the Accounting of PBOP Costs

The Financial Accounting Foundation ("FAF") has established two separate standard-setting boards: the Financial Accounting Standards Board ("FASB") and the Governmental Accounting Standards Board ("GASB"). FASB is the "designated organization in the private sector for establishing standards of financial accounting and reporting," and GASB is FASB's "counterpart for state and local government," which is similarly charged with establishing standards for financial accounting and reporting by governmental agencies and other bodies that have a specified relationship to governmental agencies.[4] The American Institute of Certified Public Accountants ("AICPA"), which is the national professional organization for Certified Public Accountants in the United States, has designated FASB as "the body to establish accounting principles pursuant to rule 203 and standards on disclosure of financial information for . . . entities' outside financial statements in published financial reports containing financial statements under rule 202" of the AICPA's Code of Professional Conduct.[5] The

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3 SFAS 106 is entitled "Employers' Accounting for Post-retirement Benefits Other Than Pensions.

4 *See* http://www.fasb.org/facts/; News Release, "The Financial Accounting Foundation Board of Trustees Approves Changes to Oversight, Structure and Operations of FAF, FASB and GASB" (issued Feb. 26, 2008), available at http://www.fasb.org/faf/nr022608.pdf.

5 Appendix A to AICPA's Code of Professional Conduct, available at http://www.aicpa.org/about/code/et_appendixes.html.

AICPA has also designated GASB to perform these same functions, pursuant to rules 202 and 203 of the AICPA's Code of Professional Conduct, "for state and local governmental entities."[6]

In 1990, FASB issued SFAS 106, which required employers to reflect in current expense an accrual for PBOPs during the working lives of covered employees. SFAS 106 was based on the recognition that PBOP plans are deferred compensation arrangements under which an employer promises to exchange future benefits for employees' current service and that the costs of PBOP plans should be recognized over the employees' periods of service for financial accounting and reporting purposes, in accordance with the specific requirements of SFAS 106. GASB did not issue SGAS 45, which addressed the same subject, and imposed similar but not identical requirements, until 2004.[7]

In 1992, the Commission issued a Statement of Policy regarding the recovery through rates of the costs of PBOPs of employees of public utilities subject to its jurisdiction, as well as certain accounting issues related thereto.[8] The Commission stated that it would recognize, as a component of jurisdictional cost-based rates of public utilities under its jurisdiction, allowances for prudently incurred costs of PBOPs of company employees "when determined on an

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6 *Id.*

7 The similarities and differences between SFAS 106 and SGAS 45 are discussed in Section I.B below.

8 Statement of Policy, *Post-Employment Benefits Other Than Pensions*, 61 FERC ¶ 61,330 (1992) ("Statement of Policy"), *reh'g denied and clarification granted in part*, 65 FERC ¶ 61,035 (1993). PBOPs are sometimes also referred to as "OPEBs". Statement of Policy at 62,199 n.1. For the sake of consistency, they will be referred to as PBOPs throughout this Request for Rehearing.

accrual basis (and supported by independent actuarial studies) that are consistent with the accounting principles set forth in SFAS 106."[9] With regard to FASB, the Commission stated that "[w]hen an authoritative body prescribes changes in accounting principles (or new principles come into being when none existed before) the Commission may examine those principles to see if they are compatible for ratemaking purposes as well."[10] In this regard, the Commission stated "[m]easurement of PBOPs for a given rate test period is a process of allocating accrued costs between periods in a rational manner so that each period bears its equitable portion of such costs," and that "SFAS 106 provides a reasonable convention for measurements of accrued costs including the transitional treatment of prior service costs."[11] The Commission also found that "[u]niform principles of cost measurements between similarly situated regulated companies and between time periods are beneficial for carrying out the Commission's regulatory programs."[12] Critically, however, the Commission went on to state that "[i]f there are special circumstances for a specific company which dictate that PBOPs should be recovered in rates through use of a different method, a case-specific review will be permitted."[13]

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9 Statement of Policy at 62,199-200.

10 *Id.* at 62,201. As noted above, at the time the Statement of Policy was issued, SGAS 45 had not been issued, so SFAS 106 was the only statement issued by an authoritative accounting body with respect to PBOPs.

11 *Id.*

12 *Id.*

13 *Id.*

Elsewhere in the Statement of Policy, the Commission provided additional direction concerning the special circumstances in which it would permit a case-specific review of the accounting method through which PBOP costs are recovered in a public utility's rates. The Commission expressly and repeatedly recognized that the Statement of Policy provides only general guidance and that the specific accounting principles set forth in SFAS 106 would not necessarily be appropriate in every case:

> The purpose of this policy statement is to provide guidance for the efficient disposition of pending or future cases which include PBOPs as a component of the cost of service and to provide a statement of the Commission's intent to permit recovery in future rates of PBOP costs appropriately deferred. The Commission is mindful that a general policy statement is an articulation of the Commission's intention, which will be followed unless particular circumstances demonstrate the policy to be inappropriate. Where, as here, the Commission has adopted a general statement of Commission policy, both the underlying validity of the policy and its application to particular facts may be challenged and are subject to further consideration in individual cases.
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> Some commenters have also objected to issuance of a Statement of Policy respecting the proper regulatory treatment of SFAS 106 requirements, claiming that there may be factual differences which would require another method of treatment of those costs. As previously stated herein, the purpose of this policy statement is to provide guidance for the efficient disposition of existing and future cases which include PBOPs as a component of cost of service and to indicate the Commission's intent to permit recovery in future rates of PBOP cost appropriately deferred. In individual cases, the application of the policy to particular facts may be challenged upon demonstration that particular circumstances dictate a different treatment.[14]

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[14] *Id.* at 62,200, 62,204-05.

B. The CAISO's Initial Use of SFAS 106 and Its Subsequent Need to Transition to the Use of SGAS 45

Pursuant to the general guidance set forth in the Statement of Policy, when the CAISO began operations in 1998, it accounted for PBOPs on the basis of SFAS 106 and included in its jurisdictional rates allowances for prudently accrued costs of providing PBOPs for CAISO employees consistent with the accounting standards set forth in SFAS 106.[15] In addition, the CAISO employed the other accounting standards issued by FASB in preparing the annual financial statements the CAISO provided to the public in accordance with generally accepted accounting principles ("GAAP"), and also in preparing the annual financial statements the CAISO provided to the Commission in accordance with the Uniform System of Accounts.[16]

Subsequently, however, the CAISO was required to transition from using FASB accounting standards, including SFAS 106, to using GASB accounting standards, including SGAS 45, because of an event related to the CAISO's governance: the resolution in 2005 of all issues concerning the process by which the CAISO Governing Board ("Board") is selected.[17] As relevant here, that

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15 The CAISO applied the SFAS 106 standards in accordance with accounting guidance provided by the Commission after the Statement of Policy was issued. *See* Letter Ruling, *Accounting for Post-Retirement Benefits Other Than Pensions*, Docket No. AI93-4-000 (June 4, 1993), *order on reh'g and clarification*, 65 FERC ¶ 61,294 (1993).

16 18 C.F.R. Part 101. As explained in the Statement of Policy, the accounting principles embodied in the Uniform System of Accounts are generally consistent with the GAAP that apply to non-regulated enterprises. Any differences are either due to the Commission's need for financial measurements to be accomplished in a specific manner to enable it to meet its regulatory responsibilities or are necessary, in the Commission's view, to permit recognition of the economic effects that regulation itself imposes on the enterprise. Statement of Policy at 62,201.

17 *See California Independent System Operator Corp.*, 112 FERC ¶ 61,010, *reh'g denied*, 112 FERC ¶ 61,337 (2005) (finding that proposed Board selection process is acceptable for

selection process provides that the members of the Board are appointed by the Governor of California and approved by the California State Senate.[18] The *AICPA Audit and Accounting Guide: State and Local Governments* ("*AICPA Government Guide*") makes it clear that the appointment of the members of the CAISO's Board by officials of the State of California renders the CAISO subject to the accounting standards promulgated by GASB. The relevant provisions of the *AICPA Government Guide* provide as follows:

> 1.01 This Audit and Accounting Guide (Guide) applies to all state and local governments. Governmental entities are subject to generally accepted accounting principles (GAAP) for state and local governments as described later in this chapter. . . . [E]ntities are governmental if they have *one or more* of the following characteristics:
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> - Popular election of officers or *appointment (or approval) of a controlling majority of the members of the organization's governing body by officials of one or more state or local governments.*
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> . . . .
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> 1.09 Pursuant to Rule 203 of the AICPA Code of Professional Conduct (AICPA, Professional Standards, vol. 2, ET sec. 203.01), *the AICPA recognizes GASB as the standard-setting authority for GAAP for state and local governments.*[19]

The CAISO determined that, under the above-quoted language of the *AICPA Government Guide* and under similar language in the *AICPA Audit and*

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purposes of meeting the independence requirements of Commission Order Nos. 888 and 2000 and that the then-current Board met those independence requirements).

18 *Id.* at P 3 & n.5 (citing Cal. Pub. Util. Code. § 337(a) (Deering 2005)).

19 Emphasis added. The *AICPA Government Guide* is provided as Attachment A hereto.

Accounting Guide: Not-for-Profit Organizations ("*AICPA Not-for-Profit Guide*"),[20] once the issues concerning the appointment of the members of the CAISO's Board by officials of the State of California were resolved, the CAISO was a "governmental" entity for purposes of the *AICPA Guides* and therefore was required to adopt the GASB accounting standards, including SGAS 45, to the extent they differed with FASB's standards.[21] As a result, beginning with the preparation of the CAISO's annual financial statements for 2006, the CAISO has adopted the accounting standards issued by GASB (including SGAS 45, as described below).

It is important to recognize that at the time the CAISO was required to adopt the GASB standards, it elected to adopt an accounting structure that prescribes the implementation of all FASB statements except where a FASB statement directly conflicts with a GASB statement.[22] The CAISO adopted this

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20 Section 1.03 of the *AICPA Not-for-Profit Guide*, which is provided as Attachment B hereto, states that "organizations are governmental organizations" if they have the characteristic of "[p]opular election of officers or appointment (or approval) of a controlling majority of the members of the organization's governing body by officials of one or more state or local governments." Together, the *AICPA Government Guide and the AICPA Not-for-Profit Guide* are referred to in this Request for Rehearing as the "*AICPA Guides*."

21 See the April 24, 2007 CAISO memorandum concerning the use of GASB rather than FASB that is provided as Attachment C hereto. To the CAISO's knowledge, it is the only public utility that is required to adopt the GASB accounting standards, including SGAS 45. Outside of the accounting context, however, the CAISO does not consider itself a governmental entity generally. *See* California Senate Rules Committee, Office of Senate Floor Analyses, Report on Senate Bill No. 1753 (2001-02 Regular. Session) Sept. 12, 2002, at p. 3, available at http://www.leginfo.ca.gov/pub/01-02/bill/sen/sb_1751-1800/sb_1753_cfa_20020912_130422_sen_floor.html (noting that the CAISO is not a governmental agency and is not subject to general state laws governing the conduct of state and local agencies); *see also San Jose Mercury News, Inc. v. Cal. Power Exchange Corp., et al*,, Sacramento Superior Ct. No. AS02065 (Jan. 1999) (indicating that the CAISO is not a governmental agency in support of court holding that the CAISO is not required to provide access to corporate records "consistent with the general policies of the California Public Records Act").

22 The CAISO adopted this accounting structure pursuant to GASB's Statement of Governmental Accounting Standards No. 20, entitled "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting"

accounting structure in order to minimize any differences between the CAISO's financial reporting standards and those of its peer independent system operators ("ISOs") and regional transmission organizations ("RTOs"), which, like the CAISO, each file annual accounting information with the Commission under FERC Form No. 1. Because the accounting standards required by GASB and FASB are substantially similar with respect to all ISOs and RTOs, the CAISO's annual financial statements as filed with the Commission are prepared using accounting principles that are essentially the same as the principles employed by its peer organizations. In fact, the CAISO's implementation of GASB did not result in any differences in the financial statements that the CAISO filed with the Commission for 2006 as compared with the financial statements the CAISO had filed for previous years. The only subsequent differences in the CAISO's financial statements are due to its adoption of SGAS 45.[23]

Even in implementing SGAS 45, moreover, the CAISO elected wherever possible to adopt accounting assumptions that closely follow or are the same as those in SFAS 106 in order to minimize any differences. Both SGAS 45 as implemented by the CAISO and SFAS 106 apply the basic principle that PBOPs should be accounted for on an accrual basis and they share both the same basis

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("SGAS 20"). Under SGAS 20, a governmental entity should apply to all "proprietary activities" the statements that FASB issued on or before November 30, 1989, provided these FASB statements do not conflict with or contradict GASB statements, and may elect to apply all FASB statements issued after November 30, 1989, except those that conflict with or contradict GASB statements. In this regard, Paragraph 7 of SGAS 20 specifically directs governmental entities to apply SGAS 45 rather than SFAS 106. *See* http://www.gasb.org/st20guide.html.

23 See pages 2-4 of the April 24, 2007 CAISO memorandum concerning the transition from GASB to FASB that is provided as Attachment D hereto.

for cost determination and the same actuarial assumptions.[24] Further, while application of SGAS 45 rather than SFAS 106 will lead to somewhat different accounting results from year to year, ultimately the estimated PBOP costs under either SGAS 45 or SFAS 106 will be settled in cash for the same actual amount. SGAS 45 and SFAS 106 differ only in one primary respect, which relates to certain details of the calculation: for purposes of calculating the present value of future PBOP obligations, SGAS 45 requires the use of discount rates based on the current rates of the long-term investments that are used to satisfy PBOP obligations, but SFAS 106 requires the use of general, non-specific discount rates.[25] This one difference can result in accrual costs for PBOP obligations based on application of SGAS 45 that are different from the accrual costs for the same PBOP obligations based on application of SFAS 106.[26]

SGAS 45 states that entities to which it applies and that have annual revenues of $100 million or more should implement it for periods beginning after December 15, 2006.[27] Because the CAISO's annual revenues exceed that threshold, the CAISO implemented SGAS 45 effective January 1, 2007.[28] In order to reflect the transition from SFAS 106 to SGAS 45, the CAISO also

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24 A table comparing the various accounting assumptions employed by the CAISO in implementing SGAS 45 with the accounting assumptions under SFAS 106 is provided as Attachment E hereto.

25 *See* Attachment E hereto.

26 As explained in Section IV.A below, the different in discount rates may, over time, very possibly result in significantly decreased expense under SGAS 45 as compared with under SFAS 106.

27 See page 4 of SGAS 45, which is provided in its entirety as Attachment F hereto.

28 See CAISO FERC Form No. 1 for the year ending 2006, at pp. 113-14 (filed July 18, 2007).

retroactively applied SGAS 45 to calculate a beginning PBOP obligation, the transition liability, as of January 1, 2006. Consequently, the CAISO recognized an adjustment of approximately $900,000 to its retained earnings (*i.e.*, beginning net unrestricted assets) as of January 1, 2006, which amount represents the net increase to its PBOP liability as of that date due to the transition.[29] The total amount of the increase, for the time period ending December 31, 2006, was $934,000. This increase reflects an average difference in annual costs recognized under SGAS 45, as compared with annual costs recognized under SFAS 106, of approximately $117,000 per year since the CAISO began operations in 1998.[30]

C. The Instant Proceedings

On April 2, 2008, the CAISO submitted in the first of the two above-referenced proceedings (*i.e.*, Docket No. AC08-41-000) a filing ("April 2 Filing") that contained two related requests. The first request was that the Commission grant the CAISO a waiver of any requirement to use SFAS 106 to account for its PBOP obligations and instead permit the CAISO to use SGAS 45 for that purpose. The CAISO explained that it is required to use SGAS 45 and other GASB accounting standards because its Board is appointed by officials of the

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29 CAISO Financial Statements, December 31, 2006 and 2006, at 20 ("CAISO Financial Statements"), available at www.caiso.com/1fcd/1fcda51231ba0.pdf. The transition liability described above was calculated by applying the applicable provisions of Statement of Governmental Accounting Standards No. 27 (entitled "Accounting for Pensions by State and Local Governmental Employers"). *Id.*

30 *I.e.*, $934,000 divided by 8 (representing the approximately eight years that elapsed from March 31, 1998, when the CAISO began commercial operations, until December 31, 2006) equals approximately $117,000 per year. This yearly amount is comparable in magnitude to the $88,000 amount, discussed below, by which the CAISO calculates PBOP costs increased for 2007 due to the use of SGAS 45.

State of California. The CAISO also stated that a preliminary analysis indicated that the use of SGAS 45 would result in an increase in annual PBOP costs in 2007 of approximately $500,000 over what the annual PBOP costs in 2007 would be under SFAS 106, primarily due to the difference in discount rates under SGAS 45 and under SFAS 106. As the CAISO explained, the preliminary analysis also indicated that the maximum possible effect of that increase on the CAISO's Grid Management Charge ("GMC") would be to raise one of the rate components of the GMC by less than one cent.[31] The second request the CAISO made in its April 2 Filing was that the Commission permit the CAISO to record the net costs of its transition from SFAS 106 to SGAS 45 (*i.e.*, the $934,000 amount described in Section I.B above) in Account 439 (entitled "Adjustments to retained earnings"), in order to adjust its beginning retained earnings balance for the period ending December 31, 2006. The CAISO explained that the adjustment in its beginning retained earnings balance would first be shown in its comparative financial statements for the period ending December 31, 2007.

On April 14, 2008, the CAISO submitted in the second of the two above-referenced proceedings (*i.e.*, Docket No. AC08-54-000) a request ("April 14 Filing") for an extension of time, until June 30, 2008, to file its FERC Form No. 1 for the year 2007. The CAISO stated that it requested the extension of time because it was awaiting both a Commission order on the April 2 Filing and

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[31] As explained in Section IV.A below, it turns out that the CAISO's preliminary analysis actually overestimated the annual increase in PBOP costs in 2007 by a significant amount: the actual annual increase in that year was approximately $88,000, not $500,000, and the maximum possible effect of that smaller increase on the GMC would be to raise one of the rate components of the GMC by approximately 3/100ths of one cent.

acceptance by the Board of the results of the audit of the CAISO's FERC Form No. 1 for 2007.

The CAISO's requests in the April 2 Filing and in the April 14 Filing were unopposed. Nevertheless, in the May 30 Order, the Commission's Chief Accountant ("Chief Accountant"), acting pursuant to delegated authority, denied both the requests contained in the April 2 Filing. The Chief Accountant gave three reasons for his denial. First, the Chief Accountant stated that "[t]he CAISO's proposal to implement SGAS No. 45 is inconsistent with the Commission's PBOP Policy Statement. The accounting standards set forth in SGAS No. 45 are not consistent with SFAS No. 106 and would result in PBOP costs being recognized differently than ordinarily required under the Commission's adopted accounting standard."[32] The second reason the Chief Accountant gave was that "the adoption of SGAS No. 45 would result in higher PBOP costs being included in the accounts and potentially increasing CAISO's GMC rate without Commission authorization."[33] Finally, the Chief Accountant stated that "the CAISO's proposed accounting would also add complexity to analyzing the data in its FERC Form No. 1 and would reduce comparability of financial information between the CAISO and other independent system operators and regional transmission organizations."[34] The Chief Accountant also noted that, "absent a waiver of the Commission's accounting and financial reporting requirements, the CAISO is directed to maintain its books and records

32 May 30 Order at 3.

33 *Id.*

in accordance with the Commission's Uniform System of Accounts for public utilities."[35] The Chief Accountant granted the CAISO's request in the April 14 Filing for an extension of time to submit its FERC Form No. 1 by June 30, 2008.[36]

The CAISO seeks rehearing of the denial in the May 30 Order of the CAISO's requests to (1) be permitted to use SGAS 45 rather than SFAS 106 to account for PBOP costs and (2) record net transitions costs as a result of implementing SGAS 45 as an adjustment to retained earnings beginning December 31, 2006. The May 30 Order committed the following three errors with regard to these CAISO requests:

First, the Chief Accountant erroneously found that the CAISO's implementation of SGAS 45 to be inconsistent with the Statement of Policy. However, nothing in the Statement of Policy prohibits a regulated entity that is subject to SGAS 45 from calculating its accrual-based PBOP expense in accordance with that statement, rather than SFAS 106. To the contrary, the Statement of Policy specifically authorized regulated entities to take different approaches to accounting for PBOPs where the facts warranted. Certainly, nothing in the Statement of Policy indicated that a regulated entity that was subject to a substantially similar standard for PBOP accounting that was not in existence at the time of the Policy Statement and that, like SFAS 106, was issued by an "authoritative body," could not employ that alternative approach.[37]

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34 *Id.*

35 *Id.* at 1-2.

36 *Id.* at 3.

37 Statement of Policy at 62,201.

Therefore, in making this finding, the Chief Accountant misapplied the Statement of Policy, violated appellate precedent and inappropriately failed to conduct an analysis based on the specific facts of the CAISO's proposal to use SGAS 45. Based on the specific facts presented by the CAISO's proposal, the Commission should approve the CAISO's accrual of PBOP expense on the basis of SGAS 45.

Second, the Chief Accountant erred in rejecting the CAISO's proposal to implement SGAS 45 on the grounds that the adoption of SGAS 45 would result in higher PBOP costs being included in the CAISO's accounts and potentially increasing the CAISO's GMC rate without Commission authorization. This rationale inappropriately allows potential ratemaking consequences, which were not the necessary result of the CAISO's proposal, to determine what is fundamentally an accounting question. It is possible that the use of SGAS 45 will not cause the GMC rate to increase, but even if it does, the CAISO will submit any appropriate filings to the Commission in advance of the increase going into effect. In addition, the Chief Accountant ignored the fact that the CAISO will incur increased administrative expenses under the May 30 Order, because it will have to calculate its PBOP expense under both SFAS 106 and SGAS 45, which expenses will be reflected in the GMC rate.

Third, the Chief Accountant erred in rejecting the CAISO's proposal to implement SGAS 45 on the grounds that it would add complexity to analyzing the data in its FERC Form No. 1 and would reduce comparability of financial information between the CAISO and other ISOs and RTOs. The use of SGAS 45 will not significantly complicate the review or comparability of financial information, and the Statement of Policy recognized that public utilities that use an accounting standard other than SFAS 106 will necessarily have to provide different financial information.[38] Moreover, where the circumstances of the ISOs and RTOs differ, as they do here because the CAISO is the only ISO or RTO that is required by the GASB to follow GSAS 45 for financial accounting purposes, it is arbitrary and unduly discriminatory to disregard those differences.

II. SPECIFICATIONS OF ERROR

The CAISO respectfully submits that the May 30 Order erred in the following respects:

1. The Chief Accountant erred in finding that the CAISO should not be permitted to use SGAS 45 rather than SFAS 106 in order to account for PBOP costs.

2. The Chief Accountant erred in finding that the CAISO should not be permitted to record net transitions costs as a result of implementing SGAS 45 as an adjustment to retained earnings beginning December 31, 2006.

III. STATEMENT OF ISSUES

In accordance with Rule 713(c)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.713(c)(2), the CAISO states that this Request for Rehearing raises the following issues:

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38 Simultaneously with the filing of this Request for Rehearing, the CAISO is also filing a further request for an extension of time, until 30 days after the Commission issues an order on this Request for Rehearing, to submit its FERC Form No. 1 for 2007 and its FERC Form No. 3Q for the first and second quarters of 2008.

1. Did the Chief Accountant correctly rule that the Statement of Policy prohibits regulated entities that are subject to the GASB's accounting standards from accounting for PBOPs in accordance with SGAS 45, rather than SFAS 106, where the facts warrant? The CAISO respectfully submits that the Chief Accountant's ruling was erroneous. Statement of Policy, *Post-Employment Benefits Other Than Pensions*, 61 FERC ¶ 61,330 (1992), *reh'g denied and clarification granted in part*, 65 FERC ¶ 61,035 (1993); *Panhandle Eastern Pipe Line Co. v. FERC*, 198 F.3d 266 (D.C. Cir. 1999); *Flagstaff Broadcasting Foundation v. FCC*, 979 F.2d 1566 (D.C. Cir. 1992); *Alabama Elec. Co-op, Inc. v. FERC*, 684 F.2d 20 (D.C. Cir. 1982).

2. Should the Chief Accountant have approved the CAISO's accrual of PBOP expense on the basis of SGAS 45 pursuant to the facts presented by the CAISO? The CAISO respectfully submits that the Chief Accountant should have approved the CAISO's proposal. Statement of Policy, *Post-Employment Benefits Other Than Pensions*, 61 FERC ¶ 61,330 (1992), *reh'g denied and clarification granted in part*, 65 FERC ¶ 61,035 (1993).

3. Should the Chief Accountant have denied the CAISO's proposal to account for PBOP expense using SGAS 45 based on potential ratemaking consequences which are not the necessary result of the CAISO's proposal to use SGAS 45? The CAISO respectfully submits that this ruling was erroneous. *Maine Yankee Atomic Power Co.*, 66 FERC ¶ 61,375, *clarification granted*, 68 FERC ¶ 61,190 (1994).

4. Should the Chief Accountant have denied the CAISO's proposal to account for PBOP expense using SGAS 45 to enforce uniformity among the accounting by ISOs and RTOs, even though the Statement of Policy expressly allows for different approaches and the CAISO's proposal reflects differences in the circumstances of ISOs and RTOs? The CAISO respectfully submits that this ruling was erroneous. Statement of Policy, *Post-Employment Benefits Other Than Pensions*, 61 FERC ¶ 61,330 (1992), *reh'g denied and clarification granted in part*, 65 FERC ¶ 61,035 (1993); *ISO New England, Inc.*, 113 FERC ¶ 61,055 (2005); *"Complex" Consol. Edison Co. of New York, Inc. v. FERC*, 165 F.3d 992 (D.C. Cir. 1999); *Alabama Elec. Co-op, Inc. v. FERC*, 684 F.2d 20 (D.C. Cir. 1982).

IV. REQUEST FOR REHEARING

A. The Finding in the May 30 Order that the CAISO's Adoption of SGAS 45 Is Inconsistent with the Statement of Policy Is Erroneous.

The May 30 Order found the CAISO's use of SGAS 45 to be inconsistent with the Statement of Policy. As explained below, that finding in the May 30 Order is erroneous. By its express terms, the Statement of Policy does not limit regulated entities to the use of SFAS 106 to calculate PBOP accruals where the facts warrant a different approach. In addition, the appellate case law acknowledged in the Statement of Policy makes it clear that citation to the Statement of Policy cannot substitute for an analysis based on the specific facts of a regulated entity and its proposed accounting for PBOP costs. Based on the specific facts presented by the CAISO's proposal, including the indisputable fact that the CAISO, alone among RTOs and ISOs, is subject to SGAS 45, the Commission should approve the CAISO's use of SGAS 45 to account for its PBOP expense.

1. The Statement of Policy and Case Precedent Regarding Policy Statements Require the Commission to Conduct a Case-Specific Review of the CAISO's Proposal.

The May 30 Order erred in rejecting the CAISO's proposal to use SGAS 45 to account for PBOP costs on the basis that it is "inconsistent" with the Statement of Policy to use an accounting standard other than SFAS 106. The Statement of Policy simply does not establish SFAS 106 as the sole permissible basis for regulated entities to account for PBOP expense, as the May 30 Order assumes. To the contrary, by its express terms, the Statement of Policy provides guidance that is only generally applicable and acknowledges that the accounting principles set forth in SFAS 106 may not necessarily be appropriate in every case. The Commission described the Statement of Policy as "a general policy statement" that "will be followed unless particular circumstances demonstrate the policy to be inappropriate."[39] Therefore, it stated that "both the underlying validity of the policy and its application to particular facts may be challenged and are subject to further consideration in individual cases."[40] Moreover, in response to the objections of commenters that "there may be factual differences which would require another method of treatment of [PBOP] costs" other than rate treatment pursuant to the SFAS 106 requirements set forth in the Statement of Policy, the

39 Statement of Policy at 62,200. *See also id.* at 62,201 ("If there are special circumstances for a specific company which dictate that PBOPs should be recovered in rates through use of a different method, a case-specific review will be permitted").

40 *Id.* at 62,200.

Commission stated that "the purpose of this policy statement is to provide guidance for the efficient disposition of existing and future cases which include PBOPs as a component of cost of service" and that, "[i]n individual cases, the application of the policy to particular facts may be challenged upon demonstration that particular circumstances dictate a different treatment."[41]

The May 30 Order disregarded these statements and improperly treated the Statement of Policy as though it were a regulation that prescribed SFAS 106 as the sole permissible basis for calculating PBOP expense on an accrual basis. Instead of recognizing and applying the Commission's explicit statements that the Statement of Policy provides only general guidance and that deviations will be permitted when it is demonstrated that particular circumstances justify departures, the May 30 Order treated the minor inconsistencies between the requirements of SGAS 45 and SFAS 106 as sufficient grounds to reject the CAISO's proposal to conform its regulatory accounting with the requirements of SGAS 45, to which it is unquestionably subject for financial accounting purposes. The premise of the May 30 Order that the Statement of Policy precludes the use of an accounting standard other than SFAS 106 is directly contradicted by the language in the Statement of Policy quoted above.

The May 30 Order not only failed to consider the language of the Statement of Policy, it also failed to consider the appellate precedents concerning the nature of policy statements. The courts have made it clear than an administrative agency errs if it applies a policy statement in a uniform manner

[41] *Id.* at 62,204-05.

without taking into account the specific circumstances in which the policy is being applied. As the United States Court of Appeals for the District of Columbia Circuit has explained:

> A general statement of policy . . . does not establish a "binding norm." It is not finally determinative of the issues or rights to which it is addressed. The agency cannot apply or rely upon a general statement of policy as law because a general statement of policy only announces what the agency seeks to establish as policy. A policy statement announces the agency's tentative intentions for the future. When the agency applies the policy in a particular situation, it must be prepared to support the policy just as if the policy statement had never been issued.[42]

In cases where an agency does not provide sufficient support for a finding that a general policy should apply in a particular situation where the applicability of that general policy is challenged, the agency fails to supply a reasoned basis for its action.[43] Further, it is an unduly discriminatory, in violation of Sections 205 and 206 of the Federal Power Act, to apply a policy statement to public utilities in a uniform manner without taking into account relevant differences (whether large or small) between those public utilities.[44]

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[42] *Panhandle Eastern Pipe Line Co. v. FERC*, 198 F.3d 266, 269 (D.C. Cir. 1999) (quoting *Pacific Gas & Electric Co. v. Federal Power Comm'n*, 506 F.2d 33, 38-39 (D.C. Cir. 1974)). Also, on rehearing of the Statement of Policy, the Commission rejected arguments that it had "promulgated an unlawful legislative rule in violation of the Administrative Procedure Act" by issuing the Statement of Policy. *Post-Employment Benefits Other Than Pensions*, 65 FERC at 61,390. Therefore, the Commission itself rejected the argument that the Statement of Policy is a "binding norm."

[43] *Flagstaff Broadcasting Foundation v. FCC*, 979 F.2d 1566, 1570 (D.C. Cir. 1992) ("This statement does not constitute a rational explanation for the adherence to a particular policy properly challenged in a specific case. A reiteration of a policy is not a reason for it.").

[44] *See Alabama Elec. Co-op, Inc. v. FERC*, 684 F.2d 20, 21 (D.C. Cir. 1982) ("[A]n application of the same rate to two groups of customers which are similar in many respects may nevertheless violate statutory prohibitions against unduly discriminatory rate schemes").

In rejecting the CAISO's proposal to use SGAS 45 on the ground that it is inconsistent with the Statement of Policy to use an accounting standard other than SFAS 106, the May 30 Order erroneously treated the Statement of Policy as a "binding norm" rather than as a policy statement. The May 30 Order improperly failed to consider whether the specific facts presented by the CAISO in support of its proposal warranted a departure from SFAS 106 in favor of the slightly different approach to calculating PBOP accruals required by SGAS 45. Therefore, the May 30 Order was unlawful and inconsistent with the Statement of Policy itself.

2. Based on the Specific Facts Presented by the CAISO's Proposal, the Commission Should Approve the CAISO's Use of SGAS 45.

The May 30 Order erred in failing to consider the specific facts presented by the CAISO's proposal to use SGAS 45 rather than SFAS 106 to account for PBOP costs. Based on those facts, the Commission should permit the CAISO to implement SGAS 45.

As explained in Section I.B above, the CAISO was required to transition to SGAS 45 from SFAS 106 because the resolution of all issues concerning the Board appointment process made the CAISO subject to the accounting standards promulgated by GASB. This conclusion is supported by the provisions of the *AICPA Guides* quoted above, as well as the memorandum provided as Attachment C hereto. The May 30 Order acknowledged, and did not question, the fact that the CAISO is required to employ the GASB standards, including

SGAS 45, for financial accounting purposes.[45] Indeed, there is no basis for any other conclusion.

The Statement of Policy explicitly states that the Commission will permit a regulated entity to employ an accounting standard other than SFAS 106 in cases where "there are special circumstances for a specific company which dictate that PBOPs should be recovered in rates through use of a different method."[46] The Statement of Policy did not qualify this statement in any way. The Commission thus expressed its willingness, when presented with special circumstances applicable to a specific regulated entity, to accept the use of an accounting method other than SFAS 106, regardless of whether the proposed alternative accounting method is greatly different from or only marginally different from SFAS 106.

In the instant case, the difference between SGAS 45 and SFAS 106 is small, both in terms of the requirements of the two accounting standards and the financial consequences of using one of those accounting standards rather than the other. The principles underlying SGAS 45 and SFAS 106 are essentially the same. Indeed, the reasons the Commission relied upon in the Statement of Policy in support of accounting for PBOPs on an accrual basis in accordance with SFAS 106 are equally applicable to the similar accounting prescribed by SGAS 45.

45 *See* May 30 Order at 2.

46 *See* Statement of Policy at 62,201.

First, the Statement of Policy found that SFAS 106 was issued by an authoritative body – FASB – and that the accounting principles embodied in SFAS 106 were compatible for ratemaking purposes.[47] These same considerations support the CAISO's proposal here: GASB, which issued SGAS 45, is likewise an authoritative body. GASB is the standard-setting board of the FAF that is FASB's "counterpart for state and local government,"[48] and the AICPA has designated GASB "as the body to establish financial accounting principles for state and local governmental entities pursuant to rule 203, and standards on disclosure of financial information for such entities outside financial statements in published financial reports containing financial statements under rule 202," of the AICPA's Code of Professional Conduct.[49]

In addition, the Statement of Policy approved the use of SFAS 106 because it provides a reasonable convention for measurements of accrued costs, including the transitional treatment of prior service costs.[50] SGAS 45 provides a similar convention for measurements of accrued costs. Like SFAS 106, SGAS 45 measures PBOPs for a given rate test period and allocates accrued costs between periods in a rational manner so that each period bears its equitable

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47 *Id.*

48 *See* News Release, "The Financial Accounting Foundation Board of Trustees Approves Changes to Oversight, Structure and Operations of FAF, FASB and GASB" (issued Feb. 26, 2008), available at http://www.fasb.org/faf/nr022608.pdf.

49 See Appendix A of AICPA's Code of Professional Conduct, available at http://www.aicpa.org/about/code/et_appendixes.html.

50 Statement of Policy at 62,201.

portion of such costs.[51] Moreover, the accounting principles embodied in SGAS 45 and in SFAS 106 are equally compatible for ratemaking purposes. Further, SGAS 45 and SFAS 106 are both standards used to determine the same future liability (PBOP costs), and while application of these somewhat different standards will lead to somewhat different accounting results from year to year, ultimately the estimated costs under either SGAS 45 or SFAS 106 will be settled in cash for the same actual amount. Because they will be settled for the same amount, the differences between estimated PBOP costs and actual PBOP costs under either SGAS 45 or SFAS 106 will be reflected as gains or losses periodically in order to close the gap at final settlement.

The calculation required by SGAS 45 is essentially the same as that required by SFAS 106 except in the one respect, which relates to relatively minor aspects of the PBOP accrual calculation: SGAS 45 requires the use of discount rates based on the current rates of the long-term investments that are used to satisfy PBOP obligations, while SFAS 106 requires the use of general, non-specific discount rates. This single difference had the financial consequence of creating net PBOP transition costs of $934,000 as of December 31, 2006. As stated in the CAISO Financial Statements, however, the CAISO's operating expenses for 2006 were not materially affected by the PBOP transition costs incurred as of January 1, 2006 (*i.e.*, $900,000), and therefore the CAISO did not need to adjust its 2006 financial statements to reflect those transition costs.[52]

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[51] *See id.*

[52] CAISO Financial Statements at 6.

The same is true of the slightly larger total amount of transition costs as of December 31, 2006.

Further, the CAISO's preliminary analysis indicated that the use of SGAS 45 would cause an increase in annual PBOP costs in 2007 of approximately $500,000 over what the annual PBOP costs in 2007 would be under SFAS 106, with the possible result that one of the rate components of the GMC would increase by less than one cent. Subsequently, the CAISO determined that the preliminary analysis overestimated the amount of PBOP costs in 2007 by a significant amount: the actual annual costs for that year were approximately $88,000, not $500,000, with the possible result that one of the rate components of the GMC would increase by approximately 3/100ths of one cent.[53] That level of potential increase in the GMC rate would have a minimal financial consequence.[54] The differences between the SGAS 45 and the SFAS 106 conventions do not result in financial consequences that are significantly different from one another. Therefore, SGAS 45 satisfies the reasonableness criterion of the Statement of Policy as well.

Given these small differences between the accounting assumptions and financial consequences under SGAS 45 and under SFAS 106, and the compatibility of *both* standards with the rationale articulated in the Statement of

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[53] A table showing this miniscule possible increase in one of the rate components of the GMC is provided as Attachment G hereto.

[54] Further, as discussed further in Section IV.C below, it may be that the use of SGAS 45 rather than SFAS 106 does not cause any increase in a rate component of the GMC. In addition, the CAISO will incur increased administrative costs (*i.e.*, additional costs for external accounting and actuarial expenses and internal CAISO compliance expenses), which will also be reflected in the GMC rate, if it is required to calculate its PBOP expense under SFAS 106 as well as under SGAS 45.

Policy, the Chief Accountant should have recognized that the CAISO's proposal to use SGAS 45 is entirely consistent with the Statement of Policy and the Commission's accounting requirements. There is nothing in the Commission's rules, including the Uniform System of Accounts, that requires the use of SFAS 106 or that forbids a public utility from using a different methodology to account for PBOP costs, including a methodology that differs from SFAS 106 primarily to the extent that it employs something other than the SFAS 106 discount rate. To the contrary, the Statement of Policy expressly permits a divergence from the SFAS 106 accounting standards where justified in specific circumstances. Therefore, the use of an accounting standard other than SFAS 106 is consistent with the Uniform System of Accounts and other Commission rules.

A further reason the Commission gave for approving the use of SFAS 106 was that uniform principles of cost measurements between similarly situated regulated companies and between time periods are beneficial for carrying out the Commission's regulatory programs.[55] Because the CAISO is required to use SGAS 45 rather than SFAS 106, the CAISO is not similarly situated to other regulated companies with regard to how it must account for PBOP costs. Indeed, to the CAISO's knowledge, it is the *only* ISO or RTO and, indeed, the only public utility, that is required to use SGAS 45 to account for PBOP costs. Therefore, the CAISO's accounting presents special circumstances of a kind that the Statement of Policy acknowledged could require the use of an accounting method other than SFAS 106. The Commission's approval of the use of SGAS

55 Statement of Policy at 62,201.

45 in order to recognize the CAISO's unique circumstances would not have a detrimental effect on the carrying out of the Commission's regulatory programs. For the most part, the CAISO's accounting under SGAS 45 would be the same as it was under SFAS 106. In fact, Commission approval of the CAISO's use of SGAS 45 would be beneficial to the Commission's regulatory programs because that approval would help to ensure that its regulatory programs are carried out in a manner that does not discriminate against the CAISO and that is consistent with the special circumstances exception described in the Statement of Policy.

To summarize, the reasons the Commission provided in the Statement of Policy for approving the use of SFAS 106 apply with equal force to the use of SGAS 45. The CAISO notes that SGAS 45 (which was issued in 2004) did not exist when the Commission issued the Statement of Policy in 1992. At that time, the only existing standard issued by an authoritative body regarding the accounting of PBOP costs on an accrual basis was SFAS 106. Now that SGAS 45 has been issued, the Commission should recognize that the reasons justifying the use of SFAS 106 also justify the use of SGAS 45 for regulated entities such as the CAISO that are subject to the latter statement.

The May 30 Order, in refusing to approve the CAISO's use of SGAS 45, failed to recognize that the CAISO's special circumstances require it to use SGAS 45, failed to recognize that the Statement of Policy permits the use of an accounting standard other than SFAS 106 in such special circumstances, failed to recognize that the differences between SFAS 106 and SGAS 45 are small, and failed to recognize that the reasons in the Statement of Policy that support the use of SFAS 106 also support the use of SGAS 45. Further, in stating that "absent a waiver of the Commission's accounting and financial reporting requirements, the CAISO is directed to maintain its books and records in accordance with the Commission's Uniform System of Accounts for public utilities,"[56] the May 30 Order failed to recognize that there is nothing in the Uniform System of Accounts that requires the use of SFAS 106 or that forbids a public utility that is required to use an accounting methodology other than SFAS 106 for financial accounting purposes to employ that same methodology for regulatory accounting. In fact, the Statement of Policy expressly permits a divergence from the SFAS 106 accounting standards where justified in specific circumstances, and thus the use of an accounting standard other than SFAS 106 is permitted under the Uniform System of Accounts. The Commission should find on rehearing of the May 30 Order that the CAISO has demonstrated that its use of SGAS 45 is fully justified and appropriate.

B. It Is Possible that the Use of SGAS 45 Will Not Cause the CAISO's GMC Rate To Increase, and Even if the Use of SGAS 45 Does Cause the GMC Rate To Increase, the CAISO Will Submit Any Appropriate Filings to the Commission In Advance of the Increase Going Into Effect.

The May 30 Order stated that the adoption of SGAS 45 would result in higher PBOP costs being included in the CAISO's accounts and potentially increasing the CAISO's GMC rate without Commission authorization.[57] The May 30 Order erred in rejecting the CAISO's proposal to use SGAS 45 on these

[56] May 30 Order at 1-2.

[57] *Id.* at 3.

grounds. As explained above, the use of SGAS 45 will cause PBOP costs to increase by approximately $88,000 for 2007. However, if PBOP costs do in fact increase by that amount, the increase might not impact the level of the GMC, because the CAISO might be able simply to pay the entire amount of the increase using funds contained in the CAISO's Operating and Capital Reserves Account, which is the account the CAISO is permitted to draw upon to maintain the GMC at the same level approved by the Commission pursuant to the CAISO's most recent GMC rate filing in the event that the CAISO subsequently incurs unanticipated costs.[58] Further, the May 30 Order failed to recognize that its requirement that the CAISO calculate its PBOP expense for regulatory purposes using SFAS 106, in addition to performing the same calculation using SGAS 45 for financial accounting purposes, will cause the CAISO to incur additional administrative expenses for actuarial and accounting services, that will be reflected in the GMC rates. Finally, even if the use of SGAS 45 were to cause the GMC to increase, the CAISO would submit any appropriate filings in advance of the increase going into effect as required by Commission precedent.[59]

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58 *See* CAISO Tariff, § 11.2.2.2.4 (stating that among the costs included in the GMC is Capital and Operating Reserves Cost, which is defined as "[t]he budgeted annual cost of pay-as-you-go capital expenditures and reasonable coverage of debt service obligations. Such reserves shall be utilized to minimize the impact of any variance between forecast and actual costs throughout the year ("Operating and Capital Reserves Costs").) *See also* CAISO Tariff, § 11.2.2.5 (concerning treatment of Operating and Capital Reserves Account).

59 *See Maine Yankee Atomic Power Co.*, 66 FERC ¶ 61,375, at 62,253, *clarification granted*, 68 FERC ¶ 61,190 (1994) ("[O]ur general policy is that cost components of formula rates that require estimation of future expenditures or that are generally accorded separate Commission scrutiny must be filed with the Commission before the costs are passed through the formula rate"). The GMC is a formula rate, *see California Independent System Operator Corp.*, 107 FERC ¶ 61,048, at P 12 (2004), and is therefore subject to this Commission requirement.

C. The Use of SGAS 45 Will Not Significantly Complicate the Review or Comparability of Financial Information, and the Statement of Policy Recognized that Public Utilities that Use an Accounting Standard Other than SFAS 106 Will Necessarily Have to Provide Different Financial Information.

The May 30 Order stated that the CAISO's proposed accounting would add complexity to analyzing the data in its FERC Form No. 1 and would reduce comparability of financial information between the CAISO and other ISOs and RTOs.[60] The May 30 Order erred in rejecting the CAISO's proposal to use SGAS 45 on these grounds.

The use of SGAS 45 will not significantly complicate the Commission's analysis of the data in the CAISO's FERC Form No. 1. As explained above, SFAS 106 and SGAS 45 are essentially the same in all but one respect. Therefore, the analysis of the data relating to the use of SGAS 45 in the CAISO's FERC Form No. 1 will be very similar to the analysis the Commission has conducted in the past of the data relating to the CAISO's use of SFAS 106. Further, even if the use of SGAS 45 does introduce some modest complication to the analysis due to the difference between the calculation required by SGAS 45 and SFAS 106, that incremental amount of complication is not a justifiable basis on which to reject the CAISO's proposal. The Commission was clear in the Statement of Policy that it would permit the use of an accounting standard other SFAS 106 in appropriate circumstances. It is implicit in this directive that the Commission permits the FERC Form No. 1 of a public utility that uses an alternative accounting standard to contain what the May 30 Order characterizes

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[60] May 30 Order at 3.

as added complexity, because the utility's use of *any* accounting standard other than SFAS 106 necessarily means that the utility's FERC Form No. 1 will contain different data than it would have contained if SFAS 106 had been used. Therefore, the May 30 Order's rejection of the CAISO's proposal on the ground of added complexity is inconsistent with the directive in the Statement of Policy that a public utility may an accounting standard other than SFAS 106 in appropriate circumstances.

For similar reasons, the May 30 Order erred in rejecting the CAISO's proposal on the ground that the use of SGAS 45 will reduce comparability of financial information between the CAISO and other ISOs and RTOs. The great similarities between SGAS 45 and SFAS 106 mean that the CAISO's financial information will still be comparable to a large degree. Further, the Statement of Policy, in approving the use of an accounting methodology other than SFAS 106 in appropriate circumstances, recognized that complete comparability of financial information between public utilities is not a paramount requirement.[61] The Statement of Policy acknowledged the general benefit of uniform principles of cost measurements *between similarly situated regulated companies*.[62] But as discussed above, the CAISO is not similarly situated to other public utilities (including ISOs and RTOs) with regard to the accounting of PBOP costs, because the CAISO is apparently alone in being required to use SGAS 45. Failing to recognize this factual distinction would unduly discriminate against the

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61 In 1992, when the Statement of Policy was issued, no ISOs or RTOs were planned or in existence.

62 Statement of Policy at 62,201.

CAISO.[63] Therefore, the Commission should find on rehearing that the May 30 Order erred in rejecting the CAISO's proposal on the ground that the use of SGAS 45 will reduce comparability of financial information.

V. CONCLUSION

WHEREFORE, for the above-stated reasons, the CAISO respectfully requests that the Commission grant rehearing of its May 30 Order, and that the Commission further find, determine, and order as described above.

Respectfully submitted,

<u>*/s/ Kenneth G. Jaffe*</u>

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Dated: June 30, 2008

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63 *See ISO New England, Inc.*, 113 FERC ¶ 61,055, at P 41 & n.42 (2005) (citing *"Complex" Consol. Edison Co. of New York, Inc. v. FERC*, 165 F.3d 992, 1013 (D.C. Cir. 1999); *Alabama Elec. Co-op*, 684 F.2d 20 (D.C. Cir. 1982)).

ATTACHMENT A

Browse Location: United States\American Institute of Certified Public Accountants (AICPA)\Audit and Accounting Guides\Industry Guides\State and Local Governments -- GASB 34 Edition (Guide) [AAG-SLV]
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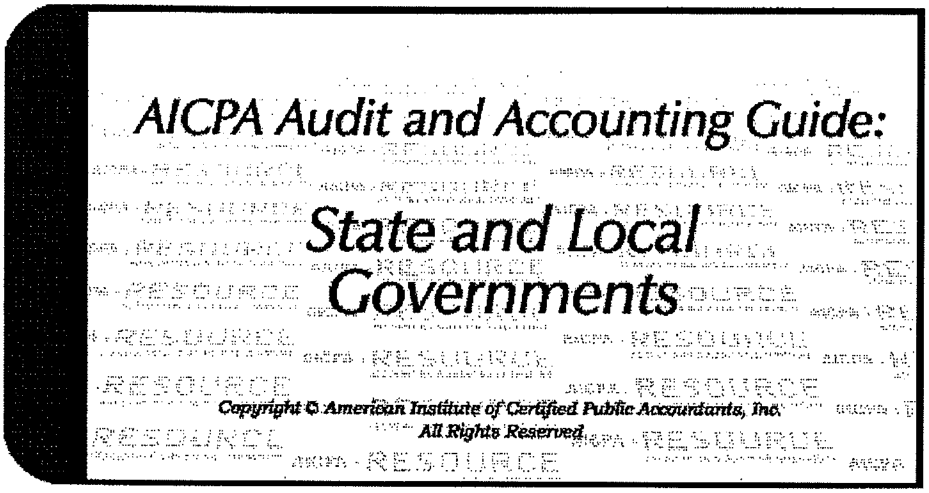

PREPARED BY THE STATE AND LOCAL GOVERNMENT AUDIT GUIDE REVISION TASK FORCE

(Updated as of May 1, 2007)

Notice to Readers

This Audit and Accounting Guide presents recommendations of the AICPA State and Local Government Audit Guide Revision Task Force on the application of generally accepted auditing standards to audits of financial statements of state and local governments. This Guide also presents the Task Force's recommendations on and descriptions of financial accounting and reporting principles and practice for state and local governments. The AICPA Accounting Standards Executive Committee has found this Guide to be consistent with existing standards and principles covered by Rules 202 and 203 of the AICPA Code of Professional Conduct. The GAAP-related accounting provisions of this Guide have been cleared by the Governmental Accounting Standards Board (GASB), except the provisions for GAAP-based fund and departmental financial statements in Chapter 14, "Audit Reporting," of this Guide. AICPA members should be prepared to justify departures from the accounting guidance in this Guide.

Auditing guidance included in an AICPA Audit and Accounting Guide is an interpretive publication pursuant to AU section 150, *Generally Accepted Auditing Standards* (AICPA, *Professional Standards*, vol. 1). Interpretive publications are recommendations on the application of SASs in specific circumstances, including engagements for entities in specialized industries. Interpretive publications are issued under the authority of the Auditing Standards Board (ASB).

An auditor should identify interpretive publications applicable to his or her audit. Interpretive publications are not as authoritative as a pronouncement of the ASB; however, if an auditor does not apply the auditing guidance included in an applicable interpretive publication, the auditor should be prepared to explain how he or she complied with the Statement on Auditing Standard (SAS) provisions addressed by such auditing guidance. The specific terms used to define professional requirements in the SASs are not intended to apply to interpretive publications such as this Guide because interpretive publications are not auditing standards. It is the ASB's intention to make conforming changes to the interpretive publications over the next several years to remove any language that would imply a professional requirement where none exists.[fn *]

State and Local Government Audit Guide Revision Task Force (1999–2002)

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The Task Force gratefully acknowledges the contributions made to the development, content, and writing of this Guide by Venita M. Wood, a consultant in governmental accounting and auditing issues. Her expertise and management of the project made this Guide possible.

The AICPA would like to acknowledge L. Michael Howard for his invaluable help in updating and maintaining the guidance in the Guide.

The AICPA also would like to acknowledge those who reviewed drafts of the conforming changes to this edition of the Guide: Frank W. Crawford, CPA, John Good, Jeff Markert, Edward P. Chait, Donald L. Rahn, CPA, and Randy Roberts.

The AICPA staff has modified this edition of this Guide to include certain changes necessary due to the issuance of authoritative pronouncements since the Guide was originally issued. This Guide has been updated to reflect relevant guidance contained in authoritative pronouncements issued through May 1, 2007, including:

- GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*
- SAS No. 114, *The Auditor's Communication With Those Charged With Governance* (Information about SAS Nos. 104, *Amendment to Statement on Auditing Standards No. 1,* Codification of Auditing Standards and Procedures (*"Due Professional Care in the Performance of Work"*), through 111, *Amendment to Statement on Auditing Standards No. 39,* Audit Sampling, is included only in the Preface of this Guide.)
- Auditing Interpretation No. 1, "Use of Electronic Confirmations" (AICPA, *Professional Standards,* vol. 1, AU sec. 9330.01–.06), which interprets AU section 330, *The Confirmation Process* (AICPA, *Professional Standards,* vol. 1).
- SSAE No. 14, *SSAE Hierarchy*
- SOP 05-1,*Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts*

This Guide also reflects the GASB staff document *Comprehensive Implementation Guide—2006.*

Users of this Guide should consider pronouncements issued subsequent to those listed above to determine their effect on entities covered by this Guide. Users may be able to obtain information about such subsequent pronouncements on the GASB's Web site at www.gasb.org and the AICPA's Web site at www.aicpa.org. In addition, the AICPA's annual Audit Risk Alert *State and Local Governmental Developments* summarizes the provisions of selected pronouncements.

Appendix H identifies the current year conforming changes made in this Guide. The changes do not include all those that might be considered necessary if the Guide were subjected to a comprehensive review and revision.

Preface

Purpose and Applicability of This Guide

The American Institute of Certified Public Accountants (AICPA) developed this Guide to help auditors understand the generally accepted accounting principles (GAAP) applicable to the financial statements of state and local governments and audit and report on those financial statements in accordance with generally accepted auditing standards (GAAS). This Guide is designed as a tool for auditors of governments of all sizes. The nature, timing, and extent of auditing procedures in a particular engagement are matters of professional judgment and will vary depending upon numerous factors, including the size of the entity and its organizational structure and internal control, materiality considerations, the auditor's assessment of risk, and applicable laws, regulations, and provisions of grants and contracts.

This Guide applies to all state and local governments as defined in Chapter 1, "Overview and Introduction." Certain other AICPA Audit and Accounting Guides also apply to audits of certain state and local governments, as discussed in Chapter 1. In particular, auditors who perform audits under *Government Auditing Standards*, the Single Audit Act Amendments of 1996, and Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, should refer to the AICPA Audit Guide *Government Auditing Standards and Circular A-133 Audits*.

Limitations and Coverage

This Guide is designed to provide guidance to auditors who are new to state and local governmental accounting and auditing as well as to auditors experienced in state and local governmental accounting and auditing. This Guide assumes that the auditor has expertise in accounting and auditing, in general, but not necessarily in the specialized accounting and auditing practices applicable to state and local governments. Therefore, the Guide concentrates on the accounting standards and auditing procedures that are unique to or significant for those governments. This Guide also is intended to be useful in providing accounting and financial reporting guidance to preparers of governmental financial statements. The guidance presented here is not all-inclusive; it is limited to certain matters that warrant special emphasis or that experience has indicated may be useful. Although this Guide does not incorporate, repeat, or summarize all authoritative pronouncements that apply to state and local governments, it does consider relevant guidance contained in authoritative pronouncements through those indicated in the Notice to Readers.

Authoritative pronouncements should be applied based on the effective dates in the pronouncements. The AICPA staff will make conforming changes to this Guide annually to incorporate relevant guidance in new accounting and auditing pronouncements. Users of this Guide should consider pronouncements issued after those listed in the Notice to Readers to consider their effect on state and local governments.

Effective Date

This Guide is effective for audits of a state or local government's financial statements for the first fiscal period ending after June 15, 2003, in which the government does apply, or is required to apply, the provisions of GASB Statements No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, or No. 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities*. (The provisions of GASB Statements No. 34 and 35 became effective in three phases. The last implementation phase was for financial statements for periods beginning after June 15, 2003. GASB Statements No. 34, paragraphs 142 through 166, and No. 35, paragraphs 6 through 12, present the Statements' effective date and transition provisions. Chapter 7, "Capital Assets," of this Guide discusses the delayed effective date provisions of GASB Statements No. 34 and No. 35 for general infrastructure assets.) This Guide supersedes the 1994 AICPA Audit and Accounting Guide *Audits of State and Local Governmental Units*, and subsequent editions of that Guide with conforming changes made by the AICPA staff.

The auditing conforming changes made in this edition of this Guide are effective for audits of financial statements for which fieldwork is completed after its issuance, subject to the effective dates of the underlying authoritative pronouncements.

Auditing Guidance Included in This Guide

In March 2006, the ASB issued SASs No. 104 through 111 (the "risk assessment standards"). Collectively, the risk assessment standards establish standards and provide guidance concerning the auditor's assessment of the risks of material misstatement (whether caused by fraud or error) in a financial statement audit; design and performance of tailored audit procedures to address assessed risks; audit risk and materiality; planning and supervision; and audit evidence. The most significant changes to existing practice that the auditor will be required to perform are as follows:

- Obtain a more in-depth understanding of the audited entity and its environment, including its internal control;
- Perform a more rigorous assessment of the risks of where and how the financial statements could be materially misstated (defaulting to a maximum control risk is no longer permitted); and
- Provide a linkage between the auditor's assessed risks and the nature, timing, and extent of audit procedures performed in response to those risks.

The Statements are effective for audits of financial statements for periods beginning on or after December 15, 2006. Early adoption is permitted. See Appendix F for a more detailed comparison between the risk assessment standards and the existing standards.

This Guide has been conformed to the new risk assessment standards to indicate, at a minimum, where these standards need to be applied. Additional implementation guidance, specific to state and local government, is being developed and will be incorporated in the 2008 edition.

For additional guidance on the risk assessment standards, please refer to the AICPA Audit Guide *Assessing and Responding to Risk in a Financial Statement Audit* and the AICPA Audit Risk Alert *Understanding the New Auditing Standards Related to Risk Assessment*.

References to Professional Standards

In citing the professional standards, references are made to the AICPA *Professional Standards* publication. Additionally, when referencing professional standards, this Guide cites section numbers and not the original statement number, as appropriate. For example, Statement on Auditing Standards (SAS) No. 54 is referred to as AU section 317. Appendix G of this Guide has been prepared to assist users in the transition.

Footnotes

fn * In December 2005, the Auditing Standards Board (ASB) issued Statement on Auditing Standards (SAS) No. 102, *Defining Professional Requirements in Statements on Auditing Standards*, and the companion Statement on Standards for Attestation Engagements (SSAE) No. 13, *Defining Professional Requirements in Statements on Standards for Attestation Engagements.* Those Statements define the terminology the ASB will use going forward to describe the degrees of responsibility that the requirements impose on the auditor or the practitioner in engagements.

SASs and SSAEs will use the words "must" or "is required" to indicate an *unconditional requirement*, with which the auditor or practitioner is required to comply. SASs and SSAEs will use the word "should" to indicate a presumptively mandatory requirement. The auditor or practitioner is also required to comply with a presumptively mandatory requirement in all cases in which the circumstances exist to which the presumptively mandatory requirement applies; however, in rare circumstances, the auditor or practitioner may depart from a presumptively mandatory requirement provided the auditor or practitioner documents his or her justification for the departure and how the alternative procedures performed in the circumstances were sufficient to achieve the objectives of the presumptively mandatory requirement. If a SAS or SSAE provides that a procedure or action is one that the auditor "should consider," the consideration of the procedure or action is presumptively required, whereas carrying out the procedure or action is not.

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Chapter 1

Overview and Introduction

Scope and Purpose

1.01 This Audit and Accounting Guide (Guide) applies to all state and local governments.[fn 1][fn 2][fn 3] Governmental entities are subject to generally accepted accounting principles (GAAP) for state and local governments as described later in this chapter. Public corporations[fn 4] and bodies corporate and politic are governmental entities. Other entities are governmental if they have one or more of the following characteristics:

- Popular election of officers or appointment (or approval) of a controlling majority of the members of the organization's governing body by officials of one or more state or local governments;
- The potential for unilateral dissolution by a government with the net assets reverting to a government; or
- The power to enact and enforce a tax levy.

Furthermore, entities are presumed to be governmental if they have the ability to issue directly (rather than through a state or municipal authority) debt that pays interest exempt from federal taxation. However, entities possessing only that ability (to issue tax-exempt debt) and none of the other governmental characteristics may rebut the presumption that they are governmental if their determination is supported by compelling, relevant evidence.

1.02 Entities are governmental or nongovernmental for accounting, financial reporting, and auditing purposes based solely on the application of the above criteria; other factors are not determinative. For example, the fact that an entity is incorporated as a not-for-profit organization and exempt from federal income taxation under the provisions of Section 501 of the Internal Revenue Code is not a criterion in determining whether an entity is governmental or nongovernmental for accounting, financial reporting, and auditing purposes.

1.03 Although some recognized Indian tribes may not meet the definition of governmental entities in paragraph 1.01, many tribes use governmental accounting and financial reporting guidance to prepare their financial statements. A section of Chapter 12, "Special-Purpose and State Governments," highlights the accounting, financial reporting, and auditing considerations relating to recognized Indian tribes.

1.04 There are over 87,000[fn 5] general- and special-purpose state and local governmental entities in the United States. *General-purpose governments* are governmental entities that provide a range of services, such as states, cities, counties, towns, and villages. Special-purpose governments are legally separate entities that perform only one activity or only a few activities. *Special-purpose governments* include, for example, cemetery districts, levee districts, assessment districts, drainage districts, school districts, utilities, hospitals or other health care organizations, public benefit corporations and authorities, public employee retirement systems (PERS), public colleges and universities, governmental external investment pools, and public entity risk pools.

1.05 An audit of a governmental entity may be conducted under four different groups of auditing standards or requirements:

a. Generally accepted auditing standards (GAAS)

b. The standards contained in *Government Auditing Standards* (also referred to as the Yellow Book), issued by the Comptroller General of the United States

c. The requirements of the Single Audit Act Amendments of 1996 (the Single Audit Act) and Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local*

Governments, and Non-Profit Organizations [fn 6]

d. Other auditing requirements, such as those required by a state oversight agency for audits of local governments

1.06 This Guide discusses in detail the requirements for a financial statement audit encompassed by GAAS. Under AU section 150, *Generally Accepted Auditing Standards* (AICPA, *Professional Standards*, vol. 1), this Guide is an interpretive publication. That is, this Guide provides guidance on the application of SASs in a governmental environment. This Guide also highlights the requirements for a financial audit encompassed by *Government Auditing Standards*, referring where appropriate to the detailed discussion of those standards in the AICPA Audit and Accounting Guide *Government Auditing Standards and Circular A-133 Audits*. That Guide provides detailed guidance on financial audits conducted in accordance with *Government Auditing Standards* as well as audits conducted in accordance with the Single Audit Act and OMB Circular A-133. Other auditing requirements are beyond the scope of GAAS and this Guide and generally are not discussed in this Guide. (See the further discussion of the four groups of auditing standards and requirements starting at paragraph 1.16.)

1.07 This Guide provides guidance for the audits of governmental financial statements that are prepared in conformity with GAAP[fn 7] and is based on pronouncements issued or cleared by the GASB. (See the following section for a discussion of GAAP for state and local governments.) This Guide contains a small amount of category (*b*) accounting guidance, which is listed in Appendix B, "Category B Guidance," of this Guide.

1.08 The accounting and auditing guidance in this Guide may become superseded by standards issued since its publication. Therefore, when planning and conducting an audit of financial statements in accordance with GAAS, the auditor should refer to the most recent applicable pronouncements of authoritative standard-setting bodies, such as the GASB, the Financial Accounting Standards Board (FASB), and the Auditing Standards Board and the Accounting Standards Executive Committee (AcSEC) of the AICPA.

GAAP for State and Local Governments

1.09 Pursuant to Rule 203 of the AICPA Code of Professional Conduct (AICPA, *Professional Standards*, vol. 2, ET sec. 203.01), the AICPA recognizes the GASB as the standard-setting authority for GAAP for state and local governments. To provide accounting and financial reporting guidance for governments, the GASB has issued various Statements and Interpretations, and its staff has issued various Technical Bulletins and Implementation Guides.

1.10 AU section 411, *The Meaning of* Present Fairly in Conformity With Generally Accepted Accounting Principles (AICPA, *Professional Standards*, vol. 1), establishes a hierarchy of GAAP applicable to state and local governmental entities that indicates the level of authority of various sources. As provided in AU section 411.12, the application of GAAP for governmental financial statements is as follows:

a. Category (*a*), officially established accounting principles, consists of GASB Statements and Interpretations, as well as AICPA and FASB pronouncements specifically made applicable to state and local governmental entities by GASB Statements or Interpretations. GASB Statements and Interpretations are periodically incorporated into the GASB Codification.[fn 8]

b. Category (*b*) consists of GASB Technical Bulletins and, if specifically made applicable to state and local governmental entities by the AICPA and cleared by the GASB,[fn 9] AICPA Industry Audit and Accounting Guides and AICPA Statements of Position.

c. Category (*c*) consists of the AICPA AcSEC Practice Bulletins, if specifically made applicable to state and local governmental entities and cleared by the GASB, as well as consensus positions of a group of accountants organized by the GASB that attempts to reach consensus positions on accounting issues applicable to state and local governmental entities.[fn 10]

d. Category (*d*) includes implementation guides (Qs and As) published by the GASB staff, as well as practices that are widely recognized and prevalent in state and local government.[fn 11]

1.11 AU section 411 states that, in the absence of a pronouncement covered by Rule 203 (that is, category (*a*) guidance) or another source of established accounting principles (that is, categories (*b*)–(*d*) guidance), the auditor of governmental financial statements may consider other accounting literature, depending on its relevance in the circumstances. Other accounting literature includes, for example:

- GASB Concepts Statements
- FASB and AICPA pronouncements when not specifically made applicable to state and local governmental entities either by the GASB or by the organization issuing them
- FASB Concepts Statements
- Federal Accounting Standards Advisory Board (FASAB) Statements, Interpretations, Technical Bulletins, and Concepts Statements
- AICPA Issues Papers
- International Accounting Standards of the International Accounting Standards Committee
- Pronouncements of other professional associations or regulatory agencies
- Technical Information Service Inquiries and Replies included in AICPA *Technical Practice Aids*
- Accounting textbooks, handbooks, and articles

The appropriateness of other accounting literature depends on its relevance to particular circumstances, the specificity of the guidance, and the general recognition of the issuer or author as an authority. For example, GASB Concepts Statements normally would be more influential than other sources in this category.

1.12 GASB pronouncements have made certain AICPA and FASB pronouncements specifically applicable to governmental entities. For example, GASB Statements No. 20, *Accounting and Financial Reporting by Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, as amended, and No. 34 require the application of certain pronouncements of the FASB and its predecessor standards-setting organizations issued before November 30, 1989, and permit the application of later FASB pronouncements in certain situations, as discussed in Chapter 2, "Financial Reporting."

1.13 This Guide makes various references to implementation guides published by the GASB staff. As discussed in paragraph 1.10, those implementation guides are category (*d*) guidance in the hierarchy of GAAP applicable to state and local governments. GASB staff implementation guides have not been reviewed by AcSEC and references to their guidance in this Guide do not elevate that guidance to category (*b*) guidance. Further, the GASB's clearance of this Guide does not elevate the guidance it contains from the implementation guides to category (*b*) guidance. Similarly, references in this Guide to discussions or examples in the nonauthoritative appendixes of GASB pronouncements or its staff's implementation guides do not elevate that guidance from "other accounting literature."

1.14 Rule 203 prohibits an auditor from expressing an unqualified opinion if the financial statements contain a material departure from accounting principles promulgated by a body designated by the AICPA Council to establish such principles (that is, category (*a*) guidance) unless, due to unusual circumstances, adherence to the pronouncements would make the statements misleading. Rule 203 states that the application of officially established accounting principles almost always results in the fair presentation of financial position, results of operations, and cash flows in conformity with GAAP. Nevertheless, Rule 203 provides for the possibility that the literal application of such a pronouncement might, in unusual circumstances, result in misleading financial statements. In such a situation, Rule 203 requires the auditor's report on the financial statements to describe the departure, its approximate effects, if practicable, and the reasons why compliance with the principle would result in a misleading statement. (See AU section 508.14 and .15, *Reports on Audited Financial Statements* [AICPA, *Professional Standards*, vol. 1].) The auditor's report should indicate the opinion units affected by the departure. (See the discussion of opinion units and their effect on the auditor's report in Chapters 4, "General Auditing Considerations," and 14, "Audit Reporting.")

1.15 AU section 411.07 states that if the accounting treatment of a transaction or event is not specified by a pronouncement covered by Rule 203, the auditor should consider whether the accounting treatment is specified by another source of established accounting principles (that is, categories (*b*)–(*d*) guidance). If such an accounting principle is relevant to the circumstances, the auditor should be prepared to justify a conclusion that another treatment is generally accepted. If there is a conflict between accounting principles relevant to the circumstances from one or more sources in category (*b*), (*c*), or (*d*), the auditor should follow the treatment specified by the source in the higher category—for example, follow category (*b*) treatment over category (*c*)—or be prepared to justify a conclusion that a treatment specified by a source in the lower category better presents the substance of the transaction in the circumstances. Therefore, no description in the auditor's report on the financial statements is required for the situations described in this paragraph, but the auditor should consider documenting such conclusions in the audit documentation.

Applicable Auditing Standards and Requirements

1.16 Audits of governmental financial statements should satisfy auditing standards established by the AICPA, which are the general, fieldwork, and reporting standards and the SASs. Audits of governmental financial statements also should consider applicable interpretative publications that provide recommendations on the application of the SASs—Audit and Accounting Guides, SOPs, and Auditing Interpretations. AU section 801, *Compliance Auditing Considerations in Audits of Governmental Entities and Recipients of Governmental Financial Assistance* (AICPA, *Professional Standards*, vol. 1) is particularly relevant to auditors of state and local governments. AU section 801 states that if, during a GAAS audit of the financial statements, the auditor becomes aware that the entity is subject to an audit requirement that may not be encompassed in the terms of the engagement, the auditor should communicate to management and the audit committee, or to others with equivalent authority and responsibility, that an audit in accordance with GAAS may not satisfy the relevant legal and contractual provisions. See Chapter 4 for a discussion about considering the requirements of AU section 801 while planning the audit.[fn 12]

1.17 In addition to GAAS, auditors of state and local governmental entities also may need to comply with *Government Auditing Standards.* Those standards are to be followed by auditors and audit organizations when required by statute or other mandate or when auditors are holding themselves out as following *Government Auditing Standards*. For financial audits,[fn 13] *Government Auditing Standards* incorporates all AICPA audit standards for fieldwork and reporting. It also contains general standards (which are similar to those of the AICPA) and additional fieldwork and reporting standards. *Government Auditing Standards* requirements and guidance relating to financial audits are discussed further in the AICPA Audit and Accounting Guide *Government Auditing Standards and Circular A-133 Audits*.

1.18 The Single Audit Act imposes additional audit responsibilities on auditors of certain state and local governments that expend federal awards. The OMB is the federal agency that has primary responsibility for implementing the Single Audit Act, and OMB Circular A-133 sets forth audit requirements for single audits. A supporting OMB document, *OMB Circular A-133 Compliance Supplement,* which is updated annually, identifies the significant compliance requirements to be considered in single and certain program-specific audits. Audits under the provisions of the Single Audit Act and OMB Circular A-133 are discussed in the AICPA Audit and Accounting Guide *Government Auditing Standards and Circular A-133 Audits*.

1.19 Before undertaking audits of governmental entities, or of specific governmental grants, programs, or contracts, auditors should be knowledgeable of the auditing requirements that affect the scope of the engagement, including those promulgated by state or local governments or federal agencies that have oversight authority over the government or are responsible for administering the specific grants, programs, or contracts.

1.20 AICPA Ethics Interpretation No. 501-4, "Failure to Follow Standards and/or Procedures or Other Requirements in Governmental Audits," of ET Section 501, *Acts Discreditable* (AICPA, *Professional Standards*, vol. 2, ET sec. 501.05), states:

> If a member . . . undertakes an obligation to follow specified government audit standards, guides, procedures, statutes, rules, and regulations, in addition to generally accepted auditing standards, he or she is obligated to follow such requirements. Failure to do so is an act discreditable to the profession in violation of Rule 501 of the AICPA Code of Professional Conduct, unless the auditor discloses in his or her report the fact that such requirements were not followed and the reason therefore.

Guidance in Other AICPA Audit Guides and Statements of Position

1.21 This Guide is not the only industry-specific AICPA Audit and Accounting Guide that auditors might have to consider when performing an audit of a governmental entity.[fn 14] Two other industry-specific Guides include governmental entities in their scope and were cleared by the GASB. Those Guides are *Health Care Organizations* and Property and Liability Insurance Companies. Therefore, certain accounting and financial reporting guidance in those Guides constitutes category (*b*) guidance for the applicable governmental entities, and the auditing guidance in those guides also should be considered during an audit of those governmental entities. (See the further discussions concerning the application of this Guide to those governmental entities in the sections of Chapter 12 entitled "Public Entity Risk Pools" and "Hospitals and Other Health Care Providers.") Further, the AICPA Audit and Accounting Guide Government Auditing Standards and Circular A-133 Audits may apply to the audits of governmental entities. (See the discussion in paragraph 1.06.) In addition, SOP 98-2, *Accounting for Costs of Activities of Not-for-Profit Organizations and State and Local Governmental Entities That Include Fund Raising,* includes governmental entities in its scope and was cleared by the GASB and, thus, is category (*b*) accounting and financial reporting guidance for governmental entities. (That SOP is included as Appendix C in this Guide.)

1.22 Other AICPA Audit and Accounting Guides and SOPs may provide useful suggested auditing procedures if a governmental entity is in a specialized industry or has transactions addressed by those Guides and SOPs, even though governmental entities are not included in their scope. Among those Guides are Brokers and Dealers in Securities; Depository and Lending Institutions: Banks and Savings Institutions, Credit Unions, Finance Companies and Mortgage Companies; Casinos; Employee Benefit Plans; Investment Companies; and Not-for-Profit Organizations.

1.23 Although not reviewed by the GASB or made specifically applicable to governmental entities, the guides listed in paragraph 1.22 and AICPA SOPs other than SOP 98-2 also have accounting guidance that may be useful as "other accounting literature" in a particular situation, provided it does not conflict with or contradict other, higher categories of governmental GAAP. (See also the discussion in Chapter 2 on the applicability of certain post-November 30, 1989 AICPA pronouncements to enterprise funds and to the resulting reporting in the government-wide financial statements.)

Other Sources of Guidance

1.24 The following AICPA publications contain guidance that may be useful in conducting audits of governmental financial statements. Under AU section 150 these are "other auditing publications" and, although they might be useful, auditors are not required to consider them.

- The AICPA issues an annual Audit Risk Alert, State and Local Governmental Developments, as a complement to this Guide. That Alert provides an overview of economic and industry conditions, regulatory developments, and recently issued accounting and auditing pronouncements that may affect audits of governmental entities. That Alert also includes information about how to obtain many of the publications referred to in this Guide and a listing of useful Internet sites. The AICPA also annually issues an Audit Risk Alert, *Government Auditing Standards and Circular A-133 Audits*, as a complement to the Audit and Accounting Guide Government Auditing Standards and Circular A-133 Audits, a general Audit Risk Alert, and Audit Risk Alerts as complements to other Guides (such as some of the other Guides mentioned in paragraphs 1.21 and 1.22) that may be useful in conducting audits of governmental financial statements.

- The AICPA has various publications to assist with financial statement audits of state and local governmental entities. *Understanding and Implementing GASB's New Financial Reporting Model—A Question and Answer Guide for Preparers and Auditors of State and Local Governmental Financial Statements, Revised Edition* digests the contents of GASB Statement No. 34 and includes observations on planning and implementation issues. *Checklists and Illustrative Financial Statements for State and Local Governments* provides checklists of GAAP-required disclosures in governmental financial statements, notes to financial statements, and required supplementary information (RSI), among other things. In the Practice Aid Series, *Auditing Governmental Financial Statements: Programs and Other Practice Aids* provides audit programs and illustrative engagement, confirmation, and management representation letters and *Applying OCBOA in State and Local Governmental Financial Statements* provides guidance on preparing and reporting on financial statements prepared in conformity with a comprehensive basis of accounting other than GAAP.

Organization of This Guide

1.25 This Guide is organized as follows:

- Chapters 2, "Financial Reporting," and 3, "The Financial Reporting Entity," provide an overview of the accounting and financial reporting requirements for governments, including the activities and financial statements that should be included in their basic financial statements and the RSI that should accompany those financial statements.

- Chapter 4, "General Auditing Considerations," provides guidance on various considerations relating to planning the audit, such as materiality, internal control, and compliance requirements that may affect the audit, and communications with the auditee.

- Chapters 5, "Cash, Investments, and Investment-Related Activity," through 10, "Equity and Financial Statement Reconciliations," discuss, for various accounts in the financial position and activity statements,[fn 15] the nature of the transactions; accounting and financial reporting considerations; and auditing considerations, including audit objectives, internal control features, and audit procedures.

- Chapter 11, "The Budget," discusses the effect of a government's budget on its activities, financial reporting, and audit. Chapter 12, "Special-Purpose and State Governments," highlights accounting, financial reporting, and auditing considerations relating to special-purpose, Indian tribal, and state governments.

- Chapters 13, "Concluding the Audit," and 14, "Audit Reporting," present various considerations relating to finalizing the audit and the auditor's reports on financial statements.

- Chapter 15, "Comprehensive Bases of Accounting Other Than Generally Accepted Accounting Principles," discusses the financial statements and auditor's reports on governmental financial statements prepared in conformity with a comprehensive basis of accounting other than GAAP, which are referred to as OCBOA financial statements.

- Chapter 16, "Auditor Association With Municipal Securities Filings," discusses the auditor's association with a government's official statements and continuing disclosure documents for debt issuances.

Transition to GASB Statement No. 34—General Infrastructure Asset Provisions

1.26 Chapter 7, "Capital Assets," of this Guide includes a separate section that discusses accounting and auditing considerations relating to the transition to the general infrastructure asset provisions established by GASB Statement No. 34. That transition section will be removed from this Guide as a conforming change when those provisions become fully effective.

Footnotes

[fn 1] Auditing and accounting matters associated with the federal government are not within the scope of this Guide. Throughout this Guide, state and local governments may be referred to using the terms *governments* or *governmental entities*.

[fn 2] Certain component units do not meet the definition of a government contained in this paragraph and, consequently, accounting, financial reporting, and auditing matters associated with the separate financial statements of those component units are not within the scope of this Guide. However, accounting, financial reporting, and auditing matters associated with reporting component units, including nongovernmental component units, in a reporting entity's basic financial statements, required supplementary information (RSI), and supplementary information other than RSI (known as SI) are within the scope of this Guide. Chapter 3, "The Financial Reporting Entity," discusses the GASB standards for defining and reporting component units.

[fn 3] Other AICPA Audit and Accounting Guides also may be applicable to audits of certain governments. See paragraph 1.21.

[fn 4] *Black's Law Dictionary* defines a public corporation as: "An artificial person (e.g. [a] municipality or a governmental corporation) created for the administration of public affairs. Unlike a private corporation

it has no protection against legislative acts altering or even repealing its charter. Instrumentalities created by [the] state, formed and owned by it in [the] public interest, supported in whole or part by public funds, and governed by managers deriving their authority from [the] state." *Sharon Realty Co. v. Westlake, Ohio Com. Pl., 188 N.E.2d 318, 323, 25, O.O.2d 322.* A public corporation is an instrumentality of the state, founded and owned in the public interest, supported by public funds and governed by those deriving their authority from the state. *York County Fair Ass'n v. South Carolina Tax Commission, 249 S.C. 337, 154 S.E.2d 361, 362.*

fn 5 U.S. Bureau of the Census, *2002 Census of Governments: Volume 1, Number 1, Government Organization.*

fn 6 The first three groups of audit standards and requirements are cumulative and progressive. That is, *Government Auditing Standards* incorporates and adds requirements to GAAS, and the Single Audit Act incorporates and adds requirements to both *Government Auditing Standards* and GAAS.

fn 7 Chapters 14, "Audit Reporting," and 15, "Comprehensive Bases of Accounting Other Than Generally Accepted Accounting Principles," also discuss auditor's reports on summary financial information (popular reports) and on financial statements prepared in conformity with a comprehensive basis of accounting other than generally accepted accounting principles (OCBOA financial statements), respectively.

fn 8 Two GASB publications, *Original Pronouncements* and *Codification of Governmental Accounting and Financial Reporting Standards* (Codification), provide authoritative accounting guidance for state and local governmental entities and are updated by the GASB as of June 30 each year. *Original Pronouncements* includes National Council on Governmental Accounting (NCGA) and GASB Statements and Interpretations and other materials in their original form, with indications of amended and interpreted standards. (GASB Statement No. 1, *Authoritative Status of NCGA Pronouncements and AICPA Industry Audit Guide*, continued in force certain pronouncements of the AICPA and the NCGA, the GASB's predecessor.) The Codification organizes currently effective governmental accounting financial reporting standards into topical areas. Those who prepare or audit governmental financial statements should obtain a current edition of *Original Pronouncements* or the Codification. This Guide refers to NCGA and GASB pronouncements. Readers can locate those references in the Codification by using its appendix, *Finding List of Original Pronouncements*, which shows where each paragraph of each original pronouncement may be found in the Codification.

fn 9 The auditor should assume that such AICPA pronouncements specifically made applicable to state and local governments have been cleared by the GASB, unless the pronouncement indicates otherwise.

fn 10 The GASB has not organized such a group.

fn 11 A conclusion that a particular practice is widely recognized and prevalent is a matter of professional judgment by individual financial statement preparers and auditors. Other accounting literature, as discussed in paragraph 1.11, cannot appropriately assert to represent widely recognized and prevalent practices and, thus, category (*d*) guidance in whole or in part. Similarly, references in this Guide to common practices do not take the place of professional judgment about whether a practice is widely recognized and prevalent or elevate that practice from category (*d*) guidance.

fn 12 Auditors also may be engaged to provide attest services—an engagement to express a conclusion on subject matter, or an assertion about the subject matter, that is the responsibility of another party. Those engagements are conducted in accordance with the AICPA's Statements on Standards for Attestation Engagements (SSAEs) and generally are not within the scope of this Guide.

fn 13 Besides financial audits, *Government Auditing Standards* also addresses attestation engagements and performance audits. Chapter 2 of *Government Auditing Standards* defines financial audits, attestation engagements, and performance audits.

fn 14 Auditors also should consult the general AICPA Audit Guides, such as *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities* and *Consideration of Internal Control in* *a Financial Statement Audit*, for practical guidance for applying the provisions of specific SASs.

fn 15 This Guide sometimes uses the term *financial position statements* in a generic manner to refer to one or more of the following—the government-wide statement of net assets, the governmental funds balance sheet, the proprietary funds statement of fund net assets or balance sheet, and the fiduciary funds statement of fiduciary net assets. This Guide sometimes uses the term *activity statements* in a generic manner to refer to one or more of the following—the government-wide statement of activities, the governmental funds statement of revenues, expenditures, and changes in fund balances, the proprietary funds statement of revenues, expenses, and changes in fund net assets or fund equity, and the fiduciary funds statement of changes in fiduciary net assets. Those financial statements are discussed in Chapter 2, "Financial Reporting."

Footnote 1:
Auditing and accounting matters associated with the federal government are not within the scope of this Guide. Throughout this Guide, state and local governments may be referred to using the terms *governments* or *governmental entities.*

Footnote 2:
Certain component units do not meet the definition of a government contained in this paragraph and, consequently, accounting, financial reporting, and auditing matters associated with the separate financial statements of those component units are not within the scope of this Guide. However, accounting, financial reporting, and auditing matters associated with reporting component units, including nongovernmental component units, in a reporting entity's basic financial statements, required supplementary information (RSI), and supplementary information other than RSI (known as SI) are within the scope of this Guide. Chapter 3, "The Financial Reporting Entity," discusses the GASB standards for defining and reporting component units.

Footnote 3:
Other AICPA Audit and Accounting Guides also may be applicable to audits of certain governments. See paragraph 1.21.

Footnote 4:
Black's Law Dictionary defines a public corporation as: "An artificial person (e.g. [a] municipality or a governmental corporation) created for the administration of public affairs. Unlike a private corporation it has no protection against legislative acts altering or even repealing its charter. Instrumentalities created by [the] state, formed and owned by it in [the] public interest, supported in whole or part by public funds, and governed by managers deriving their authority from [the] state." *Sharon Realty Co. v. Westlake, Ohio Com. Pl., 188 N.E.2d 318, 323, 25, O.O.2d 322.* A public corporation is an instrumentality of the state, founded and owned in the public interest, supported by public funds and governed by those deriving their authority from the state. *York County Fair Ass'n v. South Carolina Tax Commission, 249 S.C. 337, 154 S.E.2d 361, 362.*

Footnote 5:
U.S. Bureau of the Census, *2002 Census of Governments: Volume 1, Number 1, Government Organization.*

Footnote 6:
The first three groups of audit standards and requirements are cumulative and progressive. That is, *Government Auditing Standards* incorporates and adds requirements to GAAS, and the Single Audit Act incorporates and adds requirements to both *Government Auditing Standards* and GAAS.

Footnote 7:
Chapters 14, "Audit Reporting," and 15, "Comprehensive Bases of Accounting Other Than Generally Accepted Accounting Principles," also discuss auditor's reports on summary financial information (popular reports) and on financial statements prepared in conformity with a comprehensive basis of accounting other than generally accepted accounting principles (OCBOA financial statements), respectively.

ATTACHMENT B

Browse Location: United States\American Institute of Certified Public Accountants (AICPA)\Audit and Accounting Guides\Industry Guides\Not-for-Profit Organizations [AAG-NPO]
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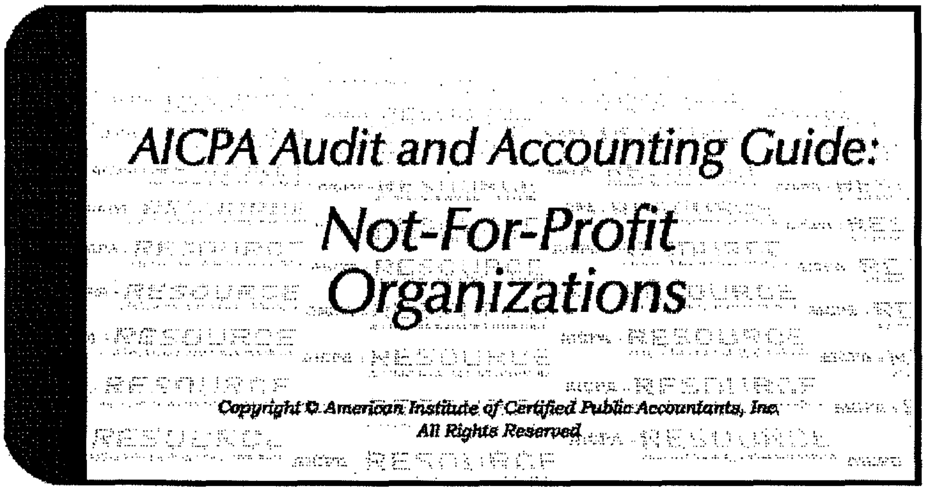

PREPARED BY THE NOT-FOR-PROFIT ORGANIZATIONS COMMITTEE

(Updated as of March 1, 2008)

Notice to Readers

This AICPA Audit and Accounting Guide has been prepared by the AICPA Not-for-Profit Organizations Committee to assist preparers of financial statements in preparing financial statements in conformity with generally accepted accounting principles (GAAP) and to assist auditors in auditing and reporting on such financial statements in accordance with generally accepted auditing standards (GAAS).

Descriptions of accounting principles and financial reporting practices in Audit and Accounting Guides are approved by the affirmative vote of at least two-thirds of the members of the Accounting Standards Executive Committee (AcSEC), which is the senior technical body of the AICPA authorized to speak for the AICPA in the areas of financial accounting and reporting. AU section 411, *The Meaning of* Present Fairly in Conformity With Generally Accepted Accounting Principles (AICPA, *Professional Standards*, vol. 1), identifies AICPA Audit and Accounting Guides that have been cleared by the Financial Accounting Standards Board (FASB) as sources of accounting principles in category *b* of the hierarchy of GAAP that it establishes. This Audit and Accounting Guide has been cleared by the FASB. AICPA members should consider the accounting principles described in this Audit and Accounting Guide if the accounting treatment of a transaction or event is not specified by a pronouncement covered by Rule 203 of the AICPA Code of Professional Conduct. In such circumstances, the accounting treatments specified by this Audit and Accounting Guide should be used, or the member should be prepared to justify another treatment, as discussed in paragraph .07 of AU section 411.[fn *]

This AICPA Audit and Accounting Guide, which contains auditing guidance, is an interpretive publication pursuant to AU section 150, *Generally Accepted Auditing Standards* (AICPA, *Professional Standards*, vol. 1). Interpretive publications are recommendations on the application of Statements on Auditing Standards (SAS) in specific circumstances, including engagements for entities in specialized industries. Interpretive publications are issued under the authority of the Auditing Standards Board (ASB). The members of the ASB have found this guide to be consistent with existing SASs.

An auditor should be aware of and consider interpretive publications applicable to his or her audit. Interpretative publications are not as authoritative as a pronouncement of the ASB; however, if an auditor does not apply the auditing guidance included in an applicable AICPA Audit and Accounting Guide, the auditor should be prepared to explain how he or she complied with the SAS provisions addressed by such auditing guidance.

FASB Accounting Standards Codification™

On January 15, 2008, the FASB launched the one-year verification phase of the *FASB Accounting Standards Codification™* (codification). After the verification period, during which constituents are encouraged to provide feedback on whether the codification content accurately reflects existing U.S. GAAP for nongovernmental entities, the FASB is expected to formally approve the codification as the single source of authoritative U.S. GAAP, other than guidance issued by the Securities and Exchange Commission (SEC). The codification includes all accounting standards issued by a standard-setter within levels A–D of the current U.S. GAAP hierarchy, including FASB, AICPA, Emerging Issues Task Force (EITF), and related literature. The codification does not change GAAP; instead it reorganizes the thousands of U.S. GAAP pronouncements into roughly 90 accounting topics, and displays all topics using a consistent structure. The SEC guidance will follow a similar topical structure in separate SEC sections.

This edition of the guide has not been conformed to the new codification. AICPA Audit and Accounting Guides, as well as other AICPA literature, will be conformed to reflect the codification after the verification phase and upon formal approval by the FASB.

Defining Professional Requirements

AU section 120, *Defining Professional Requirements in Statements on Auditing Standards*, and AT section 20, *Defining Professional Requirements in Statements on Standards for Attestation Engagements* (AICPA, *Professional Standards*, vol. 1), which were issued in December 2005, set forth the meaning of certain terms used in SASs and Standards for Attestation Engagements (SSAE), respectively, issued by the ASB in describing the professional requirements imposed on auditors and practitioners. The specific terms used to define professional requirements in these sections are not intended to apply to interpretive publications issued under the authority of the ASB because interpretive publications are not auditing or attestation standards. It is the ASB's intention to make conforming changes to the interpretive publications over the next several years to remove any language that would imply a professional requirement where none exists.

In December 2007, the Accounting and Review Services Committee (ARSC) also issued AR section 20, *Defining Professional Requirements in Statements on Standards for Accounting and Review Services* (AICPA, *Professional Standards*, vol. 2), which sets forth the meaning of certain terms used in Statements on Standards for Accounting and Review Services (SSARS) issued by the ARSC in describing the professional requirements imposed on accountants performing a compilation or review of a nonissuer. The specific terms used to define professional requirements in this section are not intended to apply to interpretive publications issued under the authority of the ARSC because interpretive publications are not SSARSs. It is the ARSC's intention to make conforming changes to the interpretive publications to remove any language that would imply a professional requirement where none exists.

AU section 120, AT section 20, and AR section 20, which were effective upon issuance, define the terminology that the ASB and ARSC will use going forward to describe the degree of responsibility that the requirements impose on the auditor, practitioner, or accountant in engagements performed for nonissuers. SASs, SSAEs, and SSARSs will use the words "must" or "is required" to indicate an unconditional requirement, with which the auditor, practitioner, or accountant is required to comply. SASs, SSAEs, and SSARSs will use the word "should" to indicate a presumptively mandatory requirement. The auditor, practitioner, or accountant is required to comply with a presumptively mandatory requirement in all cases in which the circumstances exist to which the presumptively mandatory requirement applies; however, in rare circumstances, the auditor, practitioner, or accountant may depart from a presumptively mandatory requirement provided he or she documents the justification for the departure and how the alternative procedures performed in the circumstances were sufficient to achieve the objectives of the presumptively mandatory requirement. If a SAS, SSAE, or SSARS provides that a procedure or action is one that the auditor, practitioner, and accountant "should consider," the consideration of the procedure or action is presumptively required, whereas carrying out the procedure or action is not.

This guide has been updated as applicable for AU section 120, AT section 20, and AR section 20. Refer to the Schedule of Changes appendix for additional information.

Recognition

Benjamin S. Neuhausen, *Chair* *Accounting Standards Executive Committee*	Harold L. Monk, Jr., *Chair* *Auditing Standards Board*

Not-for-Profit Organizations Committee (1995-1996)

Kenneth D. Williams, *Chair*	John H. Fisher

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The Not-for-Profit Organizations Committee gratefully acknowledges the contributions made to the development, content, and writing of this Audit and Accounting Guide by Alan S. Glazer, Professor of Business Administration, Franklin and Marshall College, and Henry R. Jaenicke, C.D. Clarkson Professor of Accounting, Drexel University.

Guidance Considered in This Edition

This edition of the Audit and Accounting Guide *Not-for-Profit Organizations* has been modified by the AICPA staff to include certain changes necessary due to the issuance of authoritative pronouncements since the guide was originally issued. Relevant accounting and auditing guidance contained in official pronouncements issued through March 1, 2008, have been considered in the development of this edition of the guide. This includes relevant guidance issued up to and including the following:

- FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements—an amendment of ARB No. 51*
- Revised FASB statements issued through March 1, 2008, including FASB Statement No. 141(R), *Business Combinations*
- FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109*
- FASB Technical Bulletin 01-1, *Effective Date for Certain Financial Institutions of Certain Provisions of Statement 140 Related to the Isolation of Transferred Financial Assets*
- FASB EITF consensus ratified by the FASB through March 1, 2008
- FASB Staff Positions issued through March 1, 2008
- FASB Derivatives Implementation Group Statement 133 Implementation Issues cleared by the FASB through March 1, 2008
- AICPA Statement of Position (SOP) 07-1, *Clarification of the Scope of the Audit and Accounting Guide Investment Companies and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies* (AICPA, *Technical Practice Aids*, ACC sec. 10,930)
- AICPA Practice Bulletin (PB) No. 15, *Accounting by the Issuer of Surplus Notes* (AICPA, *Technical Practice Aids*, PB sec. 12,150)

- AICPA SAS No. 114, *The Auditor's Communication With Those Charged With Governance* (AICPA, *Professional Standards*, vol. 1, AU sec. 380)
- Auditing Interpretation No. 1, "Communicating Deficiencies in Internal Control Over Compliance in an Office of Management and Budget (OMB) Circular A-133 Audit" of AU section 325, *Communicating Internal Control Related Matters Identified in an Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 9325 par. .01–.04)
- SOP 07-2, *Attestation Engagements That Address Specified Compliance Control Objectives and Related Controls at Entities That Provide Services to Investment Companies, Investment Advisers, or Other Service Providers* (AICPA, *Technical Practice Aids*, AUD sec. 14,430)
- SSAE No. 14, *SSAE Hierarchy* (AICPA, *Professional Standards*, vol. 1, AT sec. 50)
- Auditing Interpretation No. 6, "Reporting on Attestation Engagements Performed in Accordance With Government Auditing Standards" of AT section 101, *Attest Engagements* (AICPA, *Professional Standards*, vol. 1, AT sec. 9101 par. .56–.58)
- SSARS No. 17, *Omnibus Statement on Standards for Accounting and Review Services—2008* (AICPA, *Professional Standards*, vol. 2)
- Auditing Interpretation No. 29, "Reporting on an Uncertainty, Including an Uncertainty About an Entity's Ability to Continue as a Going Concern" of AR section 100, *Compilation and Review of Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 9100 par. .120–.129)

Users of this guide should consider pronouncements issued subsequent to those listed previously to determine their effect on entities covered by this guide. In determining the applicability of a pronouncement, its effective date should also be considered.

The changes made for the current year are identified in a schedule in appendix H of the guide. The changes do not include all those that might be considered necessary if the guide was subjected to a comprehensive review and revision.

Appendix D, which was SOP 98-3, *Audits of States, Local Governments, and Not-for-Profit Organizations Receiving Federal Awards*, has been converted to a separate AICPA Audit Guide Government Auditing Standardsand *Circular A-133 Audits*. Auditors who perform audits under *Government Auditing Standards*, the Single Audit Act Amendments of 1996, and Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations,* should refer to that separate guide.

Auditing Guidance Included in This Guide

Risk Assessment Standards

In March 2006, the ASB issued SAS Nos. 104–111 (the "risk assessment standards"). Collectively, the risk assessment standards establish standards and provide guidance concerning the auditor's assessment of the risks of material misstatement (whether caused by fraud or error) in a nonissuer financial statement audit; design and performance of tailored audit procedures to address assessed risks; audit risk and materiality; planning and supervision; and audit evidence. The most significant changes to existing practice that the auditor will be required to perform are as follows:

- Obtain a more in-depth understanding of the audited entity and its environment, including its internal control
- Perform a more rigorous assessment of the risks of where and how the financial statements could be materially misstated (defaulting to a maximum control risk is not acceptable)
- Provide a linkage between the auditor's assessed risks and the nature, timing, and extent of audit procedures performed in response to those risks

The statements are effective for audits of financial statements for periods beginning on or after December 15,

2006. Early adoption is permitted. See appendix G in this guide for a more detailed comparison between the risk assessment standards and the existing standards. This guide has been conformed to the new risk assessment standards.

For additional guidance on the risk assessment standards, please refer to the AICPA Audit Guide *Assessing and Responding to Risk in a Financial Statement Audit* (product no. 012456) and the AICPA Audit Risk Alert *Understanding the New Auditing Standards Related to Risk Assessment* (product no. 022526).

Defining Professional Requirements

As previously stated, this guide has been conformed, as applicable, to the standards found in AU section 120, AT section 20, and AR section 20, which were effective upon issuance (December 2005, except for AR section 20, which was issued in December 2007). These new standards define the terminology that the ASB and ARSC will use going forward to describe the degree of responsibility that the requirements impose on the auditor, practitioner, or accountant in engagements performed for nonissuers. Refer to the Schedule of Changes appendix for additional information.

Preface

Purpose and Applicability

This AICPA Audit and Accounting Guide (guide) has been prepared to assist nongovernmental not-for-profit organizations in preparing financial statements in conformity with generally accepted accounting principles (GAAP) and to assist independent auditors in auditing and reporting on those financial statements.

This guide applies to organizations that meet the definition of a not-for-profit organization included in appendix D of Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 116, *Accounting for Contributions Received and Contributions Made.*

Limitations

This guide does not discuss the application of all GAAP and all generally accepted auditing standards (GAAS) that are relevant to the preparation and audit of financial statements of not-for-profit organizations. This guide is directed primarily to those aspects of the preparation and audit of not-for-profit organizations' financial statements that are unique to those organizations or are considered particularly significant to them.

Impact on Other Literature

This guide incorporates certain provisions of FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made*, and No. 117, *Financial Statements of Not-for-Profit Organizations*. Not all guidance that is included in those statements, however, is incorporated, repeated, or summarized in this guide. Accordingly, those statements should be read in conjunction with this guide. Like FASB Statement Nos. 116–117, this guide is directed at not-for-profit organizations in general, and not at specific kinds of such organizations, such as voluntary health and welfare organizations or private colleges and universities. It is expected that various industry associations will publish guidance on applying both the FASB statements and this guide to specific kinds of organizations.[fn 1]

This guide supersedes the following AICPA Audit and Accounting Guides:[fn 2]

- Industry Audit Guide *Audits of Voluntary Health and Welfare Organizations*
- Industry Audit Guide *Audits of Colleges and Universities*
- Audit and Accounting Guide *Audits of Certain Nonprofit Organizations*

It also supersedes the following AICPA Statements of Position (SOP):

- SOP 74-8, *Financial Accounting and Reporting by Colleges and Universities*
- SOP 78-10, *Accounting Principles and Reporting Practices for Certain Nonprofit Organizations*
- SOP 87-2, *Accounting for Joint Costs of Informational Materials and Activities of Not-for-Profit Organizations That Include a Fund-Raising Appeal*
- SOP 94-2, *The Application of the Requirements of Accounting Research Bulletins, Opinions of the Accounting Principles Board, and Statements and Interpretations of the Financial Accounting Standards Board to Not-for-Profit Organizations*

Effective Date and Transition

The provisions of this guide, other than those included in paragraphs 1.06–.17, which are discussed in the following, are effective for financial statements for fiscal years ending on or after December 31, 1996.[fn 3] Earlier application is permitted.

The provisions included in paragraphs 1.06–.17 are effective for financial statements issued for fiscal years beginning after December 15, 1994, except for organizations with less than $5 million in total assets and less than $1 million in annual expenses. For those organizations, the effective date is fiscal years beginning after December 15, 1995. Earlier application is permitted.

Unless the provisions of this guide, other than those included in paragraphs 1.06–.17, are applied retroactively under the provisions of the following paragraph, the effect of initially applying this guide should be reported as the effect of a change in accounting principle, in a manner similar to the cumulative effect of a change in accounting principle (Accounting Principles Board [APB] Opinion No. 20, *Accounting Changes*, paragraph 19). The amount of the cumulative effect should be based on a retroactive computation. Organizations should report the cumulative effect of a change in accounting on each class of net assets in the statement of activities, after the caption "extraordinary items" (if any) and before the captions "change in unrestricted net assets," "change in temporarily restricted net assets," and "change in permanently restricted net assets."

This guide, other than the guidance in paragraphs 1.06–.17, may be applied retroactively by restating the opening net assets for the earliest year presented or for the year this guide is first applied if no prior years are presented. In the period in which this guide is first applied, organizations should disclose the nature of any restatement and its effect on the change in net assets for each period presented.

In implementing the guidance in paragraphs 1.06–.17, which incorporates the provisions of SOP 94-2 into this guide, the transition rules of the APB opinions and FASB statements adopted, other than their effective dates, should be followed. However, if there is more than one change in accounting principle as a result of applying the guidance in paragraphs 1.06–.17, organizations have the option of including the cumulative effect of adopting those accounting principles in the statement of activities in the year this guide is adopted, regardless of the transition rules of the APB opinions and FASB statements adopted,[fn 4] and the financial statements should disclose the nature of the cumulative adjustment. (Paragraphs 19–20 of APB Opinion No. 20 discuss reporting the cumulative effects of changes in accounting principles.) In circumstances in which there is more than one change in accounting principle resulting from applying this guide and the cumulative effect of adopting those accounting principles is included in the statement of changes in net assets in the year the guidance in paragraphs 1.06–.17 is adopted, this guide does not require the pro forma disclosures required by paragraphs 19(d) and 21 of APB Opinion No. 20.

Practitioners should follow the effective dates and transitional guidance for authoritative pronouncements issued for fiscal years ending on or after December 31, 1996.

References to Professional Standards

In citing the professional standards, references are made to the AICPA *Professional Standards* publication. Additionally, when referencing professional standards, this guide cites section numbers and not the original statement number, as appropriate. For example, Statement on Auditing Standards (SAS) No. 54 is referred to as AU section 317.

Footnotes

fn * In April 2005, the Financial Accounting Standards Board (FASB) issued an exposure draft of a proposed FASB statement, *The Hierarchy of Generally Accepted Accounting Principles*, objectives of which include moving responsibility for the GAAP hierarchy for nongovernmental entities from the AICPA Statement on Auditing Standards (SAS) No. 69, *The Meaning of* Present Fairly in Conformity With Generally Accepted Accounting Principles (AICPA, *Professional Standards*, vol. 1, AU sec. 411), to FASB literature. Additionally, the proposed FASB statement expands the sources of category (a) to include accounting principles that are issued after being subject to the FASB's due process (including, but not limited to FASB Staff Positions and FASB Statement 133 Implementation Issues, which are currently not addressed in SAS No. 69.)

Among other matters, the proposed FASB statement would not carry forward the Rule 203 exception from paragraph .07 of AU section 411. Accordingly, the proposed FASB statement states that an enterprise shall not represent that its financial statements are presented in accordance with generally accepted accounting principles (GAAP) if its selection of accounting principles departs from the GAAP hierarchy set forth in this statement and that departure has a material impact on its financial statements.

In response to the proposed FASB statement, in May 2005, the AICPA issued an exposure draft of a proposed SAS, *Amendment to Statement on Auditing Standards No. 69 for Nongovernmental Entities*, which deletes the GAAP hierarchy for nongovernmental entities from SAS No. 69. The final FASB statement and SAS on GAAP hierarchy will be issued concurrently and will have a uniform effective date. For more information, please visit the FASB Web site at www.fasb.org and the AICPA Web site at www.aicpa.org.

fn 1 AU section 411, *The Meaning of* Present Fairly in Conformity With Generally Accepted Accounting Principles (AICPA, *Professional Standards*, vol. 1), establishes a hierarchy of sources of generally accepted accounting principles (GAAP). The hierarchy is described in appendix G [paragraph 1.30] to chapter 1, "Introduction," of this guide. AU section 411 notes that in the absence of established accounting principles described in categories (a)–(d) of the hierarchy of GAAP, the auditor may consider other accounting literature, including pronouncements of other professional associations, depending on its relevance in the circumstances. Guidance published by industry associations may be considered "other accounting literature" in the hierarchy of sources of accounting principles established by AU section 411.

fn 2 As noted previously in this preface, this guide applies to nongovernmental not-for-profit organizations. (Paragraph 1.03 of this guide discusses the determination of whether an entity is a nongovernmental organization.)

Governmental not-for-profit organizations should follow the Governmental Accounting Standards Board's (GASB) financial reporting model standards, GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, and GASB Statement No. 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities—an amendment of GASB Statement No. 34*, other standards for governmental organizations, and the AICPA Audit and Accounting Guide *State and Local Governments*, as applicable.

fn 3 This guide does not defer the effective date of any pronouncements that cover not-for-profit organizations.

fn 4 Organizations that adopt the guidance in paragraphs 1.06–.17 in the same year in which they adopt FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made*, are permitted to apply the provisions of paragraph 17 of that statement, concerning recognition of expirations of restrictions, prospectively, as specified in that statement, regardless of whether they report the cumulative effect of adopting other accounting principles as a result of applying the guidance in paragraphs 1.06–.17 of this guide.

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Chapter 1

Introduction

Scope

1.01 This Audit and Accounting Guide (guide) covers organizations that meet the definition of a not-for-profit organization included in appendix D of Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 116, *Accounting for Contributions Received and Contributions Made*. That definition is as follows:

> An entity that possesses the following characteristics that distinguish it from a business enterprise: (*a*) contributions of significant amounts of resources from resource providers who do not expect commensurate or proportionate pecuniary return, (*b*) operating purposes other than to provide goods or services at a profit, and (*c*) absence of ownership interests like those of business enterprises. Not-for-profit organizations have those characteristics in varying degrees ([FASB Statement of Financial Accounting] Concepts Statement No. 4, paragraph 6). Organizations that clearly fall outside this definition include all investor-owned enterprises and entities that provide dividends, lower costs, or other economic benefits directly and proportionately to their owners, members, or participants, such as mutual insurance companies, credit unions, farm and rural electric cooperatives, and employee benefit plans (Concepts Statement No. 4, paragraph 7).

As noted in the previous definition, not-for-profit organizations have characteristics (*a*), (*b*), and (*c*) in varying degrees. An organization could meet the definition of a not-for-profit organization without possessing characteristic (*a*), (*b*), or (*c*). For example, some not-for-profit organizations, such as those that receive all their revenue from exchange transactions, receive no contributions.

1.02 The term *not-for-profit organizations* encompasses all entities defined as not-for-profit organizations by FASB Statement No. 116 and AICPA Statement of Position (SOP) 74-8, *Financial Accounting and Reporting by Colleges and Universities*, and SOP 78-10, *Accounting Principles and Reporting Practices for Certain Nonprofit Organizations*, which are superseded by this guide. Accordingly, this guide applies to nongovernmental not-for-profit organizations of the following kinds:[fn 1]

- Cemetery organizations
- Civic and community organizations
- Colleges and universities
- Elementary and secondary schools
- Federated fund-raising organizations
- Fraternal organizations
- Labor unions
- Libraries
- Museums
- Other cultural organizations

- Performing arts organizations
- Political parties
- Political action committees
- Private and community foundations
- Professional associations
- Public broadcasting stations
- Religious organizations
- Research and scientific organizations
- Social and country clubs
- Trade associations
- Voluntary health and welfare organizations
- Zoological and botanical societies

1.03 Paragraph 1.02 provides that this guide applies to certain nongovernmental not-for-profit organizations. Nongovernmental organizations are all organizations other than governmental organizations. Public corporations[fn 2] and bodies corporate and politic are governmental organizations. Other organizations are governmental organizations if they have one or more of the following characteristics:

a. Popular election of officers or appointment (or approval) of a controlling majority of the members of the organization's governing body by officials of one or more state or local governments

b. The potential for unilateral dissolution by a government with the net assets reverting to a government

c. The power to enact and enforce a tax levy

Furthermore, organizations are presumed to be governmental if they have the ability to issue directly (rather than through a state or municipal authority) debt that pays interest exempt from federal taxation. However, organizations possessing only that ability (to issue tax-exempt debt) and none of the other governmental characteristics may rebut the presumption that they are governmental if their determination is supported by compelling, relevant evidence.

1.04 Not-for-profit organizations that are providers of health care services[fn 3] are not covered by this guide and should follow the AICPA Audit and Accounting Guide *Health Care Organizations*.

GAAP Hierarchy for Not-for-Profit Organizations[fn GPH fn COD]

1.05 AU section 411, *The Meaning of* Present Fairly in Conformity With Generally Accepted Accounting Principles (AICPA, *Professional Standards*, vol. 1), states that the guidance provided by FASB statements and interpretations, opinions of the Accounting Principles Board (APB), and Accounting Research Bulletins (ARB) shall be considered established accounting principles pursuant to Rule 203 of the AICPA Code of Professional Conduct. (Appendix G [paragraph 1.30] of this chapter discusses AU section 411 and the hierarchy of sources of generally accepted accounting principles [GAAP].)

1.06 Not-for-profit organizations should follow the guidance in effective provisions of ARBs, APB opinions, and FASB statements and interpretations unless the specific pronouncement explicitly exempts not-for-profit organizations or their subject matter precludes such applicability. (As noted in paragraphs 1.11–.12 of this guide, not-for-profit organizations should follow the guidance in FASB Statement No. 116, No. 117, *Financial Statements of Not-for-Profit Organizations*, No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*, and No. 136, *Transfers of Assets to a Not-for-Profit Organization or Charitable Trust That Raises or Holds Contributions for Others*, and this guide in applying the guidance in pronouncements listed in appendixes C–D [paragraphs 1.26–.27] of this chapter.)

1.07 The appendixes [paragraphs 1.24–.30] of this chapter are aids to the implementation of the guidance in this chapter.

1.08 Pronouncements issued by FASB subsequent to this guide's effective date apply to not-for-profit organizations unless those pronouncements explicitly exempt not-for-profit organizations or their subject matter precludes such applicability.[fn 4]

1.09 Not-for-profit organizations may follow and are not prohibited from following the guidance in effective provisions of the APB opinions and FASB statements and interpretations listed in appendix A [paragraph 1.24] of this chapter, which specifically exempt not-for-profit organizations from their application, unless FASB Statement Nos. 116–117 or this guide provide different guidance. (However, the guidance included in the effective provisions of pronouncements listed in appendix A [paragraph 1.24] applies to all for-profit entities owned, whether owned all or in part, by not-for-profit entities.) The discussion in paragraphs 1.11–.17 of this guide should be considered in determining the hierarchy of such guidance and of guidance issued by the AICPA.

1.10 Certain financial reporting guidance listed in appendix B [paragraph 1.25] of this chapter, such as that concerning common stock and convertible debt, generally does not apply to the kinds of entities covered by this guide, because such entities do not enter into the kinds of transactions covered by that guidance. (However, the guidance included in the effective provisions of pronouncements included in appendix B [paragraph 1.25] applies to all for-profit entities owned, whether owned all or in part, by not-for-profit entities. Also, not-for-profit organizations should follow the effective provisions of pronouncements in appendix B [paragraph 1.25] if they enter into the kinds of transactions covered by that guidance.)

1.11 Other pronouncements, which are listed in appendix C [paragraph 1.26] of this chapter (ARB No. 51, *Consolidated Financial Statements*,[fn NIS] and APB Opinion No. 29, *Accounting for Nonmonetary Transactions*), [fn MAA] [fn NIS] [fn BCR] do not exempt not-for-profit organizations from their scope, but the transactions they contemplate also are covered by FASB Statement No. 116 and this guide. FASB Statement Nos. 116, 117, 124, and 136 and this guide provide guidance for applying the pronouncements to circumstances unique to not-for-profit organizations and not contemplated by the pronouncements and therefore should be followed to apply the guidance in those pronouncements to not-for-profit organizations. (However, the guidance included in the effective provisions of pronouncements included in appendix C [paragraph 1.26] should be followed by all for-profit entities owned, whether owned all or in part, by not-for-profit entities.)

1.12 Some pronouncements (listed in appendix D [paragraph 1.27] of this chapter), which may include guidance concerning the recognition and measurement of assets, liabilities, revenues, expenses, gains and losses, and financial statement display, state that their provisions apply only to entities operating in certain industries. Such entities generally are business enterprises. An example of such guidance is FASB Statement No. 63, *Financial Reporting by Broadcasters*. However, some not-for-profit organizations conduct activities[fn 5] in some of those industries and should apply the guidance in the pronouncements concerning the recognition and measurement of assets, liabilities, revenues, expenses, and gains and losses to the transactions unique to those industries. However, such not-for-profit organizations should follow the financial statement display guidance in FASB Statement No. 117 and this guide, even though it may conflict with display that would result from applying the guidance in the pronouncements listed in appendix D [paragraph 1.27].

1.13 Financial reporting pronouncements that have not been superseded and are not included in appendixes A–D [paragraphs 1.24–.27] of this chapter are listed in appendix E [paragraph 1.28] of this chapter. Not-for-profit organizations should follow the effective provisions of the pronouncements listed in appendix E [paragraph 1.28].[fn 6]

1.14 Certain other pronouncements, although they do not exempt not-for-profit organizations and do cover transactions conducted by not-for-profit organizations, include some provisions whose application by not-for-profit organizations may be unclear. Nevertheless, not-for-profit organizations are required to follow the effective provisions of those pronouncements. These provisions and their applicability are discussed below.

APB Opinion No. 16, *Business Combinations* fn * fn MA

1.15 Because the conditions for applying the pooling of interests method of accounting for a business combination generally include an exchange of common stock of the combining entities, not-for-profit organizations generally would not meet the conditions for applying that method. The AICPA Accounting Standards Executive Committee (AcSEC) believes that circumstances exist under which reporting on the combination of two or more not-for-profit organizations (or that of a not-for-profit organization with a formerly for-profit entity) by the pooling of interests method better reflects the substance of the transaction than reporting by the purchase method. Therefore, not-for-profit organizations are, under certain circumstances, permitted to report by the pooling of interests method, even though they generally do not issue common stock. Such circumstances include the combination of two or more entities to form a new entity without the exchange of consideration.

1.16 An example of acceptable practice, in some circumstances, for reporting business combinations by not-for-profit organizations if there has been no exchange of consideration is to report the (*a*) assets, (*b*) liabilities, and (*c*) net asset balances of the combined entities as of the beginning of the year and disclose the information that would be required to be disclosed for a pooling of interests under APB Opinion No. 16, *Business Combinations*.

Provisions of Certain Pronouncements Concerning Financial Statement Display

1.17 The following pronouncements include provisions specifying the financial statement display of certain financial statement elements or items such as gains and losses, extraordinary items, translation adjustments, income tax expense, and prepaid or deferred income taxes:

- APB Opinion No. 9, *Reporting the Results of Operations*
- APB Opinion No. 26, *Early Extinguishment of Debt*, as amended
- APB Opinion No. 30, *Reporting the Results of Operations Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*, as amended [fn BCR]
- FASB Statement No. 52, *Foreign Currency Translation*, as amended [fn DDI] [fn BCR]
- FASB Statement No. 109, *Accounting for Income Taxes*, as amended [fn TAX] [fn NPE] [fn BCR]

None of the preceding pronouncements considers the net asset reporting model included in FASB Statement No. 117 and this guide. Therefore, preparers of financial statements of not-for-profit organizations should consider the reporting objectives of these APB Opinions and FASB statements when exercising judgment about how to best display elements, such as in which net asset class.

Fund Accounting and Net Asset Classes

1.18 Fund accounting is a technique used by some not-for-profit organizations for purposes of internal recordkeeping and managerial control and to help ensure that the use of resources is in accordance with stipulations imposed by donors and other resource providers and with self-imposed limitations designated by those charged with governance, hereafter referred to as governing board. Under fund accounting, resources are classified into funds associated with specific activities and objectives. Prior to implementing FASB Statement No. 117, some not-for-profit organizations used fund accounting for financial reporting in conformity with applicable AICPA Industry Audit Guides and Audit and Accounting Guides.

1.19 *Montgomery's Auditing* notes that "as used in nonprofit accounting, a fund is an accounting entity with a self-balancing set of accounts for recording assets, liabilities, the fund balance, and changes in the fund balance. Separate accounts are maintained for each fund to ensure that the limitations and restrictions on the use of resources are observed. Though the fund concept involves separate accounting records, it does not entail the physical segregation of resources. Fund accounting is basically a mechanism to assist in exercising control over the purpose of particular resources and amounts of those resources available for use."[fn 7] Fund accounting is discussed further in chapter 16, "Fund Accounting," of this guide.

1.20 Paragraph 18, footnote 5, of FASB Statement No. 117 states that "this Statement does not use the terms *fund balance* or *changes in fund balances* because in current practice those terms are commonly used to refer to individual groups of assets and related liabilities rather than to an entity's net assets or changes in net assets taken as a whole...." As discussed in chapter 3, "Basic Financial Statements," of this guide, FASB Statement No. 117 requires that the amounts for each of three classes of net assets (permanently restricted, temporarily restricted, and unrestricted) be displayed in a statement of financial position and that the amounts of change in each of those classes of net assets be displayed in a statement of activities.

1.21 Therefore, under FASB Statement No. 117, reporting by individual funds or fund groups is not required. FASB Statement No. 117, however, does not preclude providing disaggregated information by individual funds or fund groups, as long as the required aggregated amounts for each of the three classes of net assets are displayed as indicated previously. Paragraph 50 of the statement specifically notes that "...how an organization maintains its internal accounting and recordkeeping systems is a matter outside the purview of the FASB."

1.22 Some not-for-profit organizations may continue to use fund accounting for purposes other than reporting in conformity with GAAP, and some may provide disaggregated information in the financial statements beyond the minimum requirements of FASB Statement No. 117. A particular fund balance may fall completely into one of the three net asset classes or may be allocated to more than one net asset class, in conformity with the requirements of FASB Statement No. 117 and as discussed in chapter 16 of this guide.

1.23 The accounting and auditing issues concerning each particular asset, liability, or class of net assets (financial statement elements) are not a function of the element's internal classification or financial statement subclassification. Accordingly, this guide is organized by financial statement elements and not by type of fund or groups of funds. Chapter 16 of this guide contains a discussion of the relationship of an organization's fund balances to its net asset classes.

Appendix A—Financial Reporting Pronouncements That Specifically Exempt Not-for-Profit Organizations From Their Application

1.24

Pronouncement	*Other References, if Any*[fn 8]	*Status of Other References*
APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*, as amended[fn NIS] [fn BCR]	SOP 94-3, *Reporting of Related Entities by Not-for-Profit Organizations* (AICPA, *Technical Practice Aids*, ACC sec. 10,610)[fn OMN] (chapter 8, appendix B of this guide)	This guide provides no guidance for the equity method of accounting for common stock. However, it does provide guidance for accounting for investments in common stock.
FASB Statement No. 89, *Financial Reporting and Changing Prices*, as amended[fn NIS]	None	None
FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, as amended[fn FMV] [fn FVO]	FASB Statement No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*; chapter 8 of this guide	Currently effective
FASB Statement No. 128, *Earnings per Share*, as amended[fn EPS] [fn NIS]	None	None
FASB Statement No. 130, *Reporting Comprehensive Income*, as amended[fn DBP] [fn	FASB Statement No. 117, *Financial Statements of Not-for-Profit Organizations*	Currently effective

NIS		
FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information*, as amended[fn NPE]	None	None
FASB Statement No. 141, *Business Combinations*, as amended[fn FMV] [fn NPE]	Paragraphs 1.15–.16 of this guide	Currently effective
FASB Statement No. 141 (revised 2007), *Business Combinations*[fn BCR]	Paragraphs 1.15–.16 of this guide	Currently effective
FASB Statement No. 160, *Non-controlling Interests in Consolidated Financial Statements—an amendment of ARB No. 51*	Paragraphs 1.15–.16 of this guide AICPA SOP No. 94-3[fn OMN] (chapter 8, appendix B of this guide)	Currently effective
FASB Interpretation No. 18, *Accounting for Income Taxes in Interim Periods*, as amended	None	None
FASB Interpretation No. 35, *Criteria for Applying the Equity Method of Accounting for Investments in Common Stock*	See APB Opinion No. 18[fn BCR]	See APB Opinion No. 18[fn BCR]
FASB Interpretation No. 46, *Consolidation of Variable Interest Entities* (revised December 2003), as amended[fn NIS] [fn BCR]	None	None

Appendix B—Financial Reporting Pronouncements That, by the Nature of Their Subject Matter, Generally Do Not Apply to Not-for-Profit Organizations

1.25 The following box lists effective date information for pronouncements in this appendix and for pronouncements that amend or supersede the pronouncements included in this appendix.

Pronouncements that were not effective when this edition of the guide was issued:

- FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements—an amendment of ARB No. 51*, does not apply to not-for-profit organizations, nor do its amendments to other standards including those identified within this appendix by the symbol[fn NIS]. Not-for-profit organizations should continue to apply the guidance in ARB No. 51 before the amendments made by FASB Statement No. 160, the guidance in SOP 94-3 and other applicable standards, until FASB issues interpretative guidance.

- FASB Statement No. 141(R), *Business Combinations*, is not applicable to combinations between not-for-profit organizations or the acquisition of a for-profit business by a not-for-profit organization, nor are its amendments to other standards, including those identified within this appendix by the symbol[fn BCR].

- FASB Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, an amendment of FASB Statement No. 87, *Employers' Accounting for Pensions*, No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*, No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, and No. 132(R), *Employers' Disclosures about Pensions and Other Postretirement Benefits—an amendment of FASB Statements No. 87, 88, and 106*, has multiple effective dates. The requirement to recognize the funded status of a defined benefit postretirement plan and the related disclosure requirements was effective for not-for-profit organizations as of the end of the fiscal year ending after June 15, 2007. The requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2008. Earlier application is encouraged. The statement requires employers to recognize the overfunded or underfunded positions of defined benefit postretirement plans (other than a multiemployer plan), including pension plans, in their statement of financial position. It also requires that employers measure plan assets and obligations as of the date of their financial statements. The statement amends several FASB standards, including those identified within this appendix by the symbol[fn DBP].

- FASB Statement No. 157, *Fair Value Measurements*, is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Earlier application is encouraged, provided that the reporting entity has not yet issued financial statements for that fiscal year, including financial statements for an interim period within that fiscal year. However, FSP FAS 157-2, *Effective Date of FASB Statement No. 157*, delays the effective date of FASB Statement No. 157 until fiscal years beginning after November 15, 2008, and interim periods within those fiscal years for fair value measurements of all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). FASB Statement No. 157 provides guidance for how to measure the fair value of financial and nonfinancial assets and liabilities. It replaces the more general guidance for determining fair value currently found in many existing FASB standards, including those identified within this appendix with the symbol[fn FMV].

- FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*, is effective for financial instruments entered into or modified after May 31, 2003. However, the effective date of the provisions regarding mandatorily redeemable financial instruments of nonpublic entities and mandatorily redeemable noncontrolling interests were deferred, in certain cases indefinitely, by FSP FAS 150-3, *Effective Date, Disclosures, and Transition for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests Under FASB Statement No. 150*, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. FASB Statement No. 150 amends FASB Statement No. 128, *Earnings per Share*, and No. 133, *Accounting for Derivative Instruments and Hedging Activities.*

- FSP FAS 126-1, *Applicability of Certain Disclosure and Interim Reporting Requirements for Obligors for Conduit Debt Securities*, is effective for fiscal periods beginning after December 15, 2006. An entity may elect to retrospectively apply the guidance to all prior periods. The FSP amends several FASB standards, including those identified within this appendix by the symbol[fn NPE].

- APB Opinion No. 14, *Accounting for Convertible Debt and Debt Issued With Stock Purchase Warrants*[fn BCR]

- APB Opinion No. 28, *Interim Financial Reporting*, as amended[fn DBP] [fn NPE] [fn FSP] [fn BCR]

- FASB Statement No. 84, *Induced Conversions of Convertible Debt*
- FASB Statement No. 123(R), *Share-Based Payment*, as amended[fn BCR]
- FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*, as amended[fn 9] [fn FMV] [fn BCR]

Appendix C—Financial Reporting Pronouncements Whose Application to Not-for-Profit Organizations Is Subject to Additional FASB or AICPA Guidance

1.26 The following box lists effective date information for pronouncements in this appendix and for pronouncements that amend or supersede the pronouncements included in this appendix.

Pronouncements that were not effective when this edition of the guide was issued:

- FASB Statement No. 160 does not apply to not-for-profit organizations, nor do its amendments to other standards including those identified within this appendix by the symbol[fn NIS]. Not-for-profit organizations should continue to apply the guidance in ARB No. 51 before the amendments made by FASB Statement No. 160, the guidance in SOP 94-3 and other applicable standards, until FASB issues interpretative guidance.
- FASB Statement No. 141(R) is not applicable to combinations between not-for-profit organizations or the acquisition of a for-profit business by a not-for-profit organization, nor are its amendments to other standards, including those identified within this appendix by the symbol[fn BCR].
- FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities—Including an amendment of FASB Statement No. 115*, is effective as of the beginning of an organization's first fiscal year that begins after November 15, 2007. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided the organization also elects to apply the provisions of FASB Statement No. 157. The statement permits an organization to irrevocably elect fair value as the initial and subsequent measurement attribute for certain financial assets and financial liabilities on a contract-by-contract basis, with changes in fair value recognized in the statement of activities as those changes occur. The statement amends several FASB standards, including those identified within this appendix by the symbol[fn FVO].
- FASB Statement No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Earlier application is encouraged, provided that the reporting entity has not yet issued financial statements for that fiscal year, including financial statements for an interim period within that fiscal year. However, FSP FAS 157-2 delays the effective date of FASB Statement No. 157 until fiscal years beginning after November 15, 2008, and interim periods within those fiscal years for fair value measurements of all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). FASB Statement No. 157 provides guidance for how to measure the fair value of financial and nonfinancial assets and liabilities. It replaces the more general guidance for determining fair value currently found in many existing FASB standards, including those identified within this appendix by the symbol[fn FMV].

Pronouncement	*Additional Guidance*

ARB No. 51, *Consolidated Financial Statements*, as amended[fn NIS]	SOP 94-3, *Reporting of Related Entities by Not-for-Profit Organizations*
APB Opinion No. 29, *Accounting for Nonmonetary Transactions*, as amended[fn FMV] [fn MAA] [fn NIS] [fn BCR]	FASB Statement No. 116 and chapter 5 of this guide provide accounting guidance for contributions
FASB Statement No. 94, *Consolidation of All Majority-Owned Subsidiaries*, as amended	See ARB No. 51
FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made*, as amended[fn FMV] [fn MAA]	This guide FASB Statement No. 136
FASB Statement No. 117, *Financial Statements of Not-for-Profit Organizations*, as amended[fn MAA]	This guide
FASB Statement No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations,* as amended[fn FMV] [fn FVO]	This guide
FASB Statement No. 136, *Transfers of Assets to a Not-for-Profit Organization or Charitable Trust That Raises or Holds Contributions for Others*, as amended[fn FMV]	This guide
FASB Statement No. 153, *Exchanges of Nonmonetary Assets*	FASB Statement No. 116 and chapter 5 of this guide provide accounting guidance for contributions
FASB Interpretation No. 30, *Accounting for Involuntary Conversions of Nonmonetary Assets to Monetary Assets*, as amended	See APB Opinion No. 29[fn BCR]

Appendix D—Financial Reporting Pronouncements Pertaining to Specialized Industry Practices of Business Enterprises

1.27 The following box lists effective date information for pronouncements in this appendix and for pronouncements that amend or supersede the pronouncements included in this appendix.

Pronouncements that were not effective when this edition of the guide was issued:

- FASB Statement No. 160 does not apply to not-for-profit organizations, nor do its amendments to other standards including those identified within this appendix by the symbol[fn NIS]. Not-for-profit organizations should continue to apply the guidance in ARB No. 51, *Consolidated Financial Statements*, before the amendments made by FASB Statement No. 160, the guidance in SOP 94-3 and other applicable standards, until FASB issues interpretative guidance.

- FASB Statement No. 141(R) is not applicable to combinations between not-for-profit organizations or the acquisition of a for-profit business by a not-for-profit organization, nor are its amendments to other standards, including those identified within this appendix by the symbol[fn BCR].

- FASB Statement No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Earlier application is encouraged, provided that the reporting entity has not yet issued financial statements for that fiscal year, including financial statements for an interim period within that fiscal year. However, FSP FAS 157-2 delays the effective date of FASB Statement No. 157 until fiscal years beginning after November 15, 2008, and interim periods within those fiscal years for fair value measurements of all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). FASB Statement No. 157 provides guidance for how to measure the fair value of financial and nonfinancial assets and liabilities. It replaces the more general guidance for determining fair value currently found in many existing FASB standards, including those identified within this appendix with the symbol fn FMV.

- FASB Statement No. 142, *Goodwill and Other Intangible Assets*, is effective for intangible assets acquired in transactions other than combinations, for example, the purchase or gift of patent or royalty rights from the holder of the patent or copyright. However, the provisions of FASB Statement No. 141, *Business Combinations*, FASB Statement No. 141 (revised 2007), *Business Combinations*, and FASB Statement No. 142 should not be applied to goodwill and intangible assets arising from a combination between two or more not-for-profit organizations or acquired in the acquisition of a for-profit business entity by a not-for-profit organization until FASB completes its project on those types of combinations and acquisitions. Thus, the guidance in APB Opinion No. 16 and No. 17, *Intangible Assets*, remains in effect for such assets. In addition, when applying APB Opinion Nos. 16 and 17, not-for-profit organizations should continue to apply the amendments to those Opinions found in other literature even though that other literature may have been superseded by FASB Statement No. 141, No. 141(R), No. 142, and No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. For example, when applying APB Opinion No. 17, not-for-profit organizations should continue to apply the amendments to that Opinion found in FASB Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*, even though that statement was superseded by Statement No. 144. On October 9, 2006, FASB issued two exposure drafts to provide guidance to not-for-profit organizations. The proposed FASB statement, *Not-for-Profit Organizations: Mergers and Acquisitions*, would amend APB Opinion Nos. 16 and 29 and FASB Statement Nos. 116 and 117. The proposed FASB statement, *Not-for-Profit Organizations: Goodwill and Other Intangible Assets Acquired in a Merger or Acquisition*, would amend FASB Statement No. 142. Readers should be alert to the issuance of a final standard.

- FSP FAS 126-1 is effective for fiscal periods beginning after December 15, 2006. An entity may elect to retrospectively apply the guidance to all prior periods. The FSP amends several FASB standards, including those identified within this appendix by the symbol fn NPE.

This appendix includes pronouncements that apply only to entities operating in certain industries, generally business enterprises. However, some not-for-profit organizations conduct activities in some of those industries and should apply the guidance concerning recognition and measurement of assets, liabilities, revenues, expenses, and gains and losses in those pronouncements to the transactions unique to those industries. In addition, those not-for-profit organizations should follow the financial statement display guidance in FASB Statement No. 117, and this guide, although it may conflict with display that would result from applying the guidance in the pronouncements included in this appendix.

- APB Opinion No. 12, *Omnibus Opinion—1967* (guidance under the heading "Capital Changes")

- APB Opinion No. 13, *Amending Paragraph 6 of APB Opinion No. 9, Application to Commercial Banks*

- FASB Statement No. 7, *Accounting and Reporting by Development Stage Enterprises*, as amended

- FASB Statement No. 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies*, as amended fn FMV

- FASB Statement No. 25, *Suspension of Certain Accounting Requirements for Oil and Gas*

Producing Companies (an amendment of FASB Statement No. 19), as amended

- FASB Statement No. 35, *Accounting and Reporting by Defined Benefit Pension Plans*, as amended [fn FMV]
- FASB Statement No. 45, *Accounting for Franchise Fee Revenue* [fn BCR]
- FASB Statement No. 50, *Financial Reporting in the Record and Music Industry*
- FASB Statement No. 51, *Financial Reporting by Cable Television Companies*, as amended
- FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises*, as amended [fn FMV] [fn NIS] [fn BCR] [fn FGI]
- FASB Statement No. 61, *Accounting for Title Plant*, as amended
- FASB Statement No. 63, *Financial Reporting by Broadcasters*, as amended [fn FMV]
- FASB Statement No. 65, *Accounting for Certain Mortgage Banking Activities*, as amended [fn FMV]
- FASB Statement No. 67, *Accounting for Costs and Initial Rental Operations of Real Estate Projects*, as amended [fn FMV]
- FASB Statement No. 69, *Disclosures about Oil and Gas Producing Activities (an amendment of FASB Statements 19, 25, 33, and 39)*, as amended [fn NPE]
- FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation*, as amended
- FASB Statement No. 72, *Accounting for Certain Acquisitions of Banking or Thrift Institutions (an amendment of APB Opinion No. 17, an interpretation of APB Opinions 16 and 17, and an amendment of FASB Interpretation No. 9)*, as amended [fn BCR]
- FASB Statement No. 90, *Regulated Enterprises—Accounting for Abandonments and Disallowances of Plant Costs (an amendment of FASB Statement No. 71)*, as amended
- FASB Statement No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases (an amendment of FASB Statements No. 13, 60, and 65 and a rescission of FASB Statement No. 17)*, as amended
- FASB Statement No. 92, *Regulated Enterprises—Accounting for Phase-in Plans (an amendment of FASB Statement No. 71)*
- FASB Statement No. 97, *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments*, as amended [fn BCR]
- FASB Statement No. 101, *Regulated Enterprises—Accounting for the Discontinuation of Application of FASB Statement No. 71*, as amended
- FASB Statement No. 110, *Reporting by Defined Benefit Pension Plans of Investment Contracts (an amendment of FASB Statement No. 35)*
- FASB Statement No. 113, *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts*, as amended [fn BCR]

- FASB Statement No. 120, *Accounting and Reporting by Mutual Life Insurance Enterprises and by Insurance Enterprises for Certain Long-Duration Participating Contracts (an amendment of FASB Statement Nos. 60, 97, and 113 and Interpretation No. 40)*[fn BCR]

- FASB Statement No. 134, *Accounting for Mortgage-Backed Securities Retained after the Securitization of Mortgage Loans Held for Sale by a Mortgage Banking Enterprise*, an amendment of FASB Statement No. 65

- FASB Statement No. 139, *Rescission of FASB Statement No. 53 and amendments to FASB Statements No. 63, 89, and 121*

- FASB Statement No. 147, *Acquisitions of Certain Financial Institutions*, an amendment of FASB Statement Nos. 72 and 144 and FASB Interpretation No. 9[fn BCR]

- FASB Statement No. 152, *Accounting for Real Estate Time-Sharing Transactions*, an amendment of FASB Statement Nos. 66 and 67

- FASB Statement No. 156, *Accounting for Servicing of Financial Assets*, as amended[fn FMV]

- FASB Interpretation No. 7, *Applying FASB Statement No. 7 in Financial Statements of Established Operating Enterprises*

- FASB Interpretation No. 9, *Applying APB Opinions No. 16 and 17 When a Savings and Loan Association or a Similar Institution Is Acquired in a Business Combination Accounted for by the Purchase Method*, as amended

- FASB Interpretation No. 33, *Applying FASB Statement No. 34 to Oil and Gas Producing Operations Accounted for by the Full Cost Method*

- FASB Interpretation No. 36, *Accounting for Exploratory Wells in Progress at the End of a Period*

- FASB Interpretation No. 40, *Applicability of Generally Accepted Accounting Principles to Mutual Life Insurance and Other Enterprises*, as amended

Appendix E—Financial Reporting Pronouncements Not Subsequently Superseded and Not Included in Appendixes A–D of This Chapter

1.28 The following box lists effective date information for pronouncements in this appendix and for pronouncements that amend or supersede the pronouncements included in this appendix.

Pronouncements that were not effective when this edition of the guide was issued:

- FASB Statement No. 160 does not apply to not-for-profit organizations, nor do its amendments to other standards including those identified within this appendix by the symbol[fn NIS]. Not-for-profit organizations should continue to apply the guidance in ARB No. 51 before the amendments made by FASB Statement No. 160, the guidance in SOP 94-3 and other applicable standards, until FASB issues interpretative guidance.

- FASB Statement No. 141(R) is not applicable to combinations between not-for-profit organizations or the acquisition of a for-profit business by a not-for-profit organization, nor are its amendments to other standards, including those identified within this appendix by the symbol[fn BCR].

- FASB Statement No. 159 is effective as of the beginning of an organization's first fiscal year that begins after November 15, 2007. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided the organization also elects to apply the provisions of FASB Statement No. 157. The statement permits an organization to irrevocably elect fair value as the initial and subsequent measurement attribute for certain financial assets and financial liabilities on a contract-by-contract basis, with changes in fair value recognized in the statement of activities as those changes occur. The statement amends several FASB standards, including those identified within this appendix by the symbol fn FVO.

- FASB Statement No. 158, an amendment of FASB Statement Nos. 87, 88, 106, and 132(R), has multiple effective dates. The requirement to recognize the funded status of a defined benefit postretirement plan and the related disclosure requirements was effective for not-for-profit organizations as of the end of the fiscal year ending after June 15, 2007. The requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2008. Earlier application is encouraged. The statement requires employers to recognize the overfunded or underfunded positions of defined benefit postretirement plans (other than a multiemployer plan), including pension plans, in their statement of financial position. It also requires that employers measure plan assets and obligations as of the date of their financial statements. The statement amends several FASB standards, including those identified within this appendix by the symbol fn DBP.

- FASB Statement No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Earlier application is encouraged, provided that the reporting entity has not yet issued financial statements for that fiscal year, including financial statements for an interim period within that fiscal year. However, FSP FAS 157-2 delays the effective date of FASB Statement No. 157 until fiscal years beginning after November 15, 2008, and interim periods within those fiscal years for fair value measurements of all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). FASB Statement No. 157 provides guidance for how to measure the fair value of financial and nonfinancial assets and liabilities. It replaces the more general guidance for determining fair value currently found in many existing FASB standards, including those identified within this appendix by the symbol fn FMV.

- FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, an interpretation of FASB Statement No. 109, is effective for fiscal years beginning after December 15, 2006. However, FSP FIN 48-2, *Effective Date of FASB Interpretation No. 48 for Certain Nonpublic Enterprises*, defers the effective date of that interpretation to fiscal years beginning after December 15, 2007, for certain nonpublic enterprises as defined by paragraph 289 of FASB Statement No. 109including nonpublic not-for-profit organizations. Earlier application is permitted. Not-for-profit organizations that have already adopted the provisions of FASB Interpretation No. 48 are not eligible for the deferral. The interpretation limits the recognition of uncertain tax positions to only those positions that are more likely than not to be sustained on audit based solely on the technical merits of the position. The interpretation amends several FASB standards, including those identified within this appendix by the symbol fn TAX.

- FASB Statement No. 150 is effective for financial instruments entered into or modified after May 31, 2003. However, the effective date of the provisions regarding mandatorily redeemable financial instruments of nonpublic entities and mandatorily redeemable noncontrolling interests were deferred, in certain cases indefinitely, by FSP FAS 150-3. FASB Statement No. 150 amends FASB Statement Nos. 128 and 133.

- FSP FAS 126-1 is effective for fiscal periods beginning after December 15,

2006. An entity may elect to retrospectively apply the guidance to all prior periods. The FSP amends several FASB standards, including those identified within this appendix by the symbol[fn NPE].

- FASB Statement No. 142 is effective for intangible assets acquired in transactions other than combinations, for example, the purchase or gift of patent or royalty rights from the holder of the patent or copyright. However, the provisions of FASB Statement No. 141, FASB Statement No. 141(R), and FASB Statement No. 142 should not be applied to goodwill and intangible assets arising from a combination between two or more not-for-profit organizations or acquired in the acquisition of a for-profit business entity by a not-for-profit organization until FASB completes its project on those types of combinations and acquisitions. Thus, the guidance in APB Opinion Nos. 16 and 17 remains in effect for such assets. In addition, when applying APB Opinion Nos. 16 and 17, not-for-profit organizations should continue to apply the amendments to those Opinions found in other literature even though that other literature may have been superseded by FASB Statement Nos. 141, 141 (R), 142, and 144. For example, when applying APB Opinion No. 17, not-for-profit organizations should continue to apply the amendments to that Opinion found in FASB Statement No. 121, even though that statement was superseded by FASB Statement No. 144. On October 9, 2006, FASB issued two exposure drafts to provide guidance to not-for-profit organizations. The proposed FASB statement, *Not-for-Profit Organizations: Mergers and Acquisitions*, would amend APB Opinion Nos. 16 and 29 and FASB Statement Nos. 116 and 117. The proposed FASB statement, *Not-for-Profit Organizations: Goodwill and Other Intangible Assets Acquired in a Merger or Acquisition*, would amend FASB Statement No. 142. Readers should be alert to the issuance of final standards.

As stated in paragraph 1.06 of this guide, not-for-profit organizations should follow the guidance in effective provisions of ARBs, APB Opinions, and FASB statements and interpretations, except for specific pronouncements that explicitly exempt not-for-profit organizations and pronouncements for which this guide provides guidance. This appendix includes pronouncements, not subsequently superseded, that (*a*) do not exempt not-for-profit organizations from their application, (*b*) by the nature of their subject matter, apply to the kinds of transactions not-for-profit organizations engage in, (*c*) are subject to no additional FASB or AICPA guidance, and (*d*) do not pertain to specialized industry practices of business enterprises. Not-for-profit organizations should follow the guidance in the effective provisions of the pronouncements included in this appendix.

- ARB No. 43, *Restatement and Revision of Accounting Research Bulletins,* as amended[fn DBP] [fn BCR]
- ARB No. 45, *Long-Term Construction-Type Contracts*
- ARB No. 46, *Discontinuance of Dating Earned Surplus*
- APB Opinion No. 2, *Accounting for the "Investment Credit,"* as amended
- APB Opinion No. 4 (amending Opinion No. 2), *Accounting for the "Investment Credit"*
- APB Opinion No. 6, *Status of Accounting Research Bulletins*, as amended
- APB Opinion No. 9, *Reporting the Results of Operations* (paragraph 1.17 of this guide discusses this pronouncement), as amended
- APB Opinion No. 10, *Omnibus Opinion—1966*, as amended
- APB Opinion No. 12, *Omnibus Opinion—1967* (except guidance under the heading, "Capital Changes"), as amended

- APB Opinion No. 16, *Business Combinations* (paragraph 1.15 of this guide discusses this pronouncement), as amended[fn *][fn MAA]
- APB Opinion No. 17, *Intangible Assets*, as amended[fn †][fn MAA]
- APB Opinion No. 21, *Interest on Receivables and Payables*, as amended[fn FMV][fn FVO]
- APB Opinion No. 22, *Disclosure of Accounting Policies*, as amended
- APB Opinion No. 23, *Accounting for Income Taxes—Special Areas*, as amended
- APB Opinion No. 26, *Early Extinguishment of Debt* (paragraph 1.17 of this guide discusses this pronouncement), as amended
- APB Opinion No. 30, *Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions* (paragraph 1.17 of this guide discusses this pronouncement), as amended[fn BCR]
- FASB Statement No. 2, *Accounting for Research and Development Costs*, as amended[fn BCR]
- FASB Statement No. 5, *Accounting for Contingencies*, as amended[fn TAX][fn BCR]
- FASB Statement No. 6, *Classification of Short-Term Obligations Expected to Be Refinanced (an amendment of ARB No. 43, Chapter 3A)*
- FASB Statement No. 10, *Extension of "Grandfather" Provisions for Business Combinations (an amendment of APB Opinion No. 16)*[fn *][fn MAA]
- FASB Statement No. 11, *Accounting for Contingencies—Transition Method (an amendment of FASB Statement No. 5)*
- FASB Statement No. 13, *Accounting for Leases*, as amended[fn FMV][fn LST]
- FASB Statement No. 15, *Accounting by Debtors and Creditors for Troubled Debt Restructurings*, as amended[fn FMV][fn BCR]
- FASB Statement No. 16, *Prior Period Adjustments*, as amended[fn *]
- FASB Statement No. 22, *Changes in the Provisions of Lease Agreements Resulting from Refundings of Tax-Exempt Debt (an amendment of FASB Statement No. 13)*, as amended
- FASB Statement No. 23, *Inception of the Lease* (an amendment of FASB Statement No. 13)
- FASB Statement No. 27, *Classification of Renewals or Extensions of Existing Sales-Type or Direct Financing Leases (an amendment of FASB Statement No. 13)*
- FASB Statement No. 28, *Accounting for Sales with Leasebacks (an amendment of FASB Statement No. 13)*, as amended
- FASB Statement No. 29, *Determining Contingent Rentals (an amendment of FASB Statement No. 13)*, as amended
- FASB Statement No. 34, *Capitalization of Interest Cost*, as amended
- FASB Statement No. 37, *Balance Sheet Classification of Deferred Income Taxes (an amendment*

of APB Opinion No. 11), as amended

- FASB Statement No. 38, *Accounting for Preacquisition Contingencies of Purchased Enterprises (an amendment of APB Opinion No. 16)*, as amended[fn *] [fn MAA]
- FASB Statement No. 42, *Determining Materiality for Capitalization of Interest Cost (an amendment of FASB Statement No. 34)*
- FASB Statement No. 43, *Accounting for Compensated Absences*, as amended
- FASB Statement No. 47, *Disclosure of Long-Term Obligations*
- FASB Statement No. 48, *Revenue Recognition When Right of Return Exists*
- FASB Statement No. 49, *Accounting for Product Financing Arrangements,* as amended
- FASB Statement No. 52, *Foreign Currency Translation* (paragraph 1.17 of this guide discusses this pronouncement), as amended[fn DDI] [fn BCR]
- FASB Statement No. 57, *Related Party Disclosures*, as amended[fn FVO]
- FASB Statement No. 58, *Capitalization of Interest in Financial Statements That Include Investments Accounted for by the Equity Method (an amendment of FASB Statement No. 34)*
- FASB Statement No. 62, *Capitalization of Interest Cost in Situations Involving Certain Tax-Exempt Borrowings and Certain Gifts and Grants (an amendment of FASB Statement No. 34)*
- FASB Statement No. 66, *Accounting for Sales of Real Estate*, as amended
- FASB Statement No. 68, *Research and Development Arrangements*, as amended[fn BCR]
- FASB Statement No. 78, *Classification of Obligations That Are Callable by the Creditor (an amendment of ARB No. 43, Chapter 3A)*
- FASB Statement No. 79, *Elimination of Certain Disclosures for Business Combinations by Nonpublic Enterprises (an amendment of APB Opinion No. 16)*[fn *] [fn MAA]
- FASB Statement No. 86, *Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed*[fn BCR]
- FASB Statement No. 87, *Employers' Accounting for Pensions*, as amended[fn FMV] [fn DBP] [fn BCR]
- FASB Statement No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*, as amended[fn DBP]
- FASB Statement No. 93, *Recognition of Depreciation by Not-for-Profit Organizations*, as amended
- FASB Statement No. 95, *Statement of Cash Flows*, as amended[fn FVO]
- FASB Statement No. 98, *Accounting for Leases:*
    - *Sale-Leaseback Transactions Involving Real Estate*
    - *Sales-Type Leases of Real Estate*

  - *Definition of the Lease Term*
  - *Initial Direct Costs of Direct Financing Leases*

  (an amendment of FASB Statements No. 13, 66, and 91 and a rescission of FASB Statement No. 26 and Technical Bulletin No. 79-11)

- FASB Statement No. 99, *Deferral of the Effective Date of Recognition of Depreciation by Not-for-Profit Organizations (an amendment of FASB Statement No. 93)*
- FASB Statement No. 102, *Statement of Cash Flows—Exemption of Certain Enterprises and Classification of Cash Flows from Certain Securities Acquired for Resale (an amendment of FASB Statement No. 95)*, as amended[fn FVO]
- FASB Statement No. 104, *Statement of Cash Flows—Net Reporting of Certain Cash Receipts and Cash Payments and Classification of Cash Flows from Hedging Transactions (an amendment of FASB Statement No. 95)*
- FASB Statement No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, as amended[fn FMV] [fn DBP] [fn BCR]
- FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*, as amended[fn FMV] [fn DDI] [fn FGI]
- FASB Statement No. 109, *Accounting for Income Taxes* (paragraph 1.17 of this guide discusses this pronouncement), as amended[fn TAX] [fn NPE] [fn BCR]
- FASB Statement No. 111, *Rescission of FASB Statement No. 32 and Technical Corrections*
- FASB Statement No. 112, *Employers' Accounting for Postemployment Benefits (an amendment of FASB Statement Nos. 5 and 43)*, as amended
- FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan (an amendment of FASB Statement Nos. 5 and 15)*, as amended
- FASB Statement No. 118, *Accounting by Creditors for Impairment of a Loan—Income Recognition and Disclosures (an amendment of FASB Statement No. 114)*
- FASB Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*, as amended (superseded by FASB Statement No. 144, but amendments to APB Opinion No. 16 still applicable as discussed in fn * to paragraph 1.15)
- FASB Statement No. 126, *Exemption from Certain Required Disclosures about Financial Instruments for Certain Nonpublic Entities*, as amended[fn NPE]
- FASB Statement No. 129, *Disclosure of Information about Capital Structure*
- FASB Statement No. 132, *Employers' Disclosures about Pensions and Other Postretirement Benefits*, as amended (revised December 2003)[fn DBP] [fn NPE]
- FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended[fn FMV] [fn FVO] [fn DDI] [fn BCR] [fn FGI]
- FASB Statement No. 135, *Rescission of FASB Statement No. 75 and Technical Corrections*, as amended

- FASB Statement No. 137, *Accounting for Derivative Instruments and Hedging Activities—Deferral of the Effective Date of FASB Statement No. 133*
- FASB Statement No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities*
- FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, as amended[fn SPE] [fn FMV]
- FASB Statement No. 142, *Goodwill and Other Intangible Assets*, as amended[fn FMV] [fn MAA] [fn NIS] [fn BCR] [fn IAL]
- FASB Statement No. 143, *Accounting for Asset Retirement Obligations*, as amended[fn FMV]
- FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, as amended[fn FMV] [fn BCR]
- FASB Statement No. 145, *Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections*
- FASB Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, as amended[fn FMV] [fn BCR]
- FASB Statement No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*
- FASB Statement No. 151, *Inventory Costs—an amendment of ARB No. 43, Chapter 4*
- FASB Statement No. 154, *Accounting Changes and Error Corrections*[fn BCR]
- FASB Statement No. 155, *Accounting for Certain Hybrid Instruments*
- FASB Statement No. 157, *Fair Value Measurements*[fn FMV] [fn LST]
- FASB Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R)*
- FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities—Including an amendment of FASB Statement No. 115*
- FASB Interpretation No. 1, *Accounting Changes Related to the Cost of Inventory*
- FASB Interpretation No. 4, *Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method*[fn BCR]
- FASB Interpretation No. 6, *Applicability of FASB Statement No. 2 to Computer Software*, as amended
- FASB Interpretation No. 8, *Classification of a Short-Term Obligation Repaid Prior to Being Replaced by a Long-Term Security*
- FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss*
- FASB Interpretation No. 19, *Lessee Guarantee of the Residual Value of Leased Property*

- FASB Interpretation No. 21, *Accounting for Leases in a Business Combination,* as amended[fn BCR]
- FASB Interpretation No. 23, *Leases of Certain Property Owned by a Governmental Unit or Authority*
- FASB Interpretation No. 24, *Leases Involving Only Part of a Building*
- FASB Interpretation No. 26, *Accounting for Purchase of a Leased Asset by the Lessee during the Term of the Lease*[fn BCR]
- FASB Interpretation No. 27, *Accounting for a Loss on a Sublease*, as amended
- FASB Interpretation No. 37, *Accounting for Translation Adjustments upon Sale of Part of an Investment in a Foreign Entity*[fn NIS]
- FASB Interpretation No. 39, *Offsetting of Amounts Related to Certain Contracts*, as amended
- FASB Interpretation No. 41, *Offsetting of Amounts Related to Certain Repurchase and Reverse Repurchase Agreements*
- FASB Interpretation No. 43, *Real Estate Sales*, as amended
- FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*, as amended[fn FMV] [fn FGI]
- FASB Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations*
- FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109*[fn BCR]

Appendix F—All Financial Reporting Pronouncements, Cross-Referenced by Appendix

1.29 The following box lists effective date information for pronouncements in this appendix and for pronouncements that amend or supersede the pronouncements included in this appendix.

Pronouncements that were not effective when this edition of the guide was issued:

- FASB Statement No. 160 does not apply to not-for-profit organizations, nor do its amendments to ARB No. 51, APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*, and No. 29, FASB Statement Nos. 60, 89, 128, 130, and 142, FASB Interpretation Nos. 37 and 46(R), AICPA Accounting Interpretation No. 1, AICPA SOP 04-2, and several EITF issues. Not-for-profit organizations should continue to apply the guidance in ARB No. 51 before the amendments made by FASB Statement No. 160, the guidance in SOP 94-3, and other applicable standards, until FASB issues interpretative guidance.
- FASB Statement No. 141(R) is not applicable to combinations between not-for-profit organizations or the acquisition of a for-profit business by a not-for-profit organization, nor are its amendments to ARB No. 43, *Restatement and Revision of Accounting Research Bulletins*; APB Opinion No. 14, *Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants*; No. 18, *The Equity Method of Accounting for Investments in Common Stock*, No. 28, *Interim Financial Reporting*; No. 30; FASB Statement No. 2, *Accounting for Research and Development Costs*; No. 5, *Accounting for Contingencies*; No.

15, *Accounting by Debtors and Creditors for Troubled Debt Restructurings*; No. 45, *Accounting for Franchise Fee Revenue*; No. 52, *Foreign Currency Translation*; No. 60 *Accounting and Reporting by Insurance Enterprises*; No. 68, *Research and Development Arrangements*; No. 86, *Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed*; No. 87; No. 97, *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments*; No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*; No. 109; No. 113, *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts*; No. 120, *Accounting and Reporting by Mutual Life Insurance Enterprises and by Insurance Enterprises for Certain Long-Duration Participating Contracts—an amendment of FASB Statements 60, 97, and 113 and Interpretation No. 40*; No. 123(R); No. 133; No. 142; No. 144; No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*; No. 150; and No. 154, *Accounting Changes and Error Corrections—a replacement of APB Opinion No. 20 and FASB Statement No. 3*; FASB Interpretation No. 21, *Accounting for Leases in a Business Combination—an interpretation of FASB Statement No. 13*; No. 26, *Accounting for Purchase of a Leased Asset by the Lessee during the Term of the Lease—an interpretation of FASB Statement No. 13*; No. 46(R), *Consolidation of Variable Interest Entities (revised December 2003)—an interpretation of ARB No. 51*; and No. 48; FASB Technical Bulletin 84-1, *Accounting for Stock Issued to Acquire the Results of a Research and Development Arrangement*; AICPA SOP 78-9, *Accounting for Investments in Real Estate Ventures* (AICPA, *Technical Practice Aids*, ACC sec. 10,240); SOP 90-7, *Financial Reporting by Entities in Reorganization Under the Bankruptcy Code* (AICPA, *Technical Practice Aids*, ACC sec. 10,460); SOP 93-6, *Employers' Accounting for Employee Stock Ownership Plans* (AICPA, *Technical Practice Aids*, ACC sec. 10,580); SOP 96-1, *Environmental Remediation Liabilities* (AICPA, *Technical Practice Aids*, ACC sec. 10,680); SOP 00-3, *Accounting by Insurance Enterprises for Demutualizations and Formations of Mutual Insurance Holding Companies and for Certain Long-Duration Participating Contracts* (AICPA, *Technical Practice Aids*, ACC sec. 10,810); SOP 01-6, *Accounting by Certain Entities (Including Entities With Trade Receivables) That Lend to or Finance the Activities of Others* (AICPA, *Technical Practice Aids*, ACC sec. 10,850); SOP 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer* (AICPA, *Technical Practice Aids*, ACC sec. 10,880); and SOP 05-1, *Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection With Modifications or Exchanges of Insurance Contracts* (AICPA, *Technical Practice Aids*, ACC sec. 10,920); and AICPA Practice Bulletin No. 4, *Accounting for Foreign Debt/Equity Swaps* (AICPA, *Technical Practice Aids*, PB sec. 12,040); Practice Bulletin No. 6, *Amortization of Discounts on Certain Acquired Loans* (AICPA, *Technical Practice Aids*, PB sec. 12,060); and Practice Bulletin No. 14, *Accounting and Reporting by Limited Liability Companies and Limited Liability Partnerships* (AICPA, *Technical Practice Aids*, PB sec. 12,140). The pronouncements superseded by FASB Statement No. 141(R), including those identified within this appendix by the symbol [fn BCR], remain in effect for not-for-profit organizations, and not-for-profit organizations should continue to apply them as indicated in paragraphs 1.24–.28 of this guide.

- FASB Statement No. 159 is effective as of the beginning of an organization's first fiscal year that begins after November 15, 2007. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided the organization also elects to apply the provisions of FASB Statement No. 157. The statement permits an organization to irrevocably elect fair value as the initial and subsequent measurement attribute for certain financial assets and financial liabilities on a contract-by-contract basis, with changes in fair value recognized in the statement of activities as those changes occur. The statement amends APB No. 21, *Interest on Receivables and Payables*, and FASB Statement Nos. 57, 95, 102, 115, 124, and 133.

- FASB Statement No. 158 an amendment of FASB Statement Nos. 87, 88, 106, and 132(R), has multiple effective dates. The requirement to recognize the funded status of a defined benefit postretirement plan and the related disclosure requirements was effective for not-for-profit organizations as of the end of the fiscal year ending after June 15, 2007. The requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2008. Earlier application is encouraged. The statement requires employers to recognize the overfunded or underfunded positions of defined benefit postretirement plans (other than a multiemployer plan), including pension plans, in their statement of financial position. It also requires that employers measure plan assets and obligations as of the date of their financial statements. The statement amends FASB Statement Nos. 87, 88, 106, 130, 132(R), ARB No. 43, and APB Opinion No. 28.

- FASB Statement No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Earlier application is encouraged, provided that the reporting entity has not yet issued financial statements for that fiscal year, including financial statements for an interim period within that fiscal year. However, FSP FAS 157-2 delays the effective date of FASB Statement No. 157 until fiscal years beginning after November 15, 2008, and interim periods within those fiscal years for fair value measurements of all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). FASB Statement No. 157 provides guidance for how to measure the fair value of financial and nonfinancial assets and liabilities. It replaces the more general guidance for determining fair value currently found in many existing FASB standards, including APB Opinion Nos. 21, 28, and 29, FASB Statement Nos. 13, 15, 19, 35, 60, 63, 65, 67, 87, 106, 107, 115, 116, 124, 133, 136, 140, 141, 142, 143, 144, 146, 150, and 156, FASB Interpretation No. 45, and various FASB Statement No. 133 implementation issues.

- FASB Interpretation No. 48, an interpretation of FASB Statement No. 109, is effective for fiscal years beginning after December 15, 2006. However, FSP FIN 48-2 defers the effective date of that interpretation to fiscal years beginning after December 15, 2007, for certain nonpublic enterprises as defined by paragraph 289 of FASB Statement No. 109, *Accounting for Income Taxes*, including nonpublic not-for-profit organizations. Earlier application is permitted. Not-for-profit organizations that have already adopted the provisions of FASB Interpretation No. 48 are not eligible for the deferral. The interpretation limits the recognition of uncertain tax positions to only those positions that are probably of being sustained on audit based solely on the technical merits of the position. The interpretation amends FASB Statement Nos. 5 and 109.

- FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*, is effective for financial instruments entered into or modified after May 31, 2003. However, the effective date of the provisions regarding mandatorily redeemable financial instruments of nonpublic entities and mandatorily redeemable noncontrolling interests were deferred, in certain cases indefinitely, by FSP 150-3. FASB Statement No. 150 amends FASB Statement Nos. 128 and 133.

- FASB Statement No. 142 is effective for intangible assets acquired in transactions other than combinations, for example, the purchase or gift of patent or royalty rights from the holder of the patent or copyright. However, the provisions of FASB Statement No. 141, No. 141(R), and No. 142 should not be applied to goodwill and intangible assets arising from a combination between two or more not-for-profit organizations or acquired in the acquisition of a for-profit business entity by a not-for-profit organization until FASB completes its project on those types of combinations and acquisitions. Thus, the guidance in APB Opinion Nos. 16 and 17 remains in effect for such assets.

In addition, when applying APB Opinion Nos. 16 and 17, not-for-profit organizations should continue to apply the amendments to those Opinions found in other literature even though that other literature may have been superseded by FASB Statement Nos. 141, 141(R), 142, and 144. For example, when applying APB Opinion No. 17, not-for-profit organizations should continue to apply the amendments to that Opinion found in FASB Statement No. 121, even though that statement was superseded by FASB Statement No. 144. On October 9, 2006, FASB issued two exposure drafts to provide guidance to not-for-profit organizations. The proposed FASB statement, *Not-for-Profit Organizations: Mergers and Acquisitions*, would amend APB Opinion Nos. 16 and 29 and FASB Statement Nos. 116 and 117. The proposed FASB statement, *Not-for-Profit Organizations: Goodwill and Other Intangible Assets Acquired in a Merger or Acquisition*, which would amend FASB Statement No. 142. Readers should be alert to the issuance of final standards.

Pronouncement	*Appendix*
ARB Nos. 1–42	Superseded
ARB No. 43	E
ARB Nos. 44 and 44 (Revised)	Superseded
ARB No. 45	E
ARB No. 46	E
ARB Nos. 47–50	Superseded
ARB No. 51	C
APB Opinion No. 1	Superseded
APB Opinion No. 2	E
APB Opinion No. 3	Superseded
APB Opinion No. 4	E
APB Opinion No. 5	Superseded
APB Opinion No. 6	E
APB Opinion Nos. 7–8	Superseded
APB Opinion No. 9	E
APB Opinion No. 10	E
APB Opinion No. 11	Superseded
APB Opinion No. 12	D, E
APB Opinion No. 13	D
APB Opinion No. 14	B
APB Opinion No. 15	Superseded
APB Opinion No. 16	E [fn:]
APB Opinion No. 17	E [fn†]

APB Opinion No. 18	A
APB Opinion Nos. 19–20	Superseded
APB Opinion No. 21	E
APB Opinion No. 22	E
APB Opinion No. 23	E
APB Opinion Nos. 24–25	Superseded
APB Opinion No. 26	E
APB Opinion No. 27	Superseded
APB Opinion No. 28	B
APB Opinion No. 29	C
APB Opinion No. 30	E
APB Opinion No. 31	Superseded
FASB Statement No. 1	Superseded
FASB Statement No. 2	E
FASB Statement Nos. 3–4	Superseded
FASB Statement No. 5	E
FASB Statement No. 6	E
FASB Statement No. 7	D
FASB Statement Nos. 8–9	Superseded
FASB Statement No. 10	E[fn]
FASB Statement No. 11	E
FASB Statement No. 12	Superseded
FASB Statement No. 13	E
FASB Statement No. 14	Superseded
FASB Statement No. 15	E
FASB Statement No. 16	E
FASB Statement No. 17–18	Superseded
FASB Statement No. 19	D
FASB Statement No. 20–21	Superseded
FASB Statement No. 22	E
FASB Statement No. 23	E
FASB Statement No. 24	Superseded
FASB Statement No. 25	D

FASB Statement No. 26	Superseded
FASB Statement No. 27	E
FASB Statement No. 28	E
FASB Statement No. 29	E
FASB Statement Nos. 30–33	Superseded
FASB Statement No. 34	E
FASB Statement No. 35	D
FASB Statement No. 36	Superseded
FASB Statement No. 37	E
FASB Statement No. 38	E[fn*]
FASB Statement Nos. 39–41	Superseded
FASB Statement No. 42	E
FASB Statement No. 43	E
FASB Statement No. 44	Superseded
FASB Statement No. 45	D
FASB Statement No. 46	Superseded
FASB Statement No. 47	E
FASB Statement No. 48	E
FASB Statement No. 49	E
FASB Statement No. 50	D
FASB Statement No. 51	D
FASB Statement No. 52	E
FASB Statement Nos. 53–56	Superseded
FASB Statement No. 57	E
FASB Statement No. 58	E
FASB Statement No. 59	Superseded
FASB Statement No. 60	D
FASB Statement No. 61	D
FASB Statement No. 62	E
FASB Statement No. 63	D
FASB Statement No. 64	Superseded
FASB Statement No. 65	D
FASB Statement No. 66	E

FASB Statement No. 67	D
FASB Statement No. 68	E
FASB Statement No. 69	D
FASB Statement No. 70	Superseded
FASB Statement No. 71	D
FASB Statement No. 72	D [fn BCR]
FASB Statement Nos. 73–77	Superseded
FASB Statement No. 78	E
FASB Statement No. 79	E [fn *]
FASB Statement Nos. 80–83	Superseded
FASB Statement No. 84	B
FASB Statement No. 85	Superseded
FASB Statement No. 86	E
FASB Statement No. 87	E
FASB Statement No. 88	E
FASB Statement No. 89	A
FASB Statement No. 90	D
FASB Statement No. 91	D
FASB Statement No. 92	D
FASB Statement No. 93	E
FASB Statement No. 94	C
FASB Statement No. 95	E
FASB Statement No. 96	Superseded
FASB Statement No. 97	D
FASB Statement No. 98	E
FASB Statement No. 99	E
FASB Statement No. 100	Superseded
FASB Statement No. 101	D
FASB Statement No. 102	E
FASB Statement No. 103	Superseded
FASB Statement No. 104	E
FASB Statement No. 105	Superseded
FASB Statement No. 106	

	E
FASB Statement No. 107	E
FASB Statement No. 108	Superseded
FASB Statement No. 109	E
FASB Statement No. 110	D
FASB Statement No. 111	E
FASB Statement No. 112	E
FASB Statement No. 113	D
FASB Statement No. 114	E
FASB Statement No. 115	A
FASB Statement No. 116	C
FASB Statement No. 117	C
FASB Statement No. 118	E
FASB Statement No. 119	Superseded
FASB Statement No. 120	D
FASB Statement No. 121	E, Superseded
FASB Statement No. 122	Superseded
FASB Statement No. 123(R)	B
FASB Statement No. 124	C
FASB Statement No. 125	Superseded
FASB Statement No. 126	E
FASB Statement No. 127	Superseded
FASB Statement No. 128	A
FASB Statement No. 129	E
FASB Statement No. 130	A
FASB Statement No. 131	A
FASB Statement No. 132(R)	E
FASB Statement No. 133	E
FASB Statement No. 134	D
FASB Statement No. 135	E
FASB Statement No. 136	C
FASB Statement No. 137	E
FASB Statement No. 138	E

FASB Statement No. 139	D
FASB Statement No. 140	E
FASB Statement No. 141 (to be superseded)	A fn BCR
FASB Statement No. 141 (revised 2007)	A
FASB Statement No. 142	E
FASB Statement No. 143	E
FASB Statement No. 144	E
FASB Statement No. 145	E
FASB Statement No. 146	E
FASB Statement No. 147	D fn BCR
FASB Statement No. 148	Superseded
FASB Statement No. 149	E
FASB Statement No. 150	B
FASB Statement No. 151	E
FASB Statement No. 152	D
FASB Statement No. 153	C
FASB Statement No. 154	E
FASB Statement No. 155	E
FASB Statement No. 156	D
FASB Statement No. 157	E
FASB Statement No. 158	E
FASB Statement No. 159	E
FASB Statement No. 160	A
FASB Interpretation No. 1	E
FASB Interpretation Nos. 2–3	Superseded
FASB Interpretation No. 4	E fn BCR
FASB Interpretation No. 5	Superseded
FASB Interpretation No. 6	E
FASB Interpretation No. 7	D
FASB Interpretation No. 8	E
FASB Interpretation No. 9	D fn BCR
FASB Interpretation Nos. 10–13	Superseded

FASB Interpretation No. 14	E
FASB Interpretation Nos. 15–17	Superseded
FASB Interpretation No. 18	A
FASB Interpretation No. 19	E
FASB Interpretation No. 20	Superseded
FASB Interpretation No. 21	E
FASB Interpretation No. 22	Superseded
FASB Interpretation No. 23	E
FASB Interpretation No. 24	E
FASB Interpretation No. 25	Superseded
FASB Interpretation No. 26	E
FASB Interpretation No. 27	E
FASB Interpretation Nos. 28–29	Superseded
FASB Interpretation No. 30	C
FASB Interpretation Nos. 31–32	Superseded
FASB Interpretation No. 33	D
FASB Interpretation No. 34	Superseded
FASB Interpretation No. 35	A
FASB Interpretation No. 36	D
FASB Interpretation No. 37	E
FASB Interpretation No. 38	Superseded
FASB Interpretation No. 39	E
FASB Interpretation No. 40	D
FASB Interpretation No. 41	E
FASB Interpretation No. 42	Superseded
FASB Interpretation No. 43	E
FASB Interpretation No. 44	Superseded
FASB Interpretation No. 45	E
FASB Interpretation No. 46(R)	A
FASB Interpretation No. 47	E
FASB Interpretation No. 48	E

Appendix G—The Hierarchy of GAAP [fn GPH] [fn COD]

1.30

AU section 411, *The Meaning of* Present Fairly in Conformity With Generally Accepted Accounting Principles, as amended,[fn 10] establishes the hierarchy of generally accepted accounting principles (GAAP).

For financial statements of entities other than governmental entities, the hierarchy is summarized as follows:

> *Category (a).* Rule 203 literature consists of officially established accounting principles, which are FASB statements and interpretations, APB opinions, and ARBs.
>
> *Category (b).* This consists of FASB Technical Bulletins and, if cleared by FASB, AICPA Industry Audit and Accounting Guides, and AICPA SOPs.
>
> *Category (c).* This consists of AICPA AcSEC Practice Bulletins that have been cleared by FASB and consensus positions of FASB EITF.
>
> *Category (d).* This consists of AICPA accounting interpretations and implementation guides (Qs and As) published by FASB staff, and practices that are widely recognized and prevalent either generally or in the industry.

If the accounting treatment of a transaction or event is not specified by Rule 203 literature, the auditor should consider whether the accounting treatment is specified by another source of established accounting principles. If an established accounting principle from one or more sources in category (*b*), (*c*), or (*d*) is relevant to the circumstances, the auditor should be prepared to justify a conclusion that another treatment is generally accepted. If there is a conflict between accounting principles relevant to the circumstances from one or more sources in category (*b*), (*c*), or (*d*), the auditor should follow the treatment specified by the source in the higher category—for example, follow category (*b*) treatment over category (*c*)—or be prepared to justify a conclusion that a treatment specified by a source in the lower category better presents the substance of the transaction in the circumstances.

Footnotes

[fn 1] This list does not necessarily include all organizations that meet the definition of a not-for-profit organization in Financial Accounting Standards Board (FASB) Statement No. 116, *Accounting for Contributions Received and Contributions Made*. This guide applies to all organizations that meet the definition, regardless of whether they are included in this list.

[fn 2] *Black's Law Dictionary* defines a public corporation as: An artificial person (for example, [a] municipality or a governmental corporation) created for the administration of public affairs. Unlike a private corporation it has no protection against legislative acts altering or even repealing its charter. Instrumentalities created by [the] state, formed and owned by it in [the] public interest, supported in whole or part by public funds, and governed by managers deriving their authority from [the] state. Sharon Realty Co. v. Westlake, Ohio Com. Pl., 188 N.E.2d 318, 323, 25 O.O.2d 322. A public corporation is an instrumentality of the state, founded and owned in the public interest, supported by public funds and governed by those deriving their authority from the state. York County Fair Ass'n v. South Carolina Tax Commission, 249 S.C. 337, 154 S.E.2d 361, 362.

[fn 3] Providers of health care services that meet the definition of a voluntary health and welfare organization in FASB Statement No. 117, *Financial Statements of Not-for-Profit Organizations*, should follow this guide.

[fn GPH] On April 28, 2005, FASB issued an exposure draft of a proposed FASB statement, *The Hierarchy of Generally Accepted Accounting Principles*, objectives of which include moving responsibility for the generally accepted accounting principles (GAAP) hierarchy for nongovernmental entities from the AICPA Statement on Auditing Standard (SAS) No. 69, *The Meaning of* Present Fairly in Conformity With Generally Accepted Accounting Principles (AICPA, *Professional Standards*, vol. 1, AU sec. 411), to FASB literature. Additionally, the proposed statement expands the sources of category (a) to include accounting principles that are issued after being subject to FASB's due process (including, but not limited to FASB Staff Positions (FSP) and FASB Statement 133 implementation issues, which are currently not addressed in SAS No. 69).

Among other matters, the proposed FASB statement would not carry forward the Rule 203 exception from paragraph 7 of SAS No. 69 (paragraph .07 of AU section 411). Accordingly, the proposed FASB statement states that an enterprise shall not represent that its financial statements are presented in accordance with GAAP if its selection of accounting principles departs from the GAAP hierarchy set forth in this statement and that departure has a material impact on its financial statements.

In response to the proposed FASB statement, in May 2005, the AICPA issued an exposure draft of a proposed SAS, *Amendment to Statement on Auditing Standards No. 69 for Nongovernmental Entities*, which deletes the GAAP hierarchy for nongovernmental entities from SAS No. 69 (AU section 411). The final FASB statement and SAS on GAAP hierarchy will be issued concurrently and will have a uniform effective date. Readers should be alert to the issuance of the final standards.

[fn COD] On January 15, 2008, FASB launched the one-year verification phase of the *FASB Accounting Standards Codification™* (codification). During the verification period, constituents are encouraged to use the online Codification Research System free of charge to research accounting issues and provide feedback on whether the codification content accurately reflects existing U.S. GAAP for nongovernmental entities. Users are advised that the codification content is not yet approved as authoritative and, therefore, they must verify research results using their existing resources for the currently effective literature. After addressing the issues raised during the constituent feedback process, FASB is expected to formally approve the codification as the single source of authoritative U.S. GAAP, other than guidance issued by the Securities and Exchange Commission (SEC). Upon approval by FASB, all accounting standards (other than the SEC guidance) used to populate the codification will be superseded. At that time, with the exception of any SEC or grandfathered guidance, all other accounting literature not included in the codification will become nonauthoritative.

[fn 4] The guidance in paragraphs 1.05-.17 of this guide addresses only the pronouncements listed in paragraph 1.06. However, not-for-profit organizations are also subject to other pronouncements included in categories (b)–(d) of paragraph .05 of AU section 411 and should apply AICPA Audit and Accounting Guides, Statements of Position (SOP), and Practice Bulletins and FASB Technical Bulletins and the consensus positions of FASB Emerging Issues Task Force (EITF) that apply to them. (Appendix G [paragraph 1.30] of this chapter discusses AU section 411 and the GAAP hierarchy.)

[fn NIS] In December 2007, FASB issued FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements—an amendment of ARB No. 51*, which establishes accounting and reporting standards for the noncontrolling interest in a subsidiary (sometimes called minority interests) and for the deconsolidation of a subsidiary. Neither FASB Statement No. 160 nor its amendments to ARB No. 51, *Consolidated Financial Statements*, APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*, and No. 29, *Accounting for Nonmonetary Transactions*, FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises*, No. 89, *Financial Reporting and Changing Prices*, No. 128, *Earnings per Share*, No. 130, *Reporting Comprehensive Income*, and No. 142, *Goodwill and Other Intangible Assets*, FASB Interpretation No. 37, *Accounting for Translation Adjustments upon Sale of Part of an Investment in a Foreign Entity—an interpretation of FASB Statement No. 52*, and No. 46(R), *Consolidation of Variable Interest Entities (revised December 2003)—an interpretation of ARB No. 51*, AICPA Accounting Interpretation No. 1, AICPA SOP 04-2, *Accounting for Real Estate Time-Sharing Transactions* (AICPA, *Technical Practice Aids*, ACC sec. 10,910), and to several EITF issues, apply to not-for-profit organizations. Not-for-profit organizations should continue to apply the guidance in Accounting Research Bulletin (ARB) No. 51, *Consolidated Financial Statements*, before the amendments made by FASB Statement No. 160, SOP 94-3, *Reporting of Related Entities by Not-for-Profit Organizations* (AICPA, *Technical Practice Aids*, ACC sec. 10,610), and other applicable standards, until FASB issues interpretative guidance. FASB Statement No. 160 is effective for fiscal years beginning on or after December 15, 2006. Earlier adoption is prohibited.

[fn MAA] On October 9, 2006, FASB issued an exposure draft of a proposed FASB statement, *Not-for-Profit Organizations: Mergers and Acquisitions*, which would eliminate the use of the pooling-of-interests method of accounting by not-for-profit organizations and would require that they apply the acquisition method to any merger or acquisition. The acquisition method would require a not-for-profit organization to identify the acquirer, recognize the identifiable assets acquired and liabilities assumed that compose the business or nonprofit activity acquired at their fair values as of the acquisition date (with certain exceptions), and recognize either goodwill or the contribution inherent in the transaction. The proposed FASB statement would amend APB Opinion No. 16, *Business Combinations*, and No. 29 and FASB Statement Nos. 116 and 117. Concurrently, FASB also issued an exposure draft of a proposed FASB statement, *Not-for-Profit Organizations: Goodwill and Other Intangible Assets Acquired in a Merger or Acquisition*, which would amend FASB Statement No. 142 to provide guidance to not-for-profit organizations for testing goodwill for impairment and applying FASB Statement No. 142's provisions (as amended) to identified intangible assets recognized as the result of a merger or acquisition. Readers should be alert to the issuance of final standards.

fn BCR In December 2007, FASB issued FASB Statement No. 141 (revised 2007), *Business Combinations*, which replaces FASB Statement No. 141, *Business Combinations*. Like its predecessor, FASB Statement No. 141(R) is not applicable to combinations between not-for-profit organizations or the acquisition of a for-profit business by a not-for-profit organization. The nullifications or amendments to other standards made by FASB Statement No. 141(R) also are not applicable to not-for-profit organizations. Thus, not-for-profit organizations should continue to apply FASB Statement No. 72, *Accounting for Certain Acquisitions of Banking or Thrift Institutions—an amendment of APB Opinion No. 17, an interpretation of APB Opinions 16 and 17, and an amendment of FASB Interpretation No. 9*, and No. 147, *Acquisitions of Certain Financial Institutions—an amendment of FASB Statements No. 72 and 144 and FASB Interpretation No. 9*, and FASB Interpretation No. 4, *Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method—an interpretation of FASB Statement No. 2*, and No. 9, *Applying APB Opinions No. 16 and 17 When a Savings and Loan Association or a Similar Institution is Acquired in a Business Combination Accounted for by the Purchase Method—an interpretation of APB Opinions No. 16 and 17*, as indicated in paragraphs 1.24–.28 of this guide. Not-for-profit organizations also should continue to apply the following standards as indicated in paragraphs 1.24–.28 of this guide without regard to the amendments made by FASB Statement No. 141(R): ARB No. 43, *Restatement and Revision of Accounting Research Bulletins*, APB Opinion No. 14, *Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants*, No. 18, *The Equity Method of Accounting for Investments in Common Stock*, No. 28, *Interim Financial Reporting*, No. 29, *Accounting for Nonmonetary Transactions*, and No. 30, *Reporting the Results of Operations Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*, FASB Statement No. 2, *Accounting for Research and Development Costs*, No. 5, *Accounting for Contingencies*, No. 15, *Accounting by Debtors and Creditors for Troubled Debt Restructurings*, No. 45, *Accounting for Franchise Fee Revenue*, No. 52, *Foreign Currency Translation*, No. 60, No. 68, *Research and Development Arrangements*, No. 86, *Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed*, No. 87, *Employers' Accounting for Pensions*, No. 97, *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments*, No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, No. 109, *Accounting for Income Taxes*, No. 113, *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts*, No. 120, *Accounting and Reporting by Mutual Life Insurance Enterprises and by Insurance Enterprises for Certain Long-Duration Participating Contracts—an amendment of FASB Statements 60, 97, and 113 and Interpretation No. 40*, No. 123(R), *Share-Based Payment*, No. 133, *Accounting for Derivative Instruments and Hedging Activities*, No. 142, No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*, and No. 154, *Accounting Changes and Error Corrections—a replacement of APB Opinion No. 20 and FASB Statement No. 3*, and FASB Interpretation No. 21, *Accounting for Leases in a Business Combination—an interpretation of FASB Statement No. 13*, No. 26, *Accounting for Purchase of a Leased Asset by the Lessee during the Term of the Lease—an interpretation of FASB Statement No. 13*, No. 46(R), and No. 48, *Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109*. In addition, the amendments made by FASB Statement No. 141(R) to FASB Technical Bulletin 84-1, *Accounting for Stock Issued to Acquire the Results of a Research and Development Arrangement*, SOP 78-9, *Accounting for Investments in Real Estate Ventures* (AICPA, *Technical Practice Aids*, ACC sec. 10,240), SOP 90-7, *Financial Reporting by Entities in Reorganization Under the Bankruptcy Code* (AICPA, *Technical Practice Aids*, ACC sec. 10,460), SOP 93-6, *Employers' Accounting for Employee Stock Ownership Plans* (AICPA, *Technical Practice Aids*, ACC sec. 10,580), SOP 96-1, *Environmental Remediation Liabilities* (AICPA, *Technical Practice Aids*, ACC sec. 10,680), SOP 00-3, *Accounting by Insurance Enterprises for Demutualizations and Formations of Mutual Insurance Holding Companies and for Certain Long-Duration Participating Contracts* (AICPA, *Technical Practice Aids*, ACC sec. 10,810), SOP 01-6, *Accounting by Certain Entities (Including Entities With Trade Receivables) That Lend to or Finance the Activities of Others* (AICPA, *Technical Practice Aids*, ACC sec. 10,850), SOP

03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer* (AICPA, *Technical Practice Aids*, ACC sec. 10,880), and SOP 05-1, *Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection With Modifications or Exchanges of Insurance Contracts* (AICPA, *Technical Practice Aids*, ACC sec. 10,920), and AICPA Practice Bulletin No. 4, *Accounting for Foreign Debt/Equity Swaps* (AICPA, *Technical Practice Aids*, PB sec. 12,040), Practice Bulletin No. 6, *Amortization of Discounts on Certain Acquired Loans* (AICPA, *Technical Practice Aids*, PB sec. 12,060), and Practice Bulletin No. 14, *Accounting and Reporting by Limited Liability Companies and Limited Liability Partnerships* (AICPA, *Technical Practice Aids*, PB sec. 12,140), do not apply to not-for-profit organizations, nor do the changes made by Statement No. 141(R) to FASB Technical Bulletin 85-5, *Issues Relating to Accounting for Business Combinations*, FSP FAS No. 141-1 and 142-1, *Interaction of FASB Statements No. 141 and No. 142 and EITF Issue No. 04-2*, and Practice Bulletin No. 11, *Accounting for Preconfirmation Contingencies in Fresh-Start Reporting* (AICPA, *Technical Practice Aids*, PB sec. 12,110), many EITF Issue consensuses, and several responses in the FASB Staff Q&A on FASB Statement No. 109.

fn 5 Such activities may be conducted by (*a*) for-profit entities owned and consolidated by not-for-profit organizations, (*b*) divisions of not-for-profit organizations, or (*c*) entire not-for-profit organizations, such as those operating as not-for-profit broadcasters.

fn 6 See footnote 4.

fn * In June 2001, FASB issued FASB Statement No. 141 which supersedes several pronouncements including APB Opinion No. 16. In December 2007, FASB issued FASB Statement No. 141(R), which replaces FASB Statement No. 141. However, neither FASB Statement No. 141 nor its replacement, FASB Statement No. 141(R), applies to combinations of two or more not-for-profit organizations or the acquisition of a for-profit business entity by a not-for-profit organization. Thus, GAAP does not change for those types of combinations. Not-for-profit organizations should continue to follow the guidance in this guide and in APB Opinion No. 16 as amended by pronouncements prior to the issuance of FASB Statement No. 141, as well as the guidance in the other pronouncements superseded by FASB Statement Nos. 141 and 141(R). Pronouncements that were amended by FASB Statement Nos. 141 and 141(R) should be applied as though Statement Nos. 141 and 141(R) had not amended them. In addition, in applying the guidance included in APB Opinion No. 16, not-for-profit organizations should continue to apply the amendments to that Opinion that were included in FASB Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*, even though FASB Statement No. 121 was superseded by FASB Statement No. 144. (FASB Statement No. 144 did not carry forward the amendments to APB Opinion No. 16 because APB Opinion No. 16 had been superseded.) For additional guidance, refer to footnotes BCR and NIS in this chapter.

fn DDI On December 8, 2006, FASB issued an exposure draft of a proposed FASB statement, *Disclosures about Derivative Instruments and Hedging Activities*, an amendment of FASB Statement No. 133, which amends and expands the disclosure requirements for derivative instruments. The proposed statement would also amend FASB Statement No. 52 and No. 107, *Disclosures about Fair Value of Financial Instruments*. Readers should be alert to the issuance of a final standard.

fn TAX In June 2006, FASB issued FASB Interpretation No. 48, an interpretation of FASB Statement No. 109. The interpretation limits the recognition of uncertain tax positions to only those positions that are more likely than not to be sustained on audit based solely on the technical merits of the position. The interpretation is effective for fiscal years beginning after December 15, 2006. However, FSP FIN 48-2 defers the effective date of that interpretation to fiscal years beginning after December 15, 2007, for certain nonpublic enterprises as defined by paragraph 289 of FASB Statement No. 109, including nonpublic not-for-profit organizations. Earlier application is permitted. Not-for-profit organizations that have already adopted the provisions of FASB Interpretation No. 48 are not eligible for the deferral.

fn NPE In October 2006, FASB issued FSP FAS 126-1, *Applicability of Certain Disclosure and Interim Reporting Requirements for Obligors for Conduit Debt Securities*, which clarifies the definition of a *public entity* in certain accounting standards to include entities that are conduit bond obligors for conduit debt securities that are traded in a public market. The FSP amends APB Opinion No. 28, *Interim Financial Reporting*, and FASB Statement No. 69, *Disclosures about Oil and Gas Producing Activities—an amendment of FASB Statements 19, 25, 33, and 39*, No. 109, No. 126, *Exemption from Certain Required Disclosures about Financial Instruments for Certain Nonpublic Entities—an* *amendment to* FASB Statement No. 107, No. 131, *Disclosures about Segments of an Enterprise and Related Information*, No. 132, *Employers' Disclosures about Pensions and Other Postretirement Benefits—an amendment of* FASB Statements No. 87, 88, *and 106*, and No. 141. It is effective for fiscal periods beginning after December 15, 2006. An entity may elect to retrospectively apply the guidance to all prior periods.

fn 7 Vincent M. O'Reilly, Murray B. Hirsch, Philip L. Defliese, and Henry R. Jaenicke, *Montgomery's Auditing*, 11th ed. (New York: John Wiley & Sons, 1990), 791.

fn 8 References in this column are provided as a guide to other sources of information about the topic covered by the listed pronouncement.

fn OMN On September 27, 2007, FASB issued an exposure draft, *Proposed FSP SOP 94-3-a and AAG-HCO-a, Omnibus Changes to Consolidation and Equity Method Guidance for Not-for-Profit Organizations*, which would make several changes to the guidance on consolidation and the equity method of accounting in SOP 94-3, *Reporting of Related Entities by Not-for-Profit Organizations.* Readers should be alert to the issuance of a final standard.

fn FMV In September 2006, FASB issued FASB Statement No. 157, *Fair Value Measurements*, which provides guidance for how to measure the fair value of financial and nonfinancial assets and liabilities. It replaces the more general guidance for determining fair value currently found in many existing FASB standards, including APB Opinions No. 21, *Interest on Receivables and Payables*, No. 28, and No. 29; FASB Statement No. 13, *Accounting for Leases*, No. 15, No. 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies*, No. 35, *Accounting and Reporting by Defined Benefit Pension Plans*, No. 60, No. 63, *Financial Reporting by Broadcasters*, No. 65, *Accounting for Certain Mortgage Banking Activities*, No. 67, *Accounting for Costs and Initial Rental Operations of Real Estate Projects*, No. 87, No. 106, No. 107, *Disclosures about Fair Value of Financial Instruments*, No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, No. 116, No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*, No. 133, No. 136, *Transfers of Assets to a Not-for-Profit Organization or Charitable Trust That Raises or Holds Contributions for Others*, No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities-a replacement of* FASB Statement No. 125, No. 141, No. 142, No. 143, *Accounting for Asset Retirement Obligations*, No. 144, No. 146, No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*, and No. 156, *Accounting for Servicing of Financial Assets—an amendment of* FASB Statement No. 140; FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others—an interpretation of* FASB Statements No. 5, 57, *and 107 and rescission of* FASB Interpretation No. 34; and various FASB Statement No. 133 implementation issues. FASB Statement No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Earlier application is encouraged, provided that the reporting entity has not yet issued financial statements for that fiscal year, including financial statements for an interim period within that fiscal year. However, FSP FAS 157-2, *Effective Date of* FASB Statement No. 157, delays the effective date of FASB Statement No. 157 until fiscal years beginning after November 15, 2008, and interim periods within those fiscal years for fair value measurements of all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually).

fn FVO In February 2007, FASB issued FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities—Including an amendment of* FASB Statement No. 115, which permits an organization to irrevocably elect fair value as the initial and subsequent measurement attribute for certain financial assets and financial liabilities on a contract-by-contract basis, with changes in fair value recognized in the statement of activities as those changes occur. The statement amends APB No. 21 and FASB Statement No. 57, *Related Party Disclosures*, No. 95, *Statement of Cash Flows*, No. 102, *Statement of Cash Flows-Exemption of Certain Enterprises and Classification of Cash Flows from Certain Securities Acquired for Resale—an amendment of* FASB Statement No. 95, No. 115, No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*, and No. 133. FASB Statement No. 159 is effective as of the beginning of an organization's first fiscal year that begins after November 15, 2007. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided the organization also elects to apply the provisions of FASB Statement No. 157.

[fn EPS] On September 30, 2005, FASB issued a revised exposure draft of a proposed FASB statement, *Earnings Per Share*, that would amend FASB Statement No. 128 to change the computational guidance for computing earnings per share. Readers should be alert to the issuance of the final standard.

[fn DBP] In September 2006, FASB issued FASB Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, an amendment of FASB Statement No. 87, No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*, No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, and No. 132(R), *Employers' Disclosures about Pensions and Other Postretirement Benefits—an amendment of FASB Statements No. 87, 88, and 106*. The statement requires employers to recognize the overfunded or underfunded positions of defined benefit postretirement plans (other than a multiemployer plan), including pension plans, in their statement of financial position. It also requires that employers measure plan assets and obligations as of the date of their financial statements. The statement amends FASB Statement No. 87, No. 88, No. 106, No. 130, No. 132(R), ARB No. 43, and APB Opinion No. 28. The requirement to recognize the funded status of a defined benefit postretirement plan and the related disclosure requirements was effective for not-for-profit organizations as of the end of the fiscal year ending after June 15, 2007. The requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2008. Earlier application is encouraged.

[fn FSP] On October 25, 2006, FASB issued FSP FAS 126-1, which makes the disclosure requirements of APB Opinion No. 28 applicable to not-for-profit organizations that meet the definition of a public entity in footnote 1 in paragraph 6 of that opinion. The FSP is applied prospectively for fiscal periods beginning after December 15, 2006.

[fn 9] FASB Statement No. 150 generally is not applicable to not-for-profit organizations. However, as explained in paragraphs 11.10–.13, some country clubs and social clubs have member interests that fall within the scope of that FASB statement.

[fn FGI] On April 18, 2007, FASB issued an exposure draft, *Accounting for Financial Guarantee Insurance Contracts—an interpretation of FASB Statement No. 60*, which would clarify how FASB Statement No. 60 applies to financial guarantee insurance (and reinsurance) contracts issued by insurance enterprises. The proposed FASB statement would amend FASB Statement Nos. 60, 107, and 133 and FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others—an interpretation of FASB Statements No. 5, 57, and 107 and rescission of FASB Interpretation No. 34*. Readers should be alert to the issuance of the final standard.

[fn †] This pronouncement remains in effect for not-for-profit organizations until the completion of FASB project on mergers and acquisitions between not-for-profit organizations and the acquisition of a for-profit business entity by a not-for-profit organization. The provisions of FASB Statement No. 142 should not be applied to goodwill and intangible assets arising from a merger or acquisition between two or more not-for-profit organizations or acquired in the acquisition of a for-profit business entity by a not-for-profit organization until FASB completes its project on those types of mergers and acquisitions. Thus, the guidance in APB Opinion No. 17, *Intangible Assets*, remains in effect for such assets. In addition, when applying APB Opinion No. 17, not-for-profit organizations should continue to apply the amendments to that Opinion found in other literature even though that other literature may have been superseded by FASB Statement Nos. 141, 141(R), 142, and 144. For example, when applying APB Opinion No. 17, not-for-profit organizations should continue to apply the amendments to that Opinion found in FASB Statement No. 121 even though that FASB statement was superseded by FASB Statement No. 144. FASB Statement No. 142 is effective for intangible assets acquired in transactions other than combinations, for example, the purchase or gift of patent or royalty rights from the holder of the patent or copyright.

[fn LST] On November 28, 2007, FASB issued an exposure draft, *Proposed FSP FAS 157-a—Application of FASB Statement No. 157 to FASB Statement No. 13 and Its Related Interpretive Accounting Pronouncements That Address Leasing Transactions*, which would provide a scope exception from FASB Statement No. 157 for accounting pronouncements that require fair value measurements for leasing transactions. This proposed FSP would amend FASB Statement Nos. 13 and 157. Readers should be alert to the issuance of the final standard.

fn SPE On August 11, 2005, FASB released a revised exposure draft of a proposed FASB statement, *Transfers of Financial Assets*, which replaces the June 10, 2003, exposure draft, *Qualifying Special-Purpose Entities and Isolation of Transferred Assets*. The proposed FASB statement would amend FASB Statement No. 140 to revise or clarify the derecognition requirements for financial assets and the initial measurement of interests related to transferred financial assets that are held by a transferor. Readers should be alert to the issuance of the final standard.

fn IAL On November 26, 2007, FASB issued an exposure draft, *Proposed FSP FAS 142-f—Determination of the Useful Life of Intangible Assets*, which would amend the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset. This proposed FSP would amend FASB Statement No. 142. Readers should be alert to the issuance of the final standard.

fn 10 Paragraph .14 of AU section 411, *The Meaning of* Present Fairly in Conformity With Generally Accepted Accounting Principles, establishes a hierarchy for federal governmental entities.

Footnote 1:
This list does not necessarily include all organizations that meet the definition of a not-for-profit organization in Financial Accounting Standards Board (FASB) Statement No. 116, *Accounting for Contributions Received and Contributions Made*. This guide applies to all organizations that meet the definition, regardless of whether they are included in this list.

Footnote 2:
Black's Law Dictionary defines a public corporation as: An artificial person (for example, [a] municipality or a governmental corporation) created for the administration of public affairs. Unlike a private corporation it has no protection against legislative acts altering or even repealing its charter. Instrumentalities created by [the] state, formed and owned by it in [the] public interest, supported in whole or part by public funds, and governed by managers deriving their authority from [the] state. Sharon Realty Co. v. Westlake, Ohio Com. Pl., 188 N.E.2d 318, 323, 25 O.O.2d 322. A public corporation is an instrumentality of the state, founded and owned in the public interest, supported by public funds and governed by those deriving their authority from the state. York County Fair Ass'n v. South Carolina Tax Commission, 249 S.C. 337, 154 S.E.2d 361, 362.

ATTACHMENT C

Memorandum

To: The File
From Bill Regan, Mike Epstein, Phil Leiber and Dennis Estrada
Date: 4/24/07
Re: GASB vs. FASB Reporting

Issue

Should the ISO report under FASB or GASB?

Business Overview

The California Independent System Operator Corporation (the Company or ISO), a not-for-profit public benefit corporation organized as a 501 (c) (3) organization exempt from federal and state income taxes. It was formed as a result of California AB 1890 (became law in 1996) to function as an Independent System Operator in accordance with FERC Orders 888 and 889 relating to the restructuring of the electric utility industry. As such we are responsible for the operation of the long-distance, high-voltage power lines that deliver electricity throughout most of California (the California Grid) and between the California Grid, neighboring control areas, neighboring states, Canada and Mexico. The Company charges a Grid Management Charge (GMC) to market participants to recover the Company's costs and to provide an operating reserve. The Company's principal objective is to ensure the reliability of the California Grid, while fostering a low-cost wholesale marketplace for electrical generation and related services in California.

The Company operates pursuant to our Tariff filed with the Federal Energy Regulatory Commission (FERC). As such ISO is regulated by FERC, which among other aspects has authority to approve the ISO's GMC rates charged to our market participants.

As a not for profit corporation the ISO is not a subset of the state of California or the federal government. Our bonds do not constitute debt or liability of the state of California and payments on the bonds are secured solely by the revenues of the ISO and the credit support (insurance, liquidity facilities and reserves) specifically associated with our debt offerings. The ISO's debt is tax exempt for both federal and state purposes.

Facts & Circumstances

At the inception of the ISO in 1998, the entity was governed by a Board of Governors (the Board), representing various stakeholders participating in the electric utility industry. These members were nominated and appointed in accordance with the Company's FERC-approved Tariff and By-laws. At that time, it was determined that we should follow FASB (not GASB), because our Board did not meet the criteria set forth for an entity to follow GASB. Further, the ISO did not meet any of the other criteria described below for consideration as a governmental entity. For example, with respect to the criterion related to direct issuers of tax exempt debt, the ISO must issue our debt through conduit entities. The California Infrastructure and Economic Development Bank (CIEDB), which is a public body organized within the government of the state of California, has been used for all of the ISO's debt to date.

Subsequently, in January 2001, the California legislature changed the composition of the Board to a five-member board appointed by the Governor. For the period from 2001 through 2005, FERC (through the ISO's tariff and bylaws) and the State of California had conflicting policies regarding the ISO's Board election process. In July 2005, FERC accepted the state of California's approach to Board member selection, which included the Governor appointment of the Board members. This July 2005 event was the recognition event for the final change in board governance.

Research

The criteria used to distinguish governmental entities from nongovernmental entities are set forth in the AICPA's *Audits of State and Local Governmental Units* (Chapter 1, paragraph 1.01 and 1.02), as follows:

> **1.01** This Audit and Accounting Guide (Guide) applies to all state and local governments. Governmental entities are subject to generally accepted accounting principles (GAAP) for state and local governments as described later in this chapter. Public corporations and bodies corporate and politic are governmental entities. Other entities are governmental if they have one or more of the following characteristics:
>
> - Popular election of officers or appointment (or approval) of a controlling majority of the members of the organization's governing body by officials of one or more state or local governments;
> - The potential for unilateral dissolution by a government with the net assets reverting to a government; or
> - The power to enact and enforce a tax levy.
>
> Furthermore, entities are presumed to be governmental if they have the ability to issue directly (rather than through a state or municipal authority) debt that pays interest exempt from federal taxation. However, entities possessing only that ability (to issue tax-exempt debt) and none of the other governmental characteristics may rebut the presumption that they are governmental if their determination is supported by compelling, relevant evidence.
>
> **1.02** Entities are governmental or nongovernmental for accounting, financial reporting, and auditing purposes **based solely on the application of the above criteria**; other factors are not determinative. For example, the fact that an entity is incorporated as a not-for-profit organization and exempt from federal income taxation under the provisions of Section 501 of the Internal Revenue Code is not a criterion in determining whether an entity is governmental or nongovernmental for accounting, financial reporting, and auditing purposes. (emphasis added)

Note that similar provisions exist within the AICPA Audit and Accounting Guide: Not-for-Profit Organizations. Paragraph 1:03 of that guide mirrors the criteria set forth in paragraph 1.01 of the state and local guide presented above. However the not-for-profit guide does not have the restrictive language set forth in 1.02 of the state and local audit guide.

Analysis and Conclusions

The criteria used to distinguish governmental entities from nongovernmental entities are set forth in the AICPA's *Audits of State and Local Governmental Units* (Chapter 1, paragraph 1.01 and 1.02) - see excerpt of the guidance above in the Research section.

We have determined that the ISO is a governmental entity and should, therefore, follow the governmental hierarchy of GAAP because the Board (the governing body of the organization) is appointed by the Governor (a state government official). Further, board member appointments require approval by the State Senate before board members can be seated.

Specifically, we considered the language of paragraph 1.02 of the guide which clarifies that the criteria we are considering (board appointment by governmental entity) should be followed prescriptively. The phrase used is "**based solely on the application of the above criteria".** We understand the above phrase was inserted into the Audit Guide to preclude entities from establishing more qualitative support for alternative treatment; rather the intent was to establish a black and white rule to be applied in these circumstances. As such, despite the fact that the conversion to GASB will cause the CAISO to report in a manner inconsistent with our six other peer organizations in the US (none of which are subject to state level appointment process; however all of which operate in a manner similar to the CAISO), we have concluded that the CAISO should report under GASB.

Additionally, as a governmental enterprise fund, the ISO is required to make an election under the provisions of GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting.* GASB 20 allows enterprise funds to follow one of two approaches of accounting and financial reporting: (1) Proprietary activities should apply all applicable GASB pronouncements as well as pronouncements issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements: FASB Statements and Interpretations, APB Opinions, and ARBs; or (2) In addition to applying the FASB Statements and Interpretations, APB Opinions, and ARBs required in (1) above, a proprietary activity may also apply all FASB Statements and Interpretations issued after November 30, 1989, except for those that conflict with or contradict GASB pronouncements (GASB 20, par. 7). The ISO is electing option 2 above.

ATTACHMENT D

Memorandum

To: The File
From Bill Regan, Mike Epstein, Phil Leiber and Dennis Estrada
Date: 4/24/07
Re: Summary of Changing Accounting from FASB to GASB

Background
The CAISO is responsible for the operation of the long-distance, high-voltage power lines that deliver electricity throughout most of California (the California Grid) and between the California Grid, neighboring control areas, neighboring states, Canada and Mexico. The CAISO charges a Grid Management Charge (GMC) to market participants to recover the CAISO's costs and to provide an operating reserve. The CAISO's principal objective is to ensure the reliability of the California Grid, while fostering a low-cost wholesale marketplace for electrical generation and related services in California. The CAISO operates pursuant to its Tariff filed with the Federal Energy Regulatory Commission (FERC).

The CAISO has annually prepared and issued two sets of financial statements, one set prepared under Generally Accepted Accounting Principles (GAAP) (Financial Accounting Standards Board (FASB) basis), and one prepared under the FERC basis (the FERC Form 1). The last issued statements were for the period ending December 31, 2005. The audit of the December 31, 2006 statements is currently being completed.

The CAISO is not a Security and Exchange Commission (SEC) reporting entity. While it is considered a Public Interest Entity by virtue of issuance of publicly traded bonds, the bonds are variable rate demand bonds backed by bond insurance and a bank liquidity line, and they do not require a full official statement with information on the CAISO. Additionally, the CAISO is not required to post its financial information for bond holders.

This memo addresses the differences in accounting and reporting between FASB and Governmental Accounting Standards Board (GASB), analyzes and concludes on the materiality of those differences, and concludes with a recommended method for issuing the 2006 financial statements.

History of Governance Issue
The CAISO is a public benefit corporation incorporated in May 1997 under the laws of the State of California. It received its tax exemption for its activities in reducing the costs of the State of California. The initial members of the Board of Governors (the Board), were appointed by and represented various stakeholders participating in the California electric utility industry. At that time, it was determined that the CAISO should follow FASB (not GASB), because their Board did not meet the criteria set forth for an entity to follow GASB. However from 2001 through 2005 there were various actions by both the State of California and FERC regarding Board composition.

- In January 2001, the California legislature changed the composition of the Board to a five-member board appointed by the California Governor and confirmed by the California Electricity Oversight Board (EOB). The new Board was subsequently appointed by the Governor, confirmed by the EOB, and seated under this legislation in January 2001.

- Effective January 2002, further state legislation provided that the Board members must be confirmed by the California State Senate instead of the EOB. Board members were reappointed by the Governor in January 2002, and were confirmed by the State Senate in January 2003.
- In 2003 FERC filed an enforcement action against the CAISO in the U.S. District Court for the District of Columbia (District Court), seeking an injunction directing the CAISO to adhere to the procedure for Board member selection that was ordered by FERC.
- The CAISO asked the District Court to dismiss FERC's enforcement action, and opposed FERC's request for an injunction.
- In June 2004 the court affirmed the CAISO's position.
- In May 2005 the CAISO filed with FERC a petition of Declaratory Order accepting the Board selection process.
- In July 2005, FERC issued an order approving the CAISO's Board selection process and finding the selection process met the independence requirements of Orders 888 and 2000.

During the audit of the 2006 financial statements, it was determined that due to the CAISO's Board member appointment process currently in place, the CAISO should be following GASB and not FASB.

Differences between FASB and GASB

Dennis Estrada and Mike Epstein performed an assessment to quantify differences in accounting between GASB and FASB. The conclusion was that the accounting by the CAISO under GASB would be the same as under FASB. The assessment considered the following items as to whether the accounting treatment would differ.

- Retiree medical plan - the CAISO should still follow FASB 106, until GASB 45 is adopted – which the CAISO plans to do in fiscal 2007.
- Refunding on bonds - different accounting under GASB 23 than was under FASB. The last refunding was in 2000, prior to the time that the CAISO would be subject to GASB in any event.
- GASB requires the presentation of financial statements to follow the common practice in the industry and functional expense accounts. The industry in this case would be the population of other RTO/ISOs The other RTO/ISOs present their financial statements in the same manner as the CAISO currently does The CAISO is a single function entity and thus breaks down the single function into the component categories like the other entities in this industry. This treatment is the same as required by FASB.

There is no change in accounting principles associated with this change to GASB reporting. Net equity (reported as net assets) at December 31, 2005 is unaffected; similarly reported financial position, results of operations and cash flows are not changed. Based on a review of the GASBs there appears to be no adjustments required to change the accounting from FASB to GASB. The requirements of GASB add the following disclosures:

- Addition of Management's Discussion and Analysis (MD&A)
- Change in presentation of net assets (split to 3 categories - restricted, unrestricted and net investment in capital assets)
- Statements of Operations and Net Assets, will change names to Statements of Revenues, Expenses and Changes in Net Assets
- Cash flows to be prepared on the direct method
- Additional cash and investment disclosures

- Additional roll forward disclosures for - Debt and Fixed Assets and
- Add additional debt maturity table

Analysis of Materiality of Differences between FASB and GASB

The CAISO has concluded that there are no material differences in accounting related to the change from FASB to GASB. Because net assets, change in net assets, and cash flows from operations under FASB will remain the same under GASB, quantitative considerations are not applicable to this analysis as there would be no changes in the amounts presented. Therefore, to assess the materiality of changing from FASB to GASB, the CAISO considered the definition of materiality, and the qualitative guidance in the auditing standards (SAB 99) related to the presentation of the financial statements.

Definition of Materiality

FASB Concepts Statement No. 2, as reaffirmed by SAB 99, defines materiality as follows:

> *"The omission or misstatement of an item in a financial report is material if, in the light of surrounding circumstances, the magnitude of the item is such that it is probable that the judgment of a reasonable person relying upon the report would have been changed or influenced by the inclusion or correction of the item."*

Primary users

The primary users of the CAISO's financial statements are generally parties connected with the CAISO's bonds (liquidity banks and insurers) and financial analysts (rating agencies), both with an interest in the CAISO's ability to meet debt service obligations on the bonds. One of the ratings agencies, S&P, looked to the ability of the CAISO to recover its costs through the GMC and the ability to collect the GMC from the market should either PG&E or SCE (the two largest Investor Owned Utilities (IOUs)) fail. Certain corporate creditors such as lessors periodically ask questions related to data not provided in financial statements. However, we are not obligated to provide CAISO financials to any such entity. Holders of CAISO's bonds are not provided CAISO's financial statements for information as they purchase the bonds on the basis of the AAA/VMIG-1 ratings assigned by the rating agencies, which are based on the bond insurance and bank liquidity facility. The underwriters, insurers and banks involved in the issuance of the CAISO's debt also issue debt both insured and uninsured of the other governmental entities and should be thoroughly familiar with their financial reporting.

Bill Regan and Phil Leiber have reviewed the nature of the changes caused by adoption of GASB standards and they have concluded that those presentation issues would have had no impact on the considerations used by financial users of the statements described above. The CAISO is in the process of informing them of the change to GASB. As confirmation of this belief, the CAISO recently issued $60M in debt with ratings by S&P and Moodys underwritten by BofA and JP Morgan without the use of any financial statements. As noted above, to assess the CAISO's credit rating, rating agencies look to the coverage provided by market collections versus GMC rates including the strength of the two IOUs and the ability of the market to cover a possible default by either of the IOUs.

A key consideration is understanding that GASB requires different presentation in certain areas. The primary users of the CAISO's financial statements have historically used both the FASB and the FERC Form 1 in the context of normal industry reporting practice. Bill Regan and Mike Epstein believe it is highly improbable that not having the GASB financials (*"omission or misstatement")* is of *"the magnitude ... such that it is probable that the judgment of a reasonable person* *relying upon the report would have been changed or influenced by the inclusion or correction of the item."*

Additionally, it should be noted that the facts relating to the detail rule requiring the change from FASB to GASB have no consequence to the CAISO financial statements or reported results of operation. Importantly, nothing about the CAISO's financial operations changed as a result of the evolution of the board appointment process. Thus, this is governance driven change not an operational driven change.

<u>Other users</u>
All market participants interested in the CAISO's operations are involved in the rate setting process where they have direct access to the CAISO's records through the budget process in setting the CAISO's GMC rate.

<u>Other RTO/ISOs</u>
Other users of the financial statements comprise those that review the CAISO's FERC filings. Recently FERC has expanded the reporting information of RTO/ISOs with an aim of better comparability. Most non-financial users look to the FERC Form 1 to compare the activities and costs of the RTO/ISOs.

Another important consideration is the CAISO's financial reporting in the context of the six other RTO/ISO. Until this year's change for the CAISO, all have reported in accordance with normal FASB accounting principles. Like the CAISO, all but PJM (an eastern RTO) are organized as nonprofit organizations and are structured to fundamentally recover their costs through service charges to their market participants. All have external debt and the primary credit issues for all relate to the ability to service that debt. All, except for ERCOT (the Texas ISO), are subject to FERC and as such, are required to file statutory FERC form 1 financial statements each year. ERCOT voluntarily files a FERC Form 1. None of the other ISO's has boards appointed in the manner that California appoints their board and therefore GASB accounting is not required.

<u>Auditing Standards (SAB 99) Considerations</u>
SAB 99 sets forth specific qualitative factors that were considered in the CAISO's assessment of materiality of the change from FASB to GASB. Each of those factors was considered as follows:

Whether the change to GASB arises from an item capable of precise measurement or whether it arises from an estimate and, if so, the degree of imprecision inherent in the estimate

The date that circumstances changed regarding reporting under FASB vs. GASB occurred is subjective, and could have been deemed to have occurred in 2001, 2004 or 2005. The technical literature applicable currently is precise as the change but not to the date.

Whether the change to GASB masks a change in earnings or other trends.

The CAISO does not have earnings. There can be no trending of results as the GMC rate structure provides for the return of excess collections to market participants through future rate adjustments

Whether the change to GASB hides a failure to meet analysts' consensus expectations for the enterprise

The change to GASB does not impact cash flows from operations or debt service coverage and as noted above there are no earnings.

Whether the change to GASB concerns a segment or other portion of the business that has been portrayed by the registrant as playing a significant role in the operations or profitability of the entity

The CAISO does not have separate reporting segments.

Whether the change to GASB affects compliance with regulatory requirements or whether the change to GASB affects compliance with loan covenants or other contractual requirements

Compliance with the CAISO's debt covenants is not impacted by the change to GASB. The GMC rate structure provides for a 25% debt service coverage which is not impacted. None of the GASB related changes adds information not otherwise disclosed related to debt service coverage or its elements.

Whether the change to GASB has the effect of increasing management's compensation (for example, by satisfying requirements for the award of bonuses or other forms of incentive compensation)

The change to GASB had no impact on any elements of management's incentive compensation program or any other aspect of compensation. Incentive compensation is based on the method used to calculate the revenue requirement and not GAAP, GASB or FERC reported amounts.

Whether the change to GASB involves concealment of an unlawful transaction

Not applicable. The change to GASB relates to selection of which accounting guidance to follow.

Whether a known change to GASB may result in a significant positive or negative market reaction

There is no market as posed by this question as there are no shareholders. Participants in the CAISO's energy market primarily monitor the CAISO's ability to process the market transactions and function as a pass-thru entity. Other users and rating agencies monitor the CAISO's and Market's ability to meet obligations and liquidity position.

Whether small intentional misstatements are pursuant to actions to "manage" earnings. While intent alone does not render a misstatement material, it may be an indicator that management believes the misstatement to be significant, particularly when intentionally made

As noted above the CAISO does not have earnings. The change to GASB relates to selection of which accounting guidance to follow.

Conclusion

We believe that the change in reporting from FASB to GASB is not a material change to the financial statements because it is not probable that the financial statement user's *judgment would have been changed or influenced by the change in presentation and disclosures from FASB to GASB.*

Accordingly, we also believe that it is appropriate to report this change from FASB to GASB on a prospective basis - issuing the 2006 financial statements under GASB. Because it would be inappropriate to re-present the 2005 FASB financial statements the CAISO plans to issue a single year set of statements in 2006 (not comparative) and by disclosing the specifics of the change in a separate footnote in the 2006 financial statements. However, we believe that this is not a material misstatement requiring restatement treatment.

ATTACHMENT E

Side-by-Side Comparison of SFAS No. 106 and GASB No. 45
(Cal ISO assumptions/results at 1/1/2007 shown in bold)

Assumption	SFAS No. 106	GASB No. 45
Actuarial Cost Method	One Permitted Cost Method (Projected Unit Credit) **Projected Unit Credit**	Six Permitted Cost Methods, Including Projected Unit Credit **Projected Unit Credit**
Cost Allocation	Ratably over Service **Average remaining service period 17.2869 years**	Ratably over Service or Salary (level $ or level % of pay) **Level $ over 15 years**
Conceptual Basis	Comparability	Funding
Attribution	Date of Hire to Full Eligibility Date	Date of Hire to Expected Retirement Date
Basis for Cost Determination	Substantive Plan	Same
Actuarial Assumptions	Explicit	Same
Amortization:		
Method	Principal Only	Principal and Interest
Transition Obligation/Asset	Straight-Line Basis over Average Remaining Service Period of Active Plan Participants, or a 20-Year Period if less than 20 years **N/A**	10 – 30 Years **N/A**

Assumption	SFAS No. 106	GASB No. 45
Prior Service Cost	Straight-Line Basis over Average Remaining Years of Service to Full Eligibility Date of Active Plan Participants **Individually based on date Plan Amendment established**	10 – 30 Years **15 years**
Gain/Loss	Straight-Line Basis over Average Remaining Service Period of Active Plan Participants **17.2869 years**	10 – 30 Years **15 years**
Gain/Loss Corridor	10% of Greater of Accumulated Postretirement Benefit Obligation or Market-Related Value of Plan Assets	None
Bases	Must Keep Track and Maintain Amortization Bases **Individually based on date Plan Amendment established**	Must Keep Track and Maintain Amortization Bases, or Fresh Start **Open amortization – i.e. Fresh Start**
Asset Valuation Method	Market-Related Value of Assets	Same
Actuarial Valuation Frequency	Not Specifically Mentioned in the Statement, but Most Frequently Annual	Biennially for Entities with more than 200 Plan Members, Triennially otherwise
Discount Rate	Set Based on Effective Yield of High-Quality Bonds that Match Expected Plan Benefit Disbursements **6.0%**	Long-Term Expected Yield on Investments to be used to Pay Plan Benefits **5.5%**

Assumption	SFAS No. 106	GASB No. 45
Measurement Date	Date of the Financial Statements (Post-SFAS No. 158) **01/01/2007**	Date not more than 24 Months Prior to the Date of the Financial Statements **01/01/2007**
Expense	Net Periodic Benefit Cost **$2,039,466**	Annual OPEB Cost, or Annual Required Contribution if Funded (i.e. no Net Other Postemployment Benefit Obligation) **$2,127,383** **Note difference of only $87,917 for 2007**
Balance Sheet	(Accrued)/Prepaid Benefit Cost **($7,182,050)**	Net Other Postemployment Benefit Obligation (Basically the Cumulative Difference Between the Annual Required Contribution (ARC) and the Amount Actually Funded) **($8,115,729)** **Note difference of $933,679 relates to transition liability and cumulative beginning difference**
Retiree Drug Subsidy (RDS)	Reflect Anticipated Cost Savings through Lower Net Per Capita Costs **RDS already in rates**	No Anticipated Cost Savings in Valuation. Treatment of RDS is Covered as Voluntary Exchange Transaction if Paid to Employer (Statement 33) or On-behalf Payments of Fringe Benefits (Statement 24) if Paid to Plan. **RDS already in rates**

ATTACHMENT F

Accounting, auditing & SEC developments
National Professional Services Group

PRICEWATERHOUSECOOPERS

Issue Date: 08/02/2004
Document Title: GASB Statement 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions

Governmental Accounting Standards Series

Statement No. 45 of the
Governmental Accounting Standards Board

Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions

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June 2004

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Summary

In addition to pensions, many state and local governmental employers provide *other postemployment*

benefits (OPEB) as part of the total compensation offered to attract and retain the services of qualified employees. OPEB includes *postemployment healthcare,* as well as other forms of postemployment benefits (for example, life insurance) when provided separately from a pension plan. This Statement establishes standards for the measurement, recognition, and display of OPEB expense/expenditures and related liabilities (assets), note disclosures, and, if applicable, required supplementary information (RSI) in the financial reports of state and local governmental employers.

The approach followed in this Statement generally is consistent with the approach adopted in Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers,* with modifications to reflect differences between pension benefits and OPEB. Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans,* addresses financial statement and disclosure requirements for reporting by administrators or trustees of OPEB plan assets or by employers or sponsors that include OPEB plan assets as trust or agency funds in their financial reports.

How This Statement Improves Financial Reporting

Postemployment benefits (OPEB as well as pensions) are part of an exchange of salaries and benefits for employee services rendered. Of the total benefits offered by employers to attract and retain qualified employees, some benefits, including salaries and active-employee healthcare, are taken while the employees are in active service, whereas other benefits, including postemployment healthcare and other OPEB, are taken after the employees' services have ended. Nevertheless, both types of benefits constitute compensation for employee services.

From an accrual accounting perspective, the cost of OPEB, like the cost of pension benefits, generally should be associated with the periods in which the exchange occurs, rather than with the periods (often many years later) when benefits are paid or provided. However, in current practice, most OPEB plans are financed on a pay-as-you-go basis, and financial statements generally do not report the financial effects of OPEB until the promised benefits are paid. As a result, current financial reporting generally fails to:

- Recognize the *cost* of benefits in periods when the related services are received by the employer
- Provide information about the *actuarial accrued liabilities* for promised benefits associated with past services and whether and to what extent those benefits have been funded
- Provide information useful in assessing potential demands on the employer's future cash flows.

This Statement improves the relevance and usefulness of financial reporting by (a) requiring systematic, accrual-basis measurement and recognition of OPEB cost (expense) over a period that approximates employees' years of service and (b) providing information about actuarial accrued liabilities associated with OPEB and whether and to what extent progress is being made in funding the plan.

Summary of Standards

Measurement (the Parameters)

Employers that participate in *single-employer* or *agent multiple-employer defined benefit* OPEB plans (sole and agent employers) are required to measure and disclose an amount for annual OPEB cost on the accrual basis of accounting. Annual OPEB cost is equal to the employer's annual required contribution to the plan (ARC), with certain adjustments if the employer has a net OPEB obligation for past under- or overcontributions.

The ARC is defined as the employer's required contributions for the year, calculated in accordance with certain parameters, and includes (a) the normal cost for the year and (b) a component for amortization of the total unfunded actuarial accrued liabilities (or funding excess) of the plan over a period not to exceed thirty years. The parameters include requirements for the frequency and timing of actuarial valuations as well as for the actuarial methods and assumptions that are acceptable for financial reporting. If the methods and assumptions used in determining a plan's funding requirements meet the parameters, the same methods and assumptions are required for financial reporting by both a plan and its participating employer(s). However, if a plan's method of financing does not meet the parameters (for example, the plan is financed on a pay-as-you-go basis), the parameters nevertheless apply for financial reporting purposes.

For financial reporting purposes, an actuarial valuation is required at least biennially for OPEB plans with a total membership (including employees in active service, terminated employees who have accumulated benefits but are not yet receiving them, and retired employees and beneficiaries currently receiving benefits) of 200 or more, or at least triennially for plans with a total membership of fewer than 200. The projection of benefits should include all benefits covered by the current *substantive plan* (the plan as understood by the employer and plan members) at the time of each valuation and should take into consideration the pattern of sharing of benefit costs between the employer and plan members to that point, as well as certain legal or contractual caps on benefits to be provided. The parameters require that the selection of actuarial assumptions, including the *healthcare cost trend rate* for postemployment healthcare plans, be guided by applicable actuarial standards.

Alternative Measurement Method

A sole employer in a plan with fewer than one hundred total plan members (including employees in active service, terminated employees who have accumulated benefits but are not yet receiving them, and retirees and beneficiaries currently receiving benefits) has the option to apply a simplified *alternative measurement method* instead of obtaining actuarial valuations. The option also is available to an agent employer with fewer than one hundred plan members, in circumstances in which the *employer's* use of the alternative measurement method would not conflict with a requirement that the *agent multiple-employer plan* obtain an actuarial valuation for plan reporting purposes. Those circumstances are:

- The plan issues a financial report prepared in conformity with the requirements of Statement 43 but is not required to obtain an actuarial valuation because (a) the plan has fewer than one hundred total plan members (all employers) and is eligible to use the alternative measurement method, or (b) the plan is not administered as a qualifying trust, or equivalent arrangement, for which Statement 43 requires the presentation of actuarial information.

- The plan does not issue a financial report prepared in conformity with the requirements of Statement 43.

This alternative method includes the same broad measurement steps as an actuarial valuation (projecting future cash outlays for benefits, discounting projected benefits to present value, and allocating the present value of benefits to periods using an actuarial cost method). However, it permits simplification of certain assumptions to make the method potentially usable by nonspecialists.

Net OPEB Obligation—Measurement

An employer's net OPEB obligation is defined as the cumulative difference between annual OPEB cost and the employer's contributions to a plan, including the OPEB liability or asset at transition, if any. (Because retroactive application of the measurement requirements of this Statement is not required, for most employers the OPEB liability at the beginning of the transition year will be zero.) An employer with a net OPEB obligation is required to measure annual OPEB cost equal to (a) the ARC, (b) one year's interest on the net OPEB obligation, and (c) an adjustment to the ARC to offset the effect of actuarial amortization of past under- or overcontributions.

Financial Statement Recognition and Disclosure

Sole and agent employers should recognize OPEB expense in an amount equal to annual OPEB cost in government-wide financial statements and in the financial statements of proprietary funds and fiduciary funds from which OPEB contributions are made. OPEB expenditures should be recognized on a modified accrual basis in governmental fund financial statements. Net OPEB obligations, if any, including amounts associated with under- or overcontributions from governmental funds, should be displayed as liabilities (or assets) in government-wide financial statements. Similarly, net OPEB obligations associated with proprietary or fiduciary funds from which contributions are made should be displayed as liabilities (or assets) in the financial statements of those funds.

Employers are required to disclose descriptive information about each defined benefit OPEB plan in which they participate, including the funding policy followed. In addition, sole and agent employers are required to disclose information about contributions made in comparison to annual OPEB cost, changes in the net OPEB obligation, the funded status of each plan as of the most recent actuarial valuation date, and the nature of the actuarial valuation process and significant methods and assumptions used. Sole and agent employers also are required to present *as RSI* a schedule of funding

progress for the most recent valuation and the two preceding valuations, accompanied by notes regarding factors that significantly affect the identification of trends in the amounts reported.

Cost-Sharing Employers

Employers participating in *cost-sharing multiple-employer* plans that are administered as trusts, or equivalent arrangements, in which (a) employer contributions to the plan are irrevocable, (b) plan assets are dedicated to providing benefits to retirees and their beneficiaries in accordance with the terms of the plan, and (c) plan assets are legally protected from creditors of the employers or plan administrator, should report as cost-sharing employers. Employers participating in multiple-employer plans that do not meet those criteria instead are required to apply the requirements of this Statement that are applicable to agent employers.

Cost-sharing employers are required to recognize OPEB expense/expenditures for their *contractually required contributions* to the plan on the accrual or modified accrual basis, as applicable. Required disclosures include identification of the way that the contractually required contribution rate is determined (for example, by statute or contract or on an actuarially determined basis). Employers participating in a cost-sharing plan are required to present as RSI schedules of funding progress and employer contributions for the plan as a whole if a plan financial report, prepared in accordance with Statement 43, is not issued and made publicly available and the plan is not included in the financial report of a public employee retirement system or another entity.

Other Guidance

Employers that participate in *defined contribution* OPEB plans are required to recognize OPEB expense/expenditures for their required contributions to the plan and a liability for unpaid required contributions on the accrual or modified accrual basis, as applicable.

This Statement also includes guidance for employers that finance OPEB as insured benefits (as defined by this Statement) and for special funding situations.

Effective Dates and Transition

This Statement generally provides for prospective implementation—that is, that employers set the beginning net OPEB obligation at zero as of the beginning of the initial year. Implementation is required in three phases based on a government's total annual revenues in the first fiscal year ending after June 15, 1999. The definitions and cutoff points for that purpose are the same as those in Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments.* This Statement is effective for periods beginning after December 15, 2006, for *phase 1 governments* (those with total annual revenues of $100 million or more); after December 15, 2007, for *phase 2 governments* (those with total annual revenues of $10 million or more but less than $100 million); and after December 15, 2008, for *phase 3 governments* (those with total annual revenues of less than $10 million).

Earlier implementation is encouraged.

Unless otherwise specified, pronouncements of the GASB apply to financial reports of all state and local governmental entities, including general purpose governments; public benefit corporations and authorities; public employee retirement systems; and public utilities, hospitals and other healthcare providers, and colleges and universities. Paragraphs 4 and 6 discuss the applicability of this Statement.

Statement No. 45 of the Governmental Accounting Standards Board

Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions

June 2004

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Statement No. 45 of the Governmental Accounting Standards Board

Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions

June 2004

INTRODUCTION

1. The objective of this Statement is to improve the faithfulness of representations and usefulness of information included in the financial reports of state and local governmental employers regarding **other postemployment benefits**[1] (OPEB). *OPEB* refers to **postemployment** benefits other than **pension benefits** and includes (a) **postemployment healthcare benefits** and (b) other types of postemployment benefits (for example, life insurance) if provided separately from a pension plan. Like pensions, OPEB arises from an exchange of salaries and benefits for employee services rendered and constitutes part of the compensation for those services. However, current financial reporting practices for OPEB generally are based on **pay-as-you-go** financing approaches. They generally fail to measure or recognize the cost of OPEB during the periods when employees render the services or to provide relevant information about OPEB obligations and the extent to which progress is being made in funding those obligations. This Statement addresses those issues.

2. The approach adopted in this Statement generally is consistent with the approach taken in Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers.* However, certain requirements of this Statement differ from the requirements of Statement 27 to reflect differences between pension benefits and OPEB.

3. Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans,* establishes standards for reporting of OPEB plans—including reporting of the **plan assets** and liabilities and, where applicable, the net assets and the changes in plan net assets, held in trust or as an agent for OPEB—and for disclosure of information about the funded status and funding progress of the plan and about employer contributions to the plan. The effective dates and many of the measurement and disclosure requirements of Statement 43 and this Statement are closely related, and certain provisions of this Statement refer to Statement 43. The two Statements include provisions to coordinate disclosures to avoid duplication when a government that participates in an OPEB plan also reports the plan as a fiduciary fund or component unit, or when a separately issued plan report, prepared in accordance with the requirements of Statement 43, is publicly available.

STANDARDS OF GOVERNMENTAL ACCOUNTING AND FINANCIAL REPORTING

Scope and Applicability of This Statement

4. This Statement establishes standards of accounting and financial reporting for **OPEB expense/expenditures** and related **OPEB liabilities** or **OPEB assets,** note disclosures, and **required supplementary information (RSI)** in the financial reports of state and local governmental employers. Accounting and financial reporting for trust and agency funds of the employer are addressed in Statement

43.

5. The requirements of this Statement address employer reporting for participation in **defined benefit OPEB plans** and in **defined contribution plans** that provide postemployment benefits other than pensions. Defined benefit OPEB plans are plans having terms that specify the *benefits* to be provided at or after separation from employment. The benefits may be specified in dollars (for example, a flat dollar payment or an amount based on one or more factors such as age, years of service, and compensation), or as a type or level of coverage (for example, prescription drugs or a percentage of healthcare insurance premiums). In contrast, a defined contribution plan is a plan having terms that (a) provide an individual account for each plan member and (b) specify *how contributions to an active plan member's account are to be determined,* rather than the income or other benefits the member or his or her beneficiaries are to receive at or after separation from employment. In a defined contribution plan, those benefits will depend *only* on the amounts contributed to the member's account, earnings on investments of those contributions, and forfeitures of contributions made for other members that may be allocated to the member's account. For example, an employer may contribute a specified amount to each active member's postemployment healthcare account each month. At or after separation from employment, the balance of the account may be used by the member or on the member's behalf for the purchase of health insurance or other healthcare benefits.

6. The requirements of this Statement apply to the financial statements of all state and local governmental employers that provide postemployment benefits other than pension benefits. The requirements apply whether the employer's financial statements are presented in separately issued (**stand-alone**) financial reports or are included in the financial reports of another governmental entity.

7. OPEB arises from an exchange of salaries and benefits for employee services, and it is part of the compensation that employers offer for services received. As used in this Statement, OPEB includes:

a. Postemployment healthcare benefits—including medical, dental, vision, hearing, and other health-related benefits—whether provided separately or provided through a **defined benefit pension plan**

b. Other forms of postemployment benefits—for example, life insurance, disability, long-term care, and other benefits—when provided separately from a defined benefit pension plan.

8. Inducements offered by employers to employees to hasten the *termination of services,* or payments made in consequence of the early termination of services (collectively referred to as ***termination offers and benefits***), are different in nature from compensation for services. Accordingly, termination offers and benefits—including **special termination benefits** as defined in National Council on Governmental Accounting (NCGA) Interpretation 8, *Certain Pension Matters,* early-retirement incentive programs, and other termination-related benefits—are distinguished from OPEB and are excluded from the scope of this Statement, regardless of who provides or administers them. However, the effects, if any, of an employee's acceptance of a special termination offer on OPEB obligations incurred *through an existing defined benefit plan* (for example, an increase in the employer's obligation to provide postemployment healthcare benefits) should be accounted for in accordance with the requirements of this Statement and Statement 43, rather than the requirements of NCGA Interpretation 8.

9. Conversion of a terminating employee's unused sick leave credits to an *individual account* to be used for payment of postemployment benefits on that person's behalf is a *termination payment,* as the term is used in Statement No. 16, *Accounting for Compensated Absences.* The portion of sick leave expected to be compensated in that manner should be accounted for as a compensated absence in accordance with the requirements of that Statement. However, when a terminating employee's unused sick leave credits are converted to provide or to enhance a *defined benefit OPEB* (for example, postemployment healthcare benefits), the resulting benefit or increase in benefit should be accounted for in accordance with the requirements of this Statement and Statement 43.

10. This Statement supersedes or amends all previous authoritative guidance on accounting and

financial reporting for an employer's OPEB expense/expenditures and related information. It supersedes GASB Statement No. 12, *Disclosure of Information on Postemployment Benefits Other Than Pension Benefits by State and Local Governmental Employers,* and paragraph 24 of GASB Statement 27. It amends paragraph 5 of NCGA Interpretation 6, *Notes to the Financial Statements Disclosure;* paragraph 2 of GASB Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues;* footnotes 6 and 7 of GASB Statement 16; paragraphs 6, 7, and 39 of GASB Statement 27; and paragraph 7 of GASB Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements.*

Employers with Defined Benefit OPEB Plans

Sole and Agent Employers

Measurement of Annual OPEB Cost and Net OPEB Obligation [2]

11. For employers with **single-employer** or **agent multiple-employer (agent) plans** (sole and agent employers), annual OPEB cost should be equal to the **annual required contributions of the employer (ARC)**[3] to the plan for that year, calculated in accordance with paragraphs 12 and 13 (the **parameters**), unless the employer has a net OPEB obligation[4] to the plan at the beginning of the year. The requirements for measuring annual OPEB cost when an employer has a net OPEB obligation are discussed in paragraphs 14 through 16. However, a sole or agent employer may elect to base its annual OPEB cost on the ARC calculated in accordance with the alternative measurement method discussed in paragraphs 33 through 35, if the employer meets either of the following criteria:

a. The employer is the sole employer in a plan with fewer than one hundred total **plan members**.

b. The employer is an agent employer with fewer than one hundred total plan members, and the *agent multiple-employer plan* in which the employer participates (1) is not required to obtain an actuarial valuation for the purpose of financial reporting in conformity with Statement 43[5] or (2) does not issue a financial report prepared in conformity with the requirements of that Statement.

For purposes of this Statement, a plan's total membership is the sum of its employees in active service, terminated employees who have accumulated benefits but are not yet receiving them, and retired employees and beneficiaries currently receiving benefits.

Calculation of the ARC (the parameters)

12. For financial reporting purposes, an **actuarial valuation** should be performed in accordance with this paragraph and paragraph 13 at the following minimum frequency:

a. For plans with a total membership of 200 or more—at least biennially

b. For plans with a total membership of fewer than 200—at least triennially.

The **actuarial valuation date** need not be the employer's balance sheet[6] date, but generally should be the same date each year (or other applicable interval). However, a new valuation should be performed if, since the previous valuation, significant changes have occurred that affect the results of the valuation, including significant changes in benefit provisions, the size or composition of the population covered by the plan, or other factors that impact long-term assumptions. The ARC reported for the employer's current fiscal year should be based on the results of the most recent actuarial valuation, performed in accordance with the parameters as of a date not more than twenty-four months before the beginning of that year, if valuations are annual, or not more than twenty-four months before the beginning of the *first year* of the two-year or three-year period for which that valuation provides the ARC, if valuations are biennial or triennial.

13. The ARC and all other actuarially determined OPEB information included in an employer's financial report should be calculated in accordance with this paragraph, consistently applied. The actuarial methods and assumptions applied for financial reporting should be the same methods and assumptions applied in determining the plan's funding requirements, unless compliance with this paragraph requires the use of different methods or assumptions. A plan and its participating employer(s) should apply the same actuarial methods and assumptions in determining similar or related information included in their respective financial reports.[7]

a. Benefits to be included:

(1) The **actuarial present value of total projected benefits** should include all benefits to be provided to plan members or beneficiaries in accordance with the current **substantive plan** (the plan terms as understood by the employer and plan members) at the time of each valuation, including any changes to plan terms that have been made and communicated to employees. Usually, the written plan is the best evidence of the terms of the exchange; however, in some cases the substantive plan may differ from the written plan. Accordingly, other information also should be taken into consideration in determining the benefits to be provided, including other communications between the employer and plan members and an established pattern of practice with regard to the sharing of benefit costs between the employer and plan members. Calculations should be made based on the types of benefits in force at the time of the valuation and the pattern of sharing of benefit costs between the employer and plan members to that point.

(2) When an employer provides benefits to both active employees and retirees through the same plan, the benefits to retirees should be segregated for actuarial measurement purposes, and the projection of future retiree benefits should be based on claims costs, or age-adjusted premiums approximating claims costs, for retirees, in accordance with actuarial standards issued by the Actuarial Standards Board.[8] However, when an employer participates in a community-rated plan, in which premium rates reflect the projected health claims experience of all participating employers rather than that of any single participating employer, and the insurer or provider organization charges the same unadjusted premiums for both active employees and retirees, it is appropriate to use the unadjusted premiums as the basis for projection of retiree benefits, to the extent permitted by actuarial standards.[9]

(3) A legal or contractual cap on the employer's share of the benefits to be provided to retirees and beneficiaries each period should be considered in projecting benefits to be provided by the employer(s) in future periods, if the cap is assumed to be effective taking into consideration the employer's record of enforcing the cap in the past and other relevant factors and circumstances.

(4) Benefits to be provided by means of **allocated insurance contracts** for which payments to an insurance company (a) have been made and (b) have irrevocably transferred to the insurer the responsibility for providing the benefits, should be excluded (and allocated insurance contracts should be excluded from plan assets).

b. **Actuarial assumptions**—The selection of all actuarial assumptions, including the **healthcare cost trend rate** in valuations of postemployment healthcare plans, should be guided by actuarial standards. Accordingly, actuarial assumptions should be based on the actual experience of the **covered group,** to the extent that credible experience data are available, but should emphasize expected long-term future trends rather than give undue weight to recent past experience. The reasonableness of each actuarial assumption should be considered independently based on its own merits, its consistency with each other assumption, and the combined impact of all assumptions.

c. Economic assumptions—In addition to complying with the guidance in subparagraph b of this paragraph, the **investment return assumption (discount rate)** should be the estimated long-term investment yield on the investments that are expected to be used to finance the payment of benefits, with consideration given to the nature and mix of current and expected investments and the basis used to determine the **actuarial value of assets** (subparagraph e). For this purpose, the investments expected to be used to finance the payment of benefits are (1) *plan assets* for plans for which the employer's funding policy is to contribute consistently an amount at least equal to the ARC, (2) *assets of the employer* for plans that have no plan assets, or (3) *a combination of the two* for plans that are being partially funded. The discount rate for a partially funded plan should be a blended rate that reflects the proportionate amounts of plan and employer assets expected to be used. The investment return assumption and other economic assumptions should include the same assumption with respect to inflation.

d. **Actuarial cost method**—One of the following actuarial cost methods should be used: **entry age, frozen entry age, attained age, frozen attained age, projected unit credit,**[10] or **aggregate,** as described in paragraph 41, Section B.

e. Actuarial value of assets—Plan assets should be valued using methods and techniques that are consistent with the class and anticipated holding period of the assets, the investment return assumption, other assumptions used in determining the actuarial present value of total projected benefits, and current actuarial standards for asset valuation.[11] Accordingly, the actuarial value of plan assets generally should be **market related.**

f. Annual required contributions of the employer (ARC)—The ARC should be actuarially determined in accordance with the parameters. The amount should include the employer's **normal cost** and a provision(s) for amortizing the total **unfunded actuarial accrued liability** (UAAL), or **unfunded actuarial liability** (UAL), in accordance with the following requirements:[12]

(1) Maximum amortization period—The maximum acceptable amortization period for the total unfunded actuarial liability is thirty years. The total unfunded actuarial liability may be amortized as one amount, or components of the total may be separately amortized. When components are amortized over different periods, the individual amortization periods should be selected so that the **equivalent single amortization period** for all components combined does not exceed the maximum acceptable period.

(2) Equivalent single amortization period—the equivalent single amortization period is the number of years incorporated in a weighted average amortization factor for all components of the total UAL combined and should be calculated as follows:

(a) Determine the amortization factor for each component of the total UAL using its associated amortization period and the discount rate selected in accordance with subparagraphs b and c of this paragraph.

(b) Calculate next year's amortization payment for each of the components by dividing each component by its associated amortization factor.

(c) Calculate the weighted average amortization factor by dividing the total UAL by the sum of next year's individual amortization payments.

(d) Calculate the equivalent single amortization period as the number of years incorporated in the weighted average amortization factor (from c) at the discount rate used in subparagraph f(2)(a) of this paragraph.

(3) Minimum amortization period—A significant decrease in the total unfunded actuarial liability generated by a change from one of the actuarial cost methods specified in subparagraph d of this paragraph to another of those methods, or by a change in the method(s) used to determine the actuarial value of assets (for example, a change from a method that spreads increases or decreases in market value over five years to a method that uses current market value), should be amortized over a period of not less than ten years. The

minimum amortization period is not required when a plan is closed to new entrants and all or almost all of the plan members have retired.

(4) Amortization method—The provision(s) for amortizing the total unfunded actuarial liability may be determined in **level dollar** amounts or as a **level percentage of projected payroll** of active plan members. If the level percentage of projected payroll method is used, the assumed **payroll growth rate** should not include an assumed increase in the number of active plan members; however, projected decreases in that number should be included if no new members are permitted to enter the plan (for example, a plan that covers only employees hired before a certain date).

g. **Contribution deficiencies** or **excess contributions** of the employer—A contribution deficiency or excess contribution is the difference between the ARC for a given year and the **employer's contributions**[13] in relation to the ARC. For the purposes of this Statement, an employer has made a contribution in relation to the ARC if the employer has (1) made payments of benefits directly to or on behalf of a retiree or beneficiary, (2) made premium payments to an insurer, or (3) irrevocably transferred assets to a trust, or equivalent arrangement, in which plan assets are dedicated to providing benefits to retirees and their beneficiaries in accordance with the terms of the plan and are legally protected from creditors of the employer(s) or plan administrator. Earmarking of employer assets or other means of financing that do not meet the conditions in the preceding sentence do not constitute contributions in relation to the ARC, and the assets earmarked or otherwise accumulated should be considered employer assets for the purposes of this Statement. Amortization of a contribution deficiency or excess contribution should begin at the next actuarial valuation, unless settlement is expected not more than one year after the deficiency or excess occurred. If settlement has not occurred by the end of that term, amortization should begin at the next actuarial valuation.

Calculation of interest on the net OPEB obligation and the adjustment to the ARC

14. The employer's net OPEB obligation comprises (a) the OPEB liability (asset) at transition, if any, determined in accordance with paragraph 37, and (b) the cumulative difference since the effective date of this Statement between annual OPEB cost and the employer's contributions, *excluding* (1) short-term differences and (2) unpaid contributions that have been converted to OPEB-related debt. A short-term difference is one that the employer intends to settle by the first actuarial valuation date after the difference occurred or, if the first valuation is scheduled within a year, not more than one year after the difference occurred. If the amount remains unsettled at the end of that term, the employer should include the entire unsettled difference in the net OPEB obligation. (An amount for actuarial amortization of the difference should be included in the next and subsequent ARCs, as required by paragraph 13g.) As discussed in footnote 3, an OPEB-related debt is any long-term liability of an employer to an OPEB plan that is not included in the ARC.[14]

15. When an employer has a net OPEB obligation, annual OPEB cost should be equal to the ARC, one year's interest on the net OPEB obligation, and an adjustment to the ARC. The interest should be calculated on the balance of the net OPEB obligation at the beginning of the year, using the investment return rate assumed in determining the ARC for that year (paragraph 13c). Because this calculation of interest is independent of the actuarial calculation, the ARC should be adjusted to offset the amount of interest (and principal, if any) already included in the ARC for amortization of past contribution deficiencies or excess contributions of the employer. That portion of the ARC is not precisely determinable but can be reasonably approximated based on the net OPEB obligation, as discussed in paragraph 16.

16. The adjustment to the ARC should be equal to the discounted present value (ordinary annuity) of the balance of the net OPEB obligation at the beginning of the year, calculated using the *same* amortization methodology used in determining the ARC *for that year.* (The adjustment applies only for that year; a new calculation should be made each year.) That is, the adjustment should be calculated using the same (a) amortization method (level dollar or level percentage of projected payroll), (b) actuarial assumptions used in applying the amortization method, and (c) amortization period that were used in determining the ARC for that year.[15] The adjustment should be *deducted* from the ARC if the beginning balance of the net

OPEB obligation is positive (cumulative annual OPEB cost is greater than cumulative employer contributions), or *added* to the ARC if the net OPEB obligation is negative.

Recognition of OPEB Expense/Expenditures, Liabilities, and Assets

17. When an employer contributes to more than one OPEB plan, all recognition requirements should be applied separately for each plan.[16] (Separate display in the financial statements is not required, except as indicated in subsequent paragraphs.) OPEB expense/expenditures include either or both of the following: (a) contributions in relation to the ARC and (b) accrual or payments of OPEB-related debt (which is not included in the ARC or the net OPEB obligation). Liabilities for OPEB-related debt should be adjusted consistent with the recognition of related expense/expenditures. ARC-related liabilities (assets) should be adjusted to equal the year-end balance of the net OPEB obligation, as discussed in paragraphs 20 and 21.

18. When an employer makes ARC-related contributions to the same plan from more than one fund, the employer should determine what portion of the ARC applies to each fund. When the employer has a net OPEB obligation and the related liability (asset) is allocated to more than one fund, between fund(s) and general long-term liabilities, or between governmental and business-type activities in the government-wide statement of net assets, the employer should allocate the interest and ARC adjustment components of annual OPEB cost to each liability (asset), based on its proportionate share of the beginning balance of the net OPEB obligation.

Recognition in governmental fund financial statements

19. OPEB expenditures from governmental funds should be recognized on the modified accrual basis. The amount recognized should be equal to the amount contributed to the plan or expected to be liquidated with expendable available financial resources. The recognition of expenditures in relation to the ARC also should be consistent with the criteria for contributions in relation to the ARC stated in paragraph 13g.

Recognition in proprietary and fiduciary fund financial statements

20. OPEB expense of proprietary and fiduciary funds should be recognized on the accrual basis in fund financial statements. The employer should report OPEB expense for the year in relation to the ARC equal to annual OPEB cost. The net OPEB obligation should be adjusted for any difference between OPEB expense in relation to the ARC and contributions made in relation to the ARC (including short-term differences incurred), based on the criteria for contributions stated in paragraph 13g. A positive (negative) year-end balance in the net OPEB obligation should be recognized as the year-end liability (asset) in relation to the ARC. OPEB expense arising from the incurrence of OPEB-related debt should be recognized in full in the year the debt is incurred.[17] Year-end balances of short-term differences or OPEB-related debt should be recognized as liabilities separate from the net OPEB obligation. OPEB liabilities and assets to different plans should not be offset in the financial statements.

Recognition in government-wide financial statements

21. OPEB expense reported in government-wide financial statements should be recognized on the accrual basis. The employer should report OPEB expense for the year in relation to the ARC equal to annual OPEB cost. The net OPEB obligation should be adjusted for any difference between OPEB expense in relation to the ARC and contributions made in relation to the ARC (including short-term differences incurred). A positive (negative) year-end balance in the net OPEB obligation should be recognized as the year-end liability (asset) in relation to the ARC. OPEB expense arising from the incurrence of OPEB-related debt should be recognized in full in the year the debt is incurred.[18] Year-end balances of short-term differences or OPEB-related debt should be recognized as liabilities separate from the net OPEB obligation. OPEB liabilities and assets to different plans should not be offset in the financial statements.

Cost-Sharing Employers

22. Employers that participate in **cost-sharing multiple-employer plans** (cost-sharing employers) should apply the following accounting and financial reporting requirements of this Statement:

a. Employers should apply the requirements of this Statement applicable to *cost-sharing employers* if the plan is administered as a formal trust, or equivalent arrangement, in which all of the following conditions are met:

(1) Employer contributions to the plan are irrevocable.

(2) Plan assets are dedicated to providing benefits to retirees and their beneficiaries in accordance with the terms of the plan.

(3) Plan assets are legally protected from creditors of the employer(s) or plan administrator.

b. If any multiple-employer plan is not administered as a formal trust, or equivalent arrangement, in which all of the preceding conditions are met, that plan should be classified as an *agent multiple-employer plan* for financial reporting purposes, and employers should apply the requirements of this Statement applicable to *agent employers.*

23. Cost-sharing employers in plans that meet the conditions of paragraph 22a should recognize annual OPEB expense/expenditures for their contractually required contributions to the plan in fund financial statements on the accrual basis or on the modified accrual basis, whichever applies for the fund(s) used to report the employer's contributions. Modified accrual recognition should be in accordance with the criteria stated in the second sentence of paragraph 19. Recognition of expense in government-wide financial statements should be on the accrual basis. OPEB liabilities and assets result from the difference between contributions required and contributions made. OPEB liabilities and assets to different plans should not be offset in the financial statements.

Notes to the Financial Statements

24. Employers should include the following information in the notes to their financial statements[19] for each defined benefit OPEB plan in which they participate, regardless of the type of plan (except as indicated). Disclosures for more than one plan should be combined in a manner that avoids unnecessary duplication.

a. Plan description.

(1) Name of the plan, identification of the **public employee retirement system (PERS)** or other entity that administers the plan, and identification of the plan as a single-employer, agent multiple-employer, or cost-sharing multiple-employer defined benefit OPEB plan.

(2) Brief description of the types of benefits and the authority under which benefit provisions are established or may be amended.

(3) Whether the OPEB plan issues a stand-alone financial report or is included in the report of a PERS or another entity, and, if so, how to obtain the report.

b. **Funding policy.**

(1) Authority under which the obligations of the plan members, employer(s), and other contributing entities (for example, state contributions to local government plans) to contribute to the plan are established or may be amended.

(2) Required contribution rate(s) of plan members. The required contribution rate(s) could be

expressed as a rate (amount) per member or as a percentage of covered payroll.

(3) Required contribution rate(s) of the employer in accordance with the funding policy, in dollars or as a percentage of current-year covered payroll, and, if applicable, legal or contractual maximum contribution rates. If the plan is a single-employer or agent plan and the rate differs significantly from the ARC, disclose how the rate is determined (for example, by statute or by contract) or that the plan is financed on a pay-as-you-go basis. If the plan is a cost-sharing plan, disclose the required contributions in dollars and the percentage of that amount contributed for the current year and each of the two preceding years, and how the required contribution rate is determined (for example, by statute or by contract, or on an actuarially determined basis) or that the plan is financed on a pay-as-you-go basis.

25. Sole and agent employers should disclose the following information for each plan, in addition to the information required by paragraph 24:

a. For the current year, annual OPEB cost and the dollar amount of contributions made. If the employer has a net OPEB obligation, also disclose the components of annual OPEB cost (ARC, interest on the net OPEB obligation, and adjustment to the ARC), the increase or decrease in the net OPEB obligation, and the net OPEB obligation at the end of the year.

b. For the current year and each of the two preceding years, annual OPEB cost, percentage of annual OPEB cost contributed that year, and net OPEB obligation at the end of the year. (For the first two years, the required information should be presented for the **transition year,** and for the current and transition years, respectively.)

c. Information about the funded status of the plan as of the most recent valuation date, including the actuarial valuation date, the actuarial value of assets, the actuarial accrued liability, the total unfunded actuarial liability (or funding excess), the actuarial value of assets as a percentage of the actuarial accrued liability (**funded ratio**), the annual covered payroll, and the ratio of the unfunded actuarial liability (or funding excess) to annual covered payroll.[20] The information should be calculated in accordance with the parameters. However, employers that meet the criteria in paragraph 11 may elect to use the alternative measurement method discussed in paragraphs 33 through 35. Employers that use the aggregate actuarial cost method should prepare this information using the entry age actuarial cost method for that purpose only. [21]

d. Disclosure of information about actuarial methods and assumptions used in valuations on which reported information about the ARC, annual OPEB cost, and the funded status and funding progress of OPEB plans is based, including the following:

(1) Disclosure that actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future, and that actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future.

(2) Disclosure that the required schedule of funding progress immediately following the notes to the financial statements presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

(3) Disclosure that calculations are based on the types of benefits provided under the terms of the substantive plan at the time of each valuation and on the pattern of sharing of costs between the employer and plan members to that point. In addition, if applicable, the employer should disclose that the projection of benefits for financial reporting purposes *does not* explicitly incorporate the potential effects of legal or contractual funding limitations (as discussed in the disclosure of funding policy in paragraph 24b(3)) on the pattern of cost sharing between the

employer and plan members in the future.[22]

(4) Disclosure that actuarial calculations reflect a long-term perspective. In addition, if applicable, disclosure that, consistent with that perspective, actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets.

(5) Identification of the actuarial methods and significant assumptions used to determine the ARC for the current year and the information required by paragraph 25c. The disclosures should include:

(a) The actuarial cost method.

(b) The method(s) used to determine the actuarial value of assets.

(c) The assumptions with respect to the inflation rate, investment return (including the method used to determine a blended rate for a partially funded plan, if applicable), **postretirement benefit increases** if applicable, **projected salary increases** if relevant to determination of the level of benefits, and, for postemployment healthcare plans, the healthcare cost trend rate. If the economic assumptions contemplate different rates for successive years (**year-based** or **select and ultimate rates**), the rates that should be disclosed are the initial and **ultimate rates.**

(d) The amortization method (level dollar or level percentage of projected payroll) and the amortization period (equivalent single amortization period, for plans that use multiple periods) for the most recent actuarial valuation and whether the period is **closed** or **open.** Employers that use the aggregate actuarial cost method should disclose that because the method does not identify or separately amortize unfunded actuarial liabilities, information about funded status and funding progress has been prepared using the entry age actuarial cost method for that purpose, and that the information presented is intended to approximate the funding progress of the plan.

Required Supplementary Information

26. Sole and agent employers should present the following information for the most recent actuarial valuation and the two preceding valuations:[23]

a. Information about the funding progress of the plan, including, for each valuation, each of the elements of information listed in paragraph 25c

b. Factors that significantly affect the identification of trends in the amounts reported, including, for example, changes in benefit provisions, the size or composition of the population covered by the plan, or the actuarial methods and assumptions used. (The amounts reported for prior years should not be restated.)

The information should be calculated in accordance with the parameters and should be presented as RSI. Employers that use the aggregate actuarial cost method should prepare the information using the entry age actuarial cost method and should disclose that fact and that the purpose of this disclosure is to provide information that *approximates* the funding progress of the plan.[24]

27. If the cost-sharing plan in which an employer participates does not issue and make publicly available a stand-alone plan financial report prepared in accordance with the requirements of Statement 43, and the plan is not included in the financial report of a PERS or another entity, the cost-sharing employer should present as RSI in its own financial report schedules of funding progress and employer contributions for the plan (and notes to these schedules), prepared in accordance with the requirements of Statement 43. The employer should disclose that the information presented relates to the cost-sharing plan as a whole, of

which the employer is one participating employer, and should provide information helpful for understanding the scale of the information presented relative to the employer.

Insured Benefits

28. For purposes of this Statement, an **insured benefit** is an OPEB financing arrangement whereby an employer pays premiums to an insurance company *while employees are in active service,* in return for which the insurance company unconditionally undertakes an obligation to pay the postemployment benefits of those employees or their beneficiaries, as defined in the employer's plan. If an employer's OPEB financing arrangement with the insurance company does not meet these criteria, the benefit is not an insured benefit for financial reporting purposes, and the employer should comply with all requirements of this Statement for sole and agent employers. Employers with insured benefits should recognize OPEB expense (in proprietary and fiduciary fund financial statements and in the government-wide statement of activities) or expenditures (in governmental fund financial statements) equal to the annual contributions or premiums required in accordance with their agreement with the insurance company and should disclose the following information in the notes to the financial statements:

a. A brief description of the insured benefit, including the authority under which benefit provisions are established or may be amended.

b. The fact that the obligation for the payment of benefits has been effectively transferred from the employer to one or more insurance companies. Also disclose whether the employer has guaranteed benefits in the event of the insurance company's insolvency.

c. The current-year OPEB expense/expenditures and contributions or premiums paid.

Employers with Defined Contribution Plans

29. Employers with defined contribution plans should recognize annual OPEB expense (in proprietary and fiduciary fund financial statements and in the government-wide statement of activities) or expenditures (in governmental fund financial statements) equal to their required contributions, in accordance with the terms of the plan. Recognition in the fund financial statements should be on the accrual or modified accrual basis, whichever applies for the fund(s) used to report the employer's contributions. Recognition in government-wide financial statements should be on the accrual basis. An OPEB liability or asset results from the difference between contributions required and contributions made to a plan. OPEB liabilities and assets to different plans should not be offset in the financial statements.

30. An OPEB plan may have both defined benefit and defined contribution characteristics. If the plan provides a defined benefit in some form—that is, if the benefit to be provided is a function of factors other than the amounts contributed to an active member's account during employment and amounts earned on contributed assets—the employer should apply the requirements of this Statement for defined benefit plans.

31. Employers should include the following information in the notes to their financial statements for each defined contribution plan to which they are required to contribute:[25]

a. Name of the plan, identification of the PERS or other entity that administers the plan, and identification of the plan as a defined contribution plan

b. Brief description of the plan provisions and the authority under which they are established or may be amended

c. Contribution requirements (for example, the contribution rate in dollars or as a percentage of salary) of the plan members, employer, and other contributing entities (for example, state contributions to local government plans) and the authority under which the requirements are established or may be amended

d. The contributions actually made by plan members and the employer.

Special Funding Situations

32. Some governmental entities are legally responsible for contributions to OPEB plans that cover the employees of another governmental entity or entities. For example, a state government may be legally responsible for the annual "employer" contributions to an OPEB plan that covers employees of school districts within the state. In those cases, the entity that is legally responsible for the contributions should comply with all applicable provisions of this Statement for measurement and recognition of expense/expenditures, liabilities, assets, note disclosures, and RSI. If the plan is a defined benefit OPEB plan and the entity with legal responsibility for contributions is the only contributing entity, the requirements of this Statement for sole employers apply, regardless of the number of entities whose employees are covered by the plan.[26]

Alternative Measurement Method for Employers with Fewer Than One Hundred Plan Members

33. The parameters of paragraphs 12 and 13 concerning the measurement of the ARC and of the funded status of OPEB plans, including the requirements of paragraph 12 regarding the minimum frequency of actuarial valuations and the requirement of paragraph 13b that the selection of actuarial assumptions should be guided by actuarial standards, generally are applicable to all sole and agent employers. However, employers that meet the criteria in paragraph 11 may elect to apply certain simplifying modifications for the selection of actuarial assumptions, as stated in paragraph 34.

34. Employers that meet the eligibility test in paragraph 33 may elect either to apply the parameters of paragraphs 12 and 13 in their entirety or to apply the parameters with one or more of the following specific modifications. Employers that apply these modifications should disclose that they have used the *alternative measurement method* permitted by this Statement and should disclose in the notes to the financial statements the source or basis of all significant assumptions or methods selected in accordance with this paragraph, in addition to all other disclosure requirements of this Statement.

a. General considerations—The projection of benefits should include assumptions regarding all significant factors affecting the amount and timing of projected future benefit payments, including, where applicable, the factors listed below. Additional assumptions may be needed depending on the benefits being provided. Assumptions generally should be based on the actual experience of the covered group, to the extent that credible experience data are available, but should emphasize expected long-term future trends rather than give undue weight to recent past experience. However, grouping techniques that base the selection of assumptions on combined experience data for similar plans may be used, as discussed in subparagraph i of this paragraph. The reasonableness of each assumption should be considered independently based on its own merits and its consistency with each other assumption. For example, each assumption of which general inflation is a component should include the same assumption with regard to that component. In addition, consideration should be given to the reasonableness of the combined impact of all assumptions.

b. Expected point in time at which benefits will begin to be provided—The assumption should reflect past experience and future expectations for the covered group. The assumption may incorporate a single assumed retirement age for all active employees or an assumption that all active employees will retire upon attaining a certain number of years of service.

c. Marital and dependency status—The employer may base these assumptions on the current status of active and retired plan members or on historical demographic data for retirees in the covered group.

d. Mortality—The employer should base this assumption on current published mortality tables.

e. Turnover—The employer generally should base both the assumed probability that an active plan member will remain employed until the assumed retirement age and the expected future working lifetime of plan members, for purposes of allocating the present value of expected benefits to periods, on the historical age-based turnover experience of the covered group using the calculation method in paragraph 35a. However, if experience data are not available, the employer should assign the probability of remaining employed until the assumed retirement age using Table 1 in paragraph 35b, and should determine the expected future working lifetime of plan members using Table 2 in paragraph 35c.

f. Healthcare cost trend rate—The employer should derive select and ultimate assumptions about healthcare cost trends in future years for which benefits are projected from an objective source.

g. Use of health insurance premiums—An employer participating in an experience-rated healthcare plan that provides benefits through premium payments to an insurer or other service provider may use the plan's current premium structure as the initial per capita healthcare rates for the purpose of projecting future healthcare benefit payments. However, if the *same premium rates* are given for both active employees and retirees, and the plan is *not* a *community-rated plan,* as discussed in paragraph 13a(2), the employer should (1) obtain from the insurer age-adjusted premium rates for retirees or, if that information cannot be obtained from the insurer, (2) estimate age-adjusted premiums for retirees using the method provided in Tables 3 through 5 of paragraph 35d, as appropriate.

h. Plans with coverage options—When a postemployment benefit plan provides plan members more than one coverage option, the employer should base assumptions regarding members' coverage choices on the experience of the covered group, considering differences, if any, in the choices of pre- and post-Medicare-eligible members.

i. Use of grouping—The employer may use grouping techniques. One such technique is to group participants based on common demographic characteristics (for example, participants within a range of ages or years of service), where the obligation for each participant in the group is expected to be similar for commonly grouped individuals. Another technique is to group plans with similar expected costs and benefits.

35. This paragraph includes calculation methods and default values for use with the alternative measurement method in determining (a) the probability that active plan members will remain employed until retirement age, (b) the expected future working lifetime of plan members, and (c) age-adjusted premiums for retirees in certain situations.

a. Employers that use historical age-based turnover experience *of the covered group* when applying the alternative measurement method, as discussed in paragraph 34e, should use the following methodology to calculate the probability of remaining employed until retirement age and the expected future working lifetime of plan members:

	Probability of Termination in Next Year (a)	**Probability of Remaining Employed for Next Year (b)**	**Probability of Remaining Employed from Earliest Entry Age to Beginning of Year (c)**	**Probability of Remaining Employed from Age Shown to Assumed Retirement Age (d)**	**Expected Future Working Lifetime for Assumed Retirement Age (e)**
Age					

Column a: For each age (n) from the earliest entry age to assumed retirement age, list the age-based *probabilities of termination in the next year* for the covered group.

Column b: Compute the *probability at each age of remaining employed for the next year*. This value should be calculated as 1 – a.

Column c: Set the initial value in column c to equal 1.000. For each subsequent age (n), column c values should be calculated as: c(n – 1) × b(n – 1).

Column d: For each age (n), these values should be calculated as the product of the values in column b from age n to the year prior to the assumed retirement age.

Column e: These values should be calculated as the sum of c from age (n) to the year prior to the assumed retirement age, divided by the value of c at age (n). At the assumed retirement age, this value should be set to 0.

b. Employers that are *not* using historical age-based turnover experience *of the covered group* when applying the alternative measurement method, as discussed in paragraph 34e, should use the following table to determine the probability of remaining employed until the assumed retirement age:

Table 1—Probability of Remaining Employed until Assumed Retirement Age, by Age[27]—Default Values[28]

Age	Assumed Retirement Age					
	50 and over	49	48	47	46	45
20	0.296	0.300	0.304	0.309	0.314	0.319
21	0.321	0.326	0.330	0.335	0.340	0.346
22	0.349	0.354	0.359	0.364	0.370	0.376
23	0.379	0.384	0.389	0.395	0.401	0.408
24	0.410	0.416	0.421	0.428	0.434	0.441
25	0.440	0.446	0.453	0.460	0.467	0.474
26	0.472	0.478	0.485	0.493	0.500	0.508
27	0.503	0.510	0.517	0.525	0.533	0.542
28	0.534	0.541	0.549	0.558	0.566	0.575
29	0.564	0.572	0.580	0.589	0.598	0.607
30	0.593	0.602	0.610	0.620	0.629	0.639
31	0.622	0.631	0.640	0.650	0.660	0.670
32	0.650	0.659	0.669	0.679	0.689	0.700
33	0.677	0.687	0.696	0.707	0.718	0.730
34	0.703	0.713	0.723	0.734	0.745	0.758
35	0.729	0.739	0.749	0.761	0.772	0.785
36	0.753	0.764	0.775	0.787	0.799	0.812
37	0.777	0.788	0.799	0.811	0.824	0.837
38	0.799	0.811	0.822	0.835	0.847	0.861
39	0.821	0.832	0.844	0.857	0.870	0.884
40	0.841	0.853	0.865	0.878	0.891	0.906
41	0.860	0.873	0.885	0.899	0.912	0.927
42	0.879	0.891	0.904	0.918	0.932	0.947
43	0.896	0.909	0.922	0.936	0.950	0.965
44	0.912	0.925	0.938	0.953	0.967	0.983
45	0.928	0.941	0.955	0.969	0.984	1.000
46	0.943	0.957	0.970	0.985	1.000	1.000
47	0.958	0.971	0.985	1.000	1.000	1.000
48	0.972	0.986	1.000	1.000	1.000	1.000
49	0.986	1.000	1.000	1.000	1.000	1.000
50+	For ages 50+, the probability of remaining employed until retirement age is 1.000.					

c. Employers that are *not* using historical age-based turnover experience *of the covered group* when applying the alternative measurement method, as discussed in paragraph 34e, should use the following table to determine the expected future working lifetime of plan members:

Table 2—Expected Future Working Lifetimes of Employees, by Age[29] —Default Values[30]

Age	Assumed Retirement Age														
	75	**74**	**73**	**72**	**71**	**70**	**69**	**68**	**67**	**66**	**65**	**64**	**63**	**62**	**61**
20	22	22	21	21	21	21	20	20	20	19	19	19	19	18	18
21	23	23	22	22	22	21	21	21	20	20	20	19	19	19	18
22	24	23	23	23	22	22	22	21	21	21	20	20	20	19	19
23	25	24	24	24	23	23	22	22	22	21	21	21	20	20	19
24	26	25	25	24	24	24	23	23	22	22	22	21	21	20	20
25	26	26	26	25	25	24	24	23	23	23	22	22	21	21	20
26	27	27	26	26	25	25	24	24	24	23	23	22	22	21	21
27	28	28	27	27	26	26	25	25	24	24	23	23	22	21	21
28	29	28	28	27	27	26	25	25	24	24	23	23	22	22	21
29	29	29	28	28	27	26	26	25	25	24	24	23	22	22	21
30	30	29	29	28	27	27	26	26	25	24	24	23	23	22	21
31	30	30	29	28	28	27	26	26	25	25	24	23	23	22	21
32	30	30	29	28	28	27	27	26	25	25	24	23	23	22	21
33	31	30	29	29	28	27	27	26	25	25	24	23	23	22	21
34	31	30	29	29	28	27	27	26	25	24	24	23	22	22	21
35	31	30	29	29	28	27	27	26	25	24	24	23	22	21	21
36	31	30	29	29	28	27	26	26	25	24	23	23	22	21	20
37	31	30	29	28	28	27	26	25	25	24	23	22	22	21	20
38	31	30	29	28	27	27	26	25	24	23	23	22	21	20	19
39	30	30	29	28	27	26	26	25	24	23	22	21	21	20	19
40	30	29	29	28	27	26	25	24	23	23	22	21	20	19	18
41	30	29	28	27	26	26	25	24	23	22	21	20	20	19	18
42	30	29	28	27	26	25	24	23	22	22	21	20	19	18	17
43	29	28	27	26	25	25	24	23	22	21	20	19	18	17	17
44	29	28	27	26	25	24	23	22	21	20	19	19	18	17	16
45	28	27	26	25	24	23	22	22	21	20	19	18	17	16	15
46	27	27	26	25	24	23	22	21	20	19	18	17	16	15	14
47	27	26	25	24	23	22	21	20	19	18	17	16	15	14	13
48	26	25	24	23	22	21	20	19	19	18	17	16	15	14	13
49	26	25	24	23	22	21	20	19	18	17	16	15	14	13	12

50+ For ages 50+, expected future working lifetime equals assumed retirement age minus age.

	Assumed Retirement Age															
Age	**60**	**59**	**58**	**57**	**56**	**55**	**54**	**53**	**52**	**51**	**50**	**49**	**48**	**47**	**46**	**45**
20	18	17	17	17	16	16	16	16	15	15	15	14	14	14	13	13
21	18	18	17	17	17	16	16	16	15	15	15	15	14	14	14	13
22	19	18	18	17	17	17	16	16	16	15	15	15	14	14	14	13
23	19	19	18	18	18	17	17	16	16	16	15	15	14	14	14	13
24	19	19	19	18	18	17	17	17	16	16	15	15	15	14	14	13
25	20	19	19	19	18	18	17	17	16	16	15	15	15	14	14	13
26	20	20	19	19	18	18	17	17	16	16	16	15	15	14	14	13
27	20	20	19	19	18	18	17	17	16	16	15	15	14	14	13	13
28	21	20	20	19	19	18	17	17	16	16	15	15	14	14	13	13
29	21	20	20	19	19	18	17	17	16	16	15	15	14	13	13	12
30	21	20	20	19	18	18	17	17	16	15	15	14	14	13	12	12
31	21	20	20	19	18	18	17	16	16	15	15	14	13	13	12	11
32	21	20	19	19	18	17	17	16	15	15	14	14	13	12	11	11
33	21	20	19	18	18	17	16	16	15	14	14	13	12	12	11	10
34	20	20	19	18	17	17	16	15	15	14	13	13	12	11	10	10
35	20	19	18	18	17	16	16	15	14	13	13	12	11	10	10	9
36	20	19	18	17	17	16	15	14	14	13	12	11	11	10	9	8
37	19	18	18	17	16	15	15	14	13	12	11	11	10	9	8	7
38	19	18	17	16	16	15	14	13	12	12	11	10	9	8	7	7
39	18	17	17	16	15	14	13	12	12	11	10	9	8	7	7	6
40	18	17	16	15	14	13	13	12	11	10	9	8	7	7	6	5
41	17	16	15	14	14	13	12	11	10	9	8	8	7	6	5	4
42	16	15	15	14	13	12	11	10	9	8	8	7	6	5	4	3
43	16	15	14	13	12	11	10	9	8	8	7	6	5	4	3	2
44	15	14	13	12	11	10	9	9	8	7	6	5	4	3	2	1
45	14	13	12	11	10	9	9	8	7	6	5	4	3	2	1	0
46	13	12	11	11	10	9	8	7	6	5	4	3	2	1	0	0
47	13	12	11	10	9	8	7	6	5	4	3	2	1	0	0	0
48	12	11	10	9	8	7	6	5	4	3	2	1	0	0	0	0
49	11	10	9	8	7	6	5	4	3	2	1	0	0	0	0	0
50+	For ages 50+, expected future working lifetime equals assumed retirement age minus age.															

d. When the same premiums are charged to active employees and retirees, and the employer or plan **sponsor** is unable to obtain age-adjusted premium information for retirees from the insurer or service provider, the following approach should be used to age-adjust premiums for purposes of projecting future benefits for retirees:

(1) To adjust premiums for ages under 65:

(a) Identify the premium charged for active and retired plan members under age 65.
(b) Calculate the average age of plan members (actives and retirees or beneficiaries) to which the premium identified in step a applies.
(c) For each active plan member, and each retired member or beneficiary under age 65, identify the greater of expected retirement age or current age.
(d) Calculate the average of the ages identified in step c.
(e) Calculate the midpoint age between the result of step d and age 65: result of step d + (0.5 × [65 – result of step d]).
(f) Using the results of steps b and e, locate the appropriate factor in Table 3. The factor also can be calculated directly as 1.04(result of step e – result of step b).

(g) Multiply the factor identified in step f by the premium identified in step a. The result is the current-year age-adjusted premium that should be used as the basis for projecting future benefits for ages under age 65.

Table 3—Default Factors for Calculating Age-Adjusted Premiums for Ages under 65

Average Age of Plan Members	Midpoint Age (from paragraph 35d(1)(c))												
	52	53	54	55	56	57	58	59	60	61	62	63	64
25	2.88	3.00	3.12	3.24	3.37	3.51	3.65	3.79	3.95	4.10	4.27	4.44	4.62
26	2.77	2.88	3.00	3.12	3.24	3.37	3.51	3.65	3.79	3.95	4.10	4.27	4.44
27	2.67	2.77	2.88	3.00	3.12	3.24	3.37	3.51	3.65	3.79	3.95	4.10	4.27
28	2.56	2.67	2.77	2.88	3.00	3.12	3.24	3.37	3.51	3.65	3.79	3.95	4.10
29	2.46	2.56	2.67	2.77	2.88	3.00	3.12	3.24	3.37	3.51	3.65	3.79	3.95
30	2.37	2.46	2.56	2.67	2.77	2.88	3.00	3.12	3.24	3.37	3.51	3.65	3.79
31	2.28	2.37	2.46	2.56	2.67	2.77	2.88	3.00	3.12	3.24	3.37	3.51	3.65
32	2.19	2.28	2.37	2.46	2.56	2.67	2.77	2.88	3.00	3.12	3.24	3.37	3.51
33	2.11	2.19	2.28	2.37	2.46	2.56	2.67	2.77	2.88	3.00	3.12	3.24	3.37
34	2.03	2.11	2.19	2.28	2.37	2.46	2.56	2.67	2.77	2.88	3.00	3.12	3.24
35	1.95	2.03	2.11	2.19	2.28	2.37	2.46	2.56	2.67	2.77	2.88	3.00	3.12
36	1.87	1.95	2.03	2.11	2.19	2.28	2.37	2.46	2.56	2.67	2.77	2.88	3.00
37	1.80	1.87	1.95	2.03	2.11	2.19	2.28	2.37	2.46	2.56	2.67	2.77	2.88
38	1.73	1.80	1.87	1.95	2.03	2.11	2.19	2.28	2.37	2.46	2.56	2.67	2.77
39	1.67	1.73	1.80	1.87	1.95	2.03	2.11	2.19	2.28	2.37	2.46	2.56	2.67
40	1.60	1.67	1.73	1.80	1.87	1.95	2.03	2.11	2.19	2.28	2.37	2.46	2.56
41	1.54	1.60	1.67	1.73	1.80	1.87	1.95	2.03	2.11	2.19	2.28	2.37	2.46
42	1.48	1.54	1.60	1.67	1.73	1.80	1.87	1.95	2.03	2.11	2.19	2.28	2.37
43	1.42	1.48	1.54	1.60	1.67	1.73	1.80	1.87	1.95	2.03	2.11	2.19	2.28
44	1.37	1.42	1.48	1.54	1.60	1.67	1.73	1.80	1.87	1.95	2.03	2.11	2.19
45	1.32	1.37	1.42	1.48	1.54	1.60	1.67	1.73	1.80	1.87	1.95	2.03	2.11
46	1.27	1.32	1.37	1.42	1.48	1.54	1.60	1.67	1.73	1.80	1.87	1.95	2.03
47	1.22	1.27	1.32	1.37	1.42	1.48	1.54	1.60	1.67	1.73	1.80	1.87	1.95
48	1.17	1.22	1.27	1.32	1.37	1.42	1.48	1.54	1.60	1.67	1.73	1.80	1.87
49	1.12	1.17	1.22	1.27	1.32	1.37	1.42	1.48	1.54	1.60	1.67	1.73	1.80
50	1.08	1.12	1.17	1.22	1.27	1.32	1.37	1.42	1.48	1.54	1.60	1.67	1.73
51	1.04	1.08	1.12	1.17	1.22	1.27	1.32	1.37	1.42	1.48	1.54	1.60	1.67
52	1.00	1.04	1.08	1.12	1.17	1.22	1.27	1.32	1.37	1.42	1.48	1.54	1.60
53	0.96	1.00	1.04	1.08	1.12	1.17	1.22	1.27	1.32	1.37	1.42	1.48	1.54
54	0.92	0.96	1.00	1.04	1.08	1.12	1.17	1.22	1.27	1.32	1.37	1.42	1.48
55	0.89	0.92	0.96	1.00	1.04	1.08	1.12	1.17	1.22	1.27	1.32	1.37	1.42
56	0.85	0.89	0.92	0.96	1.00	1.04	1.08	1.12	1.17	1.22	1.27	1.32	1.37
57	0.82	0.85	0.89	0.92	0.96	1.00	1.04	1.08	1.12	1.17	1.22	1.27	1.32
58	0.79	0.82	0.85	0.89	0.92	0.96	1.00	1.04	1.08	1.12	1.17	1.22	1.27
59	0.76	0.79	0.82	0.85	0.89	0.92	0.96	1.00	1.04	1.08	1.12	1.17	1.22
60	0.73	0.76	0.79	0.82	0.85	0.89	0.92	0.96	1.00	1.04	1.08	1.12	1.17

(2) To adjust premiums for ages 65 or older:[31]

(a) Identify the premium charged for active and retired plan members age 65 or older.
(b) Calculate the average age of plan members (actives and retirees or beneficiaries) to which the premium identified in step a applies.
(c) For each active plan member, and each retired member or beneficiary (whether age pre-65 or age 65 or older), identify the greater of current age or age 65.
(d) Calculate the average of the ages identified in step c.
(e) Calculate the average life expectancy of all plan members (actives and retirees or beneficiaries).
(f) Calculate the midpoint age between the result of step d and the result of step e: result of step d + (0.5 × [result of step e – result of step d]).
(g) Using the results of steps b and f, locate the appropriate factor in Table 4 (for plans with no Medicare coordination) or Table 5 (for plans with Medicare coordination). The factor in Table 4 also can be calculated directly as 1.04(64 – result of step b) ′ 1.03(result of step f – 64). The factor in Table 5 also can be calculated directly as 0.5 × 1.04(64 – result of step b) × 1.03(result of step f – 64).
(h) Multiply the factor identified in step g by the premium identified in step a. The result is the current-year age-adjusted premium that should be used as the basis for projecting future benefits for ages 65 or older.

Table 4—Default Factors for Calculating Age-Adjusted Premiums for Ages 65 or Older (No Medicare Coordination)

Average Age of Plan Members	Midpoint Age (from paragraph 35d(2)(f))										
	65	66	67	68	69	70	71	72	73	74	75
25	4.75	4.90	5.04	5.20	5.35	5.51	5.68	5.85	6.02	6.20	6.39
26	4.57	4.71	4.85	5.00	5.15	5.30	5.46	5.62	5.79	5.97	6.14
27	4.40	4.53	4.66	4.80	4.95	5.10	5.25	5.41	5.57	5.74	5.91
28	4.23	4.35	4.48	4.62	4.76	4.90	5.05	5.20	5.35	5.52	5.68
29	4.06	4.19	4.31	4.44	4.57	4.71	4.85	5.00	5.15	5.30	5.46
30	3.91	4.03	4.15	4.27	4.40	4.53	4.67	4.81	4.95	5.10	5.25
31	3.76	3.87	3.99	4.11	4.23	4.36	4.49	4.62	4.76	4.90	5.05
32	3.61	3.72	3.83	3.95	4.07	4.19	4.31	4.44	4.58	4.71	4.86
33	3.47	3.58	3.69	3.80	3.91	4.03	4.15	4.27	4.40	4.53	4.67
34	3.34	3.44	3.54	3.65	3.76	3.87	3.99	4.11	4.23	4.36	4.49
35	3.21	3.31	3.41	3.51	3.62	3.72	3.84	3.95	4.07	4.19	4.32
36	3.09	3.18	3.28	3.38	3.48	3.58	3.69	3.80	3.91	4.03	4.15
37	2.97	3.06	3.15	3.25	3.34	3.44	3.55	3.65	3.76	3.88	3.99
38	2.86	2.94	3.03	3.12	3.21	3.31	3.41	3.51	3.62	3.73	3.84
39	2.75	2.83	2.91	3.00	3.09	3.18	3.28	3.38	3.48	3.58	3.69
40	2.64	2.72	2.80	2.89	2.97	3.06	3.15	3.25	3.34	3.44	3.55
41	2.54	2.61	2.69	2.77	2.86	2.94	3.03	3.12	3.22	3.31	3.41
42	2.44	2.51	2.59	2.67	2.75	2.83	2.91	3.00	3.09	3.18	3.28
43	2.35	2.42	2.49	2.56	2.64	2.72	2.80	2.89	2.97	3.06	3.15
44	2.26	2.32	2.39	2.47	2.54	2.62	2.69	2.78	2.86	2.94	3.03
45	2.17	2.24	2.30	2.37	2.44	2.52	2.59	2.67	2.75	2.83	2.92
46	2.09	2.15	2.21	2.28	2.35	2.42	2.49	2.57	2.64	2.72	2.80
47	2.01	2.07	2.13	2.19	2.26	2.33	2.40	2.47	2.54	2.62	2.70
48	1.93	1.99	2.05	2.11	2.17	2.24	2.30	2.37	2.44	2.52	2.59
49	1.85	1.91	1.97	2.03	2.09	2.15	2.21	2.28	2.35	2.42	2.49
50	1.78	1.84	1.89	1.95	2.01	2.07	2.13	2.19	2.26	2.33	2.40
51	1.72	1.77	1.82	1.87	1.93	1.99	2.05	2.11	2.17	2.24	2.30
52	1.65	1.70	1.75	1.80	1.86	1.91	1.97	2.03	2.09	2.15	2.22
53	1.59	1.63	1.68	1.73	1.78	1.84	1.89	1.95	2.01	2.07	2.13
54	1.52	1.57	1.62	1.67	1.72	1.77	1.82	1.88	1.93	1.99	2.05
55	1.47	1.51	1.56	1.60	1.65	1.70	1.75	1.80	1.86	1.91	1.97
56	1.41	1.45	1.50	1.54	1.59	1.63	1.68	1.73	1.79	1.84	1.89
57	1.36	1.40	1.44	1.48	1.53	1.57	1.62	1.67	1.72	1.77	1.82
58	1.30	1.34	1.38	1.42	1.47	1.51	1.56	1.60	1.65	1.70	1.75
59	1.25	1.29	1.33	1.37	1.41	1.45	1.50	1.54	1.59	1.64	1.68
60	1.20	1.24	1.28	1.32	1.36	1.40	1.44	1.48	1.53	1.57	1.62

Table 5—Default Factors for Calculating Age-Adjusted Premiums for Ages 65 or Older (with Medicare Coordination)

Average Age of Plan Members	Midpoint Age (from paragraph 35d(2)(f))										
	65	66	67	68	69	70	71	72	73	74	75
25	2.38	2.45	2.52	2.60	2.68	2.76	2.84	2.92	3.01	3.10	3.20
26	2.29	2.35	2.43	2.50	2.57	2.65	2.73	2.81	2.90	2.98	3.07
27	2.20	2.26	2.33	2.40	2.47	2.55	2.62	2.70	2.78	2.87	2.95
28	2.11	2.18	2.24	2.31	2.38	2.45	2.52	2.60	2.68	2.76	2.84
29	2.03	2.09	2.16	2.22	2.29	2.36	2.43	2.50	2.57	2.65	2.73
30	1.95	2.01	2.07	2.14	2.20	2.27	2.33	2.40	2.48	2.55	2.63
31	1.88	1.94	1.99	2.05	2.11	2.18	2.24	2.31	2.38	2.45	2.53
32	1.81	1.86	1.92	1.97	2.03	2.09	2.16	2.22	2.29	2.36	2.43
33	1.74	1.79	1.84	1.90	1.96	2.01	2.07	2.14	2.20	2.27	2.33
34	1.67	1.72	1.77	1.83	1.88	1.94	1.99	2.05	2.12	2.18	2.24
35	1.61	1.65	1.70	1.76	1.81	1.86	1.92	1.98	2.03	2.10	2.16
36	1.54	1.59	1.64	1.69	1.74	1.79	1.84	1.90	1.96	2.02	2.08
37	1.48	1.53	1.58	1.62	1.67	1.72	1.77	1.83	1.88	1.94	2.00
38	1.43	1.47	1.51	1.56	1.61	1.66	1.70	1.76	1.81	1.86	1.92
39	1.37	1.41	1.46	1.50	1.55	1.59	1.64	1.69	1.74	1.79	1.85
40	1.32	1.36	1.40	1.44	1.49	1.53	1.58	1.62	1.67	1.72	1.77
41	1.27	1.31	1.35	1.39	1.43	1.47	1.52	1.56	1.61	1.66	1.71
42	1.22	1.26	1.29	1.33	1.37	1.41	1.46	1.50	1.55	1.59	1.64
43	1.17	1.21	1.25	1.28	1.32	1.36	1.40	1.44	1.49	1.53	1.58
44	1.13	1.16	1.20	1.23	1.27	1.31	1.35	1.39	1.43	1.47	1.52
45	1.09	1.12	1.15	1.19	1.22	1.26	1.30	1.33	1.37	1.42	1.46
46	1.04	1.07	1.11	1.14	1.17	1.21	1.25	1.28	1.32	1.36	1.40
47	1.00	1.03	1.06	1.10	1.13	1.16	1.20	1.23	1.27	1.31	1.35
48	0.96	0.99	1.02	1.05	1.09	1.12	1.15	1.19	1.22	1.26	1.30
49	0.93	0.96	0.98	1.01	1.04	1.08	1.11	1.14	1.17	1.21	1.25
50	0.89	0.92	0.95	0.97	1.00	1.03	1.06	1.10	1.13	1.16	1.20
51	0.86	0.88	0.91	0.94	0.97	0.99	1.02	1.05	1.09	1.12	1.15
52	0.82	0.85	0.87	0.90	0.93	0.96	0.98	1.01	1.04	1.08	1.11
53	0.79	0.82	0.84	0.87	0.89	0.92	0.95	0.98	1.00	1.03	1.07
54	0.76	0.79	0.81	0.83	0.86	0.88	0.91	0.94	0.97	0.99	1.02
55	0.73	0.75	0.78	0.80	0.83	0.85	0.88	0.90	0.93	0.96	0.99
56	0.70	0.73	0.75	0.77	0.79	0.82	0.84	0.87	0.89	0.92	0.95
57	0.68	0.70	0.72	0.74	0.76	0.79	0.81	0.83	0.86	0.88	0.91
58	0.65	0.67	0.69	0.71	0.73	0.76	0.78	0.80	0.83	0.85	0.88
59	0.63	0.65	0.66	0.68	0.71	0.73	0.75	0.77	0.79	0.82	0.84
60	0.60	0.62	0.64	0.66	0.68	0.70	0.72	0.74	0.76	0.79	0.81

EFFECTIVE DATE AND TRANSITION

36. The requirements of this Statement are effective in three phases. Governments that were *phase 1 governments* for the purpose of implementation of Statement 34 should apply the requirements of this Statement in financial statements for periods beginning after December 15, 2006. Governments that were *phase 2 governments* for the purpose of implementation of Statement 34 should apply the requirements of this Statement in financial statements for periods beginning after December 15, 2007. Governments that were *phase 3 governments* for the purpose of implementation of Statement 34 should apply the

requirements of this Statement in financial statements for periods beginning after December 15, 2008. The related Statement 43 on OPEB plan reporting is effective for plan reporting periods beginning after December 15, 2005, 2006, or 2007, for plans in which the largest participating employer is a phase 1, phase 2, or phase 3 government, respectively, for purposes of this paragraph. Earlier application of this Statement is encouraged. All component units should implement the requirements of this Statement no later than the same year as their primary government.

OPEB Liabilities (Assets) at Transition (Defined Benefit OPEB Plans)

Sole and Agent Employers

37. When first implementing the requirements of this Statement, sole and agent employers should set their net OPEB obligation at zero as of the beginning of the transition year and should apply the measurement and recognition requirements of this Statement on a prospective basis. However, a sole or agent employer that has actuarial information for years prior to implementation may elect to compute its net OPEB obligation (asset) at transition retroactively. An employer that elects to apply the requirements of this Statement retroactively should follow the method required for calculation of pension liabilities (assets) in paragraphs 30 through 35 of Statement 27. However, the calculation period set forth in paragraph 32 of that Statement is not mandatory. Employers should disclose in the notes to the financial statements the calculation period used.

Cost-Sharing Employers

38. The OPEB liability at the beginning of the transition year for a cost-sharing employer should be equal to the employer's (a) contractually required contributions that are due and payable at the effective date and (b) OPEB-related debt, if applicable. If a cost-sharing employer has recognized OPEB liabilities for amounts other than those specified in this paragraph, those liabilities should be reduced to zero.

Disclosures

39. In the transition year, employers should make the following disclosures for each single-employer, agent, and cost-sharing plan, even if the OPEB liability (asset) was zero both before and at the effective date. The employer should disclose either that this Statement was implemented prospectively (zero net OPEB obligation at transition) or that an OPEB liability (asset) at transition was determined in accordance with this Statement. The employer also should disclose the amount of the OPEB liability (asset) at transition, if any, and the difference, if any, between that amount and any previously reported liability (asset) to the same plan.

The provisions of this Statement need not be applied to immaterial items.

This Statement was adopted by the affirmative votes of six members of the Governmental Accounting Standards Board. Mr. Reilly dissented.

Mr. Reilly dissents to this Statement because he objects to the requirement to account for health insurance premium rate differentials (implied rate subsidy) as OPEB when an employer otherwise provides no explicit OPEB benefits. Mr. Reilly objects primarily because he believes the cost will far exceed the perceived benefits and also because of many conceptual and practical considerations.

Mr. Reilly points out that the decision to permit retired employees to participate in a health insurance program is not always made by the employer. In most instances health insurance companies have independent policies that allow retirees to pay the premiums and remain in an insurance program. Some states have legislation that provides the same option. Under these circumstances—that is, when the employer does not provide the option—Mr. Reilly believes that continued participation by retirees does not constitute "part of an exchange of salaries and benefits for employee services rendered."

Mr. Reilly believes that this Statement will require thousands of governments to incur the high cost of an actuarial study to determine the implicit rate subsidy, or premium differential, and the related annual OPEB cost. The financial statements will, therefore, reflect what the impact would be *if* health insurance companies charged a different premium for retirees than for active employees. He believes this information is neither relevant nor valid because financial statements should not reflect "what-if" situations.

Mr. Reilly believes the accounting effort necessary to implement the requirement is excessive. In addition to having to accrue a liability to reflect the premium differential for participating retirees, employers will need to adjust the premium cost for active employees. The accounting treatment becomes more difficult when retirees reach the age of 65 and start receiving Medicare benefits. Depending on how premiums are calculated, there may be a reverse rate subsidy that will result in complex adjustments to the accounting records. These same governments will also have to provide elaborate note disclosures and numerous detailed financial and statistical schedules as RSI. The questionable net results, he believes, do not justify the substantial cost and effort. In fact, there has been no evidence introduced or shown to indicate that financial statements would be improved as a result of treating health insurance premium differentials as OPEB. Nor has there been a field test or illustration prepared to show that the perceived benefits gained justify the cost and effort necessary to account for and report premium rate differentials as OPEB.

Mr. Reilly believes that this standard will impose a funding-based approach on circumstances and events that do not require advance funding. Consequently, he believes that very few governments, if any, will fund the annual required contributions. These governments will, therefore, be forced to carry a liability (the net OPEB obligation) that will never be liquidated.

Mr. Reilly also points out that this requirement ignores and conflicts with the basic nature and theory of insurance. All participants in insurance programs receive economic benefit by being protected against certain financial losses. Professional administrators of health insurance programs consider health insurance to be one of the purest forms of insurance. They state this because various groups of people with diverse risks all pay the same premiums. The more one moves to "risk rating"—that is, different rates for different groups such as gender, age, health condition, family size, profession, and so forth—the more one moves away from the concept of insurance. Retirees are a group within the overall risk pool, and the manner in which health claims costs are measured and recovered through premiums, he believes, is a matter of public policy and should not be dictated by actuarial standards.

Mr. Reilly also disagrees with the reasons stated in the Basis for Conclusions of this Statement regarding the requirement to account for premium rate differentials as OPEB. He points out that the types and variety of OPEB plans in existence are numerous and that loss of comparability of financial statements is not an issue. Most fundamentally, he believes that requiring calculated premium rate differentials to be treated as OPEB could have a negative impact on the reliability and usefulness of financial statements. Because of the potential for liabilities that will never be liquidated and the uncertainties associated with reducing healthcare expenses for active employees, users of financial statements could be misled, and their ability to assess financial position, results of operations, and future cash flows could be diminished.

Although Mr. Reilly recognizes that healthcare claims cost for retirees is, on the average, greater than for active employees, the retirees are, nevertheless, part of a large risk group. If one accepts separate measurement of costs for retirees, then one should advocate risk rating for all groups. Because people in some professions, for example, incur claims costs that are two or more times greater than average, risk rating would result in more precise expenses being reflected in the statement of activities. Such practice, however, like the requirement to account for premium rate differentials, would suggest that insurance premiums are an inappropriate measurement for financial reporting. Mr. Reilly therefore believes that the Board should recognize and accept the nature of insurance and risk pools and the fact that common or blended premiums constitute an acceptable method for measuring and recording healthcare costs.

Mr. Reilly also points out that the original Exposure Draft did not require premium rate differentials to be treated as OPEB. He believes the Board made the change in the revised Exposure Draft and the final document primarily because of objections raised by actuaries and a hypothetical (and what he believes is a biased) example furnished by them to illustrate their point. During due process of the revised Exposure Draft, the majority of respondents supported not requiring premium rate differentials to be treated as OPEB. He believes that their arguments, including many conceptual as well as practical reasons, were well founded and compelling. Therefore, he believes that a case has not been made to require health insurance premium rate differentials to be accounted for as OPEB when an employer otherwise provides no explicit benefits.

Members of the Governmental Accounting Standards Board:

Tom L. Allen, *Chairman*
Cynthia B. Green
William W. Holder
Edward J. Mazur
Paul R. Reilly
Richard C. Tracy
James M. Williams

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[1]Consistent with previous GASB pronouncements, the glossary and actuarial terminology presented in paragraphs 40 and 41 are authoritative elements of this Statement. Terms defined in those paragraphs are printed in **boldface type** when they first appear.

[2]The terms ***annual OPEB cost*** and ***net OPEB obligation*** are used to refer to the results of applying the *measurement* requirements of this Statement, regardless of the amounts that should be *recognized* in the financial statements using the accrual or modified accrual basis of accounting. *Recognition* requirements are addressed in paragraphs 17 through 21, *after* the measurement requirements. When the modified accrual basis is used, the amount recognized as OPEB expenditures may not be equal to annual OPEB cost. However, regardless of the amount recognized, paragraph 25 requires the disclosure of annual OPEB cost and, if applicable, the components of annual OPEB cost and net OPEB obligation balances.

[3]When the actuarial determination of the ARC is based on a projection of **covered payroll** for the period to which the ARC will apply, the payroll measure used may be the projected covered payroll, the budgeted payroll, or the actual covered payroll for the year. Any of those measures of covered payroll, consistently applied, is acceptable for calculating annual OPEB cost and the net OPEB obligation, if any. Comparisons between the ARC and contributions made should be based on the same measure of covered payroll, consistently applied, whether that measure is projected, budgeted, or actual payroll. The ARC does not include payments of **OPEB-related debt.** An OPEB-related debt is any long-term liability of an employer *to an OPEB plan* that is *not* included in the ARC. Payments generally are made in accordance with installment contracts that usually include interest. Examples include contractually deferred contributions and amounts assessed to an employer upon joining a multiple-employer plan. Therefore, payments of OPEB-related debt are not included in annual OPEB cost.

[4]The net OPEB obligation may be either positive (a liability) or negative (an asset). The term *net OPEB obligation,* as used in this Statement, refers to either situation.

[5]That is, the plan does not meet the criteria of paragraph 4 of Statement 43 for financial reporting as a trust, or equivalent arrangement, or the plan meets those criteria but has fewer than one hundred total plan members and, therefore, is eligible to use the alternative measurement method.

[6]For purposes of this Statement, the term *balance sheet* includes the government-wide and proprietary fund statements of net assets and the statement of fiduciary net assets, required to be presented as

components of the basic financial statements, as discussed in Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments.*

[7]This provision and the parameters also are included in Statement 43.

[8]See Actuarial Standard of Practice No. 6 (ASOP 6), *Measuring Retiree Group Benefit Obligations,* revised edition (Washington, DC: Actuarial Standards Board, December 2001), or its successor documents.

[9]ASOP 6, as revised in December 2001, discusses the issue as follows:

> Use of Premium Rates—Although an analysis of the plan sponsor's actual claims experience is preferable, the actuary may use premium rates as the basis for initial per capita health care rates, with appropriate analysis and adjustment for the premium rate basis. The actuary who uses premium rates for this purpose should adjust them for changes in benefit levels, covered population, or program administration. The actuary should consider that the actual cost of health insurance varies by age . . . , but the premium rates paid by the plan sponsor may not. For example, the actuary may use a single unadjusted premium rate applicable to both active employees and non-Medicare-eligible retirees if the actuary has determined that the insurer would offer the same premium rate if only non-Medicare-eligible retirees were covered. [paragraph 3.4.5]

[10]**Unprojected unit credit** is acceptable for plans in which benefits already accumulated for years of service are not affected by future salary levels.

[11]See footnote 8.

[12]The total unfunded actuarial liability may be positive (**actuarial accrued liability** greater than the actuarial value of assets) or negative (actuarial accrued liability less than the actuarial value of assets, or **funding excess**). The term *unfunded actuarial liability* refers to either situation. Separate determination and **amortization** of the unfunded actuarial liability are not part of the aggregate actuarial cost method and are not required when that method is used with regard to the computation of the ARC; however, the disclosure requirements of paragraphs 25c, 25d(5)(d), and 26 are applicable when that method is used.

[13]As used in this Statement, the term *employer's contributions* means contributions made in relation to the ARC. The term does not include amounts attributable to plan members under the terms of the plan (for example, employee contributions transmitted to the plan by the employer and contributions paid by the employer on the employees' behalf that are not included in the ARC). Similarly, the net OPEB obligation should not include amounts attributable to plan members under the terms of the plan.

[14]Or in the actuarially determined required contributions of a cost-sharing employer.

[15]When more than one period is used in determining the ARC, the period for the adjustment to the ARC should be the period used to amortize net **actuarial experience gains and losses.** When the ARC is determined according to the frozen entry age, frozen attained age, or aggregate actuarial cost method, the period for the adjustment to the ARC should be the average remaining service life of active plan members.

[16]An employer contributes to more than one OPEB plan if any portion of the total assets contributed to a plan administrator(s) is accumulated solely for the payment of benefits to certain classes of employees (for example, public safety employees) and may not legally be used to pay benefits to other classes of employees (for example, general employees). That portion of the total assets and the associated benefits constitutes a separate plan for which separate recognition by the employer is required, even if the assets are pooled by the plan administrator with other assets for investment purposes.

[17]For example, if a government enters a cost-sharing OPEB plan and, as a condition of entry, incurs an OPEB-related debt to the plan in the amount of the unfunded actuarial accrued liabilities for past service of its employees at the time of entry, the government should recognize the full amount of the debt in the year

that it enters the plan.

[18]See footnote 17.

[19]Statement 43 includes the requirements for the notes to the financial statements (and schedules of RSI, if applicable) of OPEB plans reported as trust or agency funds in the employer's financial reports. When similar information is required by this Statement and Statement 43, the employer should present the disclosures in a manner that avoids unnecessary duplication.

[20]Paragraph 26a requires sole and agent employers to present as RSI (schedule of funding progress) the same elements of information for the most recent actuarial valuation *and the two preceding valuations* .

[21]For sole employers that include the plan in the financial reporting entity (as a trust fund), presentation of information about the plan's funded status and funding progress as required for the plan by Statement 43 meets the requirements of this paragraph and paragraph 26. For agent employers, the requirements of this paragraph and paragraph 26 apply to the employer's *individual* plan. The information should be presented even if the aggregate multiple-employer plan (all employers) is included as an OPEB trust fund in the employer's report and the required funded status and funding progress information is presented for the aggregate plan.

[22]If an employer also elects to include in the annual financial report pro forma *quantitative information* about postemployment healthcare benefits (for example, pro forma calculations of the ARC, annual OPEB cost, or the funded status of the plan) recalculated to take into consideration a funding limitation, that information should be presented as supplementary information.

[23]Until three actuarial valuations have been performed in accordance with the parameters, the required information should be presented for as many years as it is available. Retroactive application of this Statement is not required. However, as provided in paragraph 37, employers that have available actuarial information that was calculated using methods and assumptions that do not differ significantly from the parameters for periods prior to the implementation date may elect to apply the measurement requirements of this Statement retroactively. Those employers may be able to provide information in accordance with the parameters for the prior three actuarial valuations when this Statement is first implemented.

[24] See footnote 21.

[25]Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans,* discusses the requirements for the notes to the financial statements of defined contribution plans that are reported as trust funds in the employer's financial reports. When similar information is required by this Statement and Statement 25, the employer should present the disclosures in a manner that avoids unnecessary duplication.

[26]Statement No. 24, *Accounting and Financial Reporting for Certain Grants and Other Financial Assistance,* provides standards for recognizing payments made on a government's behalf by another entity.

[27]Age could be the *entry age* or the *attained (current) age* of the plan member, depending upon the calculation being made.

[28]These default probabilities were adapted from data maintained by the U.S. Office of Personnel Management regarding the experience of the employee group covered by the Federal Employees Retirement System.

[29]See footnote 27.

[30]See footnote 28.

[31]The procedures described in paragraph 35d(2) would be applied only in cases in which retirees age 65 or older are included in a single, blended premium rate assessed by the insurer or service provider. If separate premium rates are assessed for retirees age 65 or older, preparers would follow the steps in paragraph 35d(1) for age-adjusting blended premiums for under age 65 and would use the separately assessed premium rates (without additional age adjustment) for age 65 or older.

GLOSSARY

40. This paragraph contains definitions of certain terms *as they are used in this Statement;* the terms may have different meanings in other contexts. Terms defined in paragraph 41, "Actuarial Terminology," are cross-referenced to that paragraph.

Actuarial accrued liability

See paragraph 41, A-4.

Actuarial assumptions

See paragraph 41, C-2.

Actuarial cost method

See paragraph 41, A-2.

Actuarial experience gain or loss

See paragraph 41, A-8.

Actuarial present value of total projected benefits

Total projected benefits include all benefits estimated to be payable to plan members (retirees and beneficiaries, terminated employees entitled to benefits but not yet receiving them, and current active members) as a result of their service through the valuation date and their expected future service. The actuarial present value of total projected benefits as of the valuation date is the present value of the cost to finance benefits payable in the future, discounted to reflect the expected effects of the time value (present value) of money and the probabilities of payment. Expressed another way, it is the amount that would have to be invested on the valuation date so that the amount invested plus investment earnings will provide sufficient assets to pay total projected benefits when due.

Actuarial valuation

See paragraph 41, C-3.

Actuarial valuation date

The date as of which an actuarial valuation is performed.

Actuarial value of assets

See paragraph 41, A-5.

Agent multiple-employer plan (agent plan)

An aggregation of single-employer plans, with pooled administrative and investment functions.

Separate accounts are maintained for each employer so that the employer's contributions provide benefits only for the employees of that employer. A separate actuarial valuation is performed for each individual employer's plan to determine the employer's periodic contribution rate and other information for the individual plan, based on the benefit formula selected by the employer and the individual plan's proportionate share of the pooled assets. The results of the individual valuations are aggregated at the administrative level.

Aggregate actuarial cost method

See paragraph 41, B-4.

Allocated insurance contract

A contract with an insurance company under which related payments to the insurance company are currently used to purchase an immediate or deferred benefit for individual members.

Amortization (of unfunded actuarial accrued liability)

See paragraph 41, C-5.

Annual OPEB cost

An accrual-basis measure of the periodic cost of an employer's participation in a defined benefit OPEB plan.

Annual required contributions of the employer (ARC)

The employer's periodic required contributions to a defined benefit OPEB plan, calculated in accordance with the parameters.

Attained age actuarial cost method

See paragraph 41, B-3.

Closed amortization period (closed basis)

A specific number of years that is counted from one date and, therefore, declines to zero with the passage of time. For example, if the amortization period initially is thirty years on a closed basis, twenty-nine years remain after the first year, twenty-eight years after the second year, and so forth. In contrast, an open amortization period (open basis) is one that begins again or is recalculated at each actuarial valuation date. Within a maximum number of years specified by law or policy (for example, thirty years), the period may increase, decrease, or remain stable.

Contribution deficiencies (excess contributions)

The difference between the annual required contributions of the employer(s) (ARC) and the employer' s actual contributions in relation to the ARC.

Cost-sharing multiple-employer plan

A single plan with pooling (cost-sharing) arrangements for the participating employers. All risks, rewards, and costs, including benefit costs, are shared and are not attributed individually to the employers. A single actuarial valuation covers all plan members, and the same contribution rate(s) applies for each employer.

Covered group

Plan members included in an actuarial valuation.

Covered payroll

Annual compensation paid to active employees covered by an OPEB plan. If employees also are covered by a pension plan, the covered payroll should include all elements included in compensation on which contributions to the pension plan are based. For example, if pension contributions are calculated on base pay including overtime, covered payroll includes overtime compensation.

Defined benefit OPEB plan

An OPEB plan having terms that specify the *benefits* to be provided at or after separation from employment. The benefits may be specified in dollars (for example, a flat dollar payment or an amount based on one or more factors such as age, years of service, and compensation), or as a type or level of coverage (for example, prescription drugs or a percentage of healthcare insurance premiums).

Defined benefit pension plan

A pension plan having terms that specify the amount of pension benefits to be provided at a future date or after a certain period of time. The amount specified usually is a function of one or more factors such as age, years of service, and compensation.

Defined contribution plan

A pension or OPEB plan having terms that (a) provide an individual account for each plan member and (b) specify *how contributions to an active plan member's account are to be determined,* rather than the income or other benefits the member or his or her beneficiaries are to receive at or after separation from employment. Those benefits will depend *only* on the amounts contributed to the member's account, earnings on investments of those contributions, and forfeitures of contributions made for other members that may be allocated to the member's account. For example, an employer may contribute a specified amount to each active member's postemployment healthcare account each month. At or after separation from employment, the balance of the account may be used by the member or on the member's behalf for the purchase of health insurance or other healthcare benefits.

Employer's contributions

Contributions made in relation to the annual required contributions of the employer (ARC). An employer has made a contribution in relation to the ARC if the employer has (a) made payments of benefits directly to or on behalf of a retiree or beneficiary, (b) made premium payments to an insurer, or (c) irrevocably transferred assets to a trust, or equivalent arrangement, in which plan assets are dedicated to providing benefits to retirees and their beneficiaries in accordance with the terms of the plan and are legally protected from creditors of the employer(s) or plan administrator.

Entry age actuarial cost method

See paragraph 41, B-2.

Equivalent single amortization period

The weighted average of all amortization periods used when components of the total unfunded actuarial accrued liability are separately amortized and the average is calculated in accordance with the parameters.

Excess contributions (contribution deficiencies)

See Contribution deficiencies (excess contributions).

Frozen attained age actuarial cost method

See paragraph 41, B-6.

Frozen entry age actuarial cost method

See paragraph 41, B-5.

Funded ratio

The actuarial value of assets expressed as a percentage of the actuarial accrued liability.

Funding excess

The excess of the actuarial value of assets over the actuarial accrued liability. See also paragraph 41, A-6.

Funding policy

The program for the amounts and timing of contributions to be made by plan members, employer(s), and other contributing entities (for example, state government contributions to a local government plan) to provide the benefits specified by an OPEB plan.

Healthcare cost trend rate

The rate of change in per capita health claims costs over time as a result of factors such as medical inflation, utilization of healthcare services, plan design, and technological developments.

Insured benefit

An OPEB financing arrangement whereby an employer pays premiums to an insurance company, *while employees are in active service,* in return for which the insurance company unconditionally undertakes an obligation to pay the postemployment benefits of those employees or their beneficiaries, as defined in the employer's plan.

Investment return assumption (discount rate)

The rate used to adjust a series of future payments to reflect the time value of money.

Level dollar amortization method

The amount to be amortized is divided into equal dollar amounts to be paid over a given number of years; part of each payment is interest and part is principal (similar to a mortgage payment on a building). Because payroll can be expected to increase as a result of inflation, level dollar payments generally represent a decreasing percentage of payroll; in dollars adjusted for inflation, the payments can be expected to decrease over time.

Level percentage of projected payroll amortization method

Amortization payments are calculated so that they are a constant percentage of the projected payroll of active plan members over a given number of years. The dollar amount of the payments generally will increase over time as payroll increases due to inflation; in dollars adjusted for inflation, the payments can be expected to remain level.

Market-related value of plan assets

A term used with reference to the actuarial value of assets. A market-related value may be fair value, market value (or estimated market value), or a calculated value that recognizes changes in fair value or market value over a period of, for example, three to five years.

Net OPEB obligation

The cumulative difference since the effective date of this Statement between annual OPEB cost and the employer's contributions to the plan, including the OPEB liability (asset) at transition, if any, and excluding (a) short-term differences and (b) unpaid contributions that have been converted to OPEB-related debt.

Normal cost

See paragraph 41, A-3. In this Statement, the term refers to employer normal cost.

OPEB assets

The amount recognized by an employer for contributions to an OPEB plan greater than OPEB expense.

OPEB expenditures

The amount recognized by an employer in each accounting period for contributions to an OPEB plan on the modified accrual basis of accounting.

OPEB expense

The amount recognized by an employer in each accounting period for contributions to an OPEB plan on the accrual basis of accounting.

OPEB liabilities

The amount recognized by an employer for contributions to an OPEB plan less than OPEB expense/expenditures.

OPEB-related debt

All long-term liabilities of an employer *to an OPEB plan,* the payment of which is *not* included in the annual required contributions of a sole or agent employer (ARC) or the actuarially determined required contributions of a cost-sharing employer. Payments generally are made in accordance with installment contracts that usually include interest. Examples include contractually deferred contributions and amounts assessed to an employer upon joining a multiple-employer plan.

Open amortization period (open basis)

See Closed amortization period (closed basis).

Other postemployment benefits

Postemployment benefits other than pension benefits. Other postemployment benefits (OPEB) include postemployment healthcare benefits, regardless of the type of plan that provides them, and all postemployment benefits provided separately from a pension plan, excluding benefits defined as termination offers and benefits.

Parameters

The set of requirements for calculating actuarially determined OPEB information included in financial reports.

Pay-as-you-go

See paragraph 41, C-8.

Payroll growth rate

An actuarial assumption with respect to future increases in total covered payroll attributable to inflation; used in applying the level percentage of projected payroll amortization method.

Pension benefits

Retirement income and all other benefits, including disability benefits, death benefits, life insurance, and other ancillary benefits, *except healthcare benefits,* that are provided through a *defined benefit* pension plan to plan members and beneficiaries after termination of employment or after retirement. Postemployment healthcare benefits are considered other postemployment benefits, whether they are provided through a defined benefit pension plan or another type of plan.

Plan assets

Resources, usually in the form of stocks, bonds, and other classes of investments, that have been segregated and restricted in a trust, or equivalent arrangement, in which (a) employer contributions to the plan are irrevocable, (b) assets are dedicated to providing benefits to retirees and their beneficiaries, and (c) assets are legally protected from creditors of the employer(s) or plan administrator, for the payment of benefits in accordance with the terms of the plan.

Plan members

The individuals covered by the terms of an OPEB plan. The plan membership generally includes employees in active service, terminated employees who have accumulated benefits but are not yet receiving them, and retired employees and beneficiaries currently receiving benefits.

Postemployment

The period between termination of employment and retirement as well as the period after retirement.

Postemployment healthcare benefits

Medical, dental, vision, and other health-related benefits provided to terminated or retired employees and their dependents and beneficiaries.

Postretirement benefit increase

An increase in the benefits of retirees or beneficiaries granted to compensate for the effects of inflation (cost-of-living adjustment) or for other reasons. *Ad hoc* increases may be granted periodically by a decision of the board of trustees, legislature, or other authoritative body; both the decision to grant an increase and the amount of the increase are discretionary. *Automatic* increases are periodic increases specified in the terms of the plan; they are nondiscretionary except to the extent that the plan terms can be changed.

Projected salary increase assumption

An actuarial assumption with respect to future increases in the individual salaries and wages of active plan members; used in determining the actuarial present value of total projected benefits when the benefit amounts are related to salaries and wages. The expected increases commonly include amounts for inflation, enhanced productivity, and employee merit and seniority.

Projected unit credit actuarial cost method

See paragraph 41, B-1.

Public employee retirement system (PERS)

A state or local governmental entity entrusted with administering one or more pension plans. A PERS also may administer other types of employee benefit plans, including postemployment healthcare plans and deferred compensation plans. A PERS also may be an employer that provides or participates in a pension plan or other types of employee benefit plans for employees of the system.

Required supplementary information (RSI)

Schedules, statistical data, and other information that are an essential part of financial reporting and should be presented with, but are not part of, the basic financial statements of a governmental entity.

Select and ultimate rates

Actuarial assumptions that contemplate different rates for successive years. Instead of a single assumed rate with respect to, for example, the investment return assumption, the actuary may apply different rates for the early years of a projection and a single rate for all subsequent years. For example, if an actuary applies an assumed investment return of 8 percent for year 20W0, 7.5 percent for 20W1, and 7 percent for 20W2 and thereafter, then 8 percent and 7.5 percent are select rates, and 7 percent is the ultimate rate.

Single-employer plan

A plan that covers the current and former employees, including beneficiaries, of only one employer.

Special termination benefits

Benefits offered by an employer for a short period of time as an inducement to employees to hasten the termination of services. For example, to reduce payroll and related costs, an employer might offer enhanced pension benefits or OPEB to employees as an inducement to take early termination, for employees who accept the offer within a sixty-day window of opportunity.

Sponsor

The entity that established the plan. The sponsor generally is the employer or one of the employers that participate in the plan to provide benefits for their employees. Sometimes, however, the sponsor establishes the plan for the employees of other entities but does not include its own employees and, therefore, is not a participating employer of that plan. An example is a state government that establishes a plan for the employees of local governments within the state, but the employees of the state government are covered by a different plan.

Stand-alone plan financial report

A report that contains the financial statements of a plan and is issued by the plan or by the public employee retirement system that administers the plan. The term *stand-alone* is used to distinguish such a financial report from plan financial statements that are included in the financial report of the plan sponsor or employer (pension or other employee benefit trust fund).

Substantive plan

The terms of an OPEB plan as understood by the employer(s) and plan members.

Terminal funding

See paragraph 41, C-10.

Termination offers and benefits

Inducements offered by employers to employees to hasten the termination of services, or payments made in consequence of the early termination of services. Termination offers and benefits include special termination benefits, early-retirement incentive programs, and other termination-related benefits.

Transition year

The fiscal year in which this Statement is first implemented.

Ultimate rate

See Select and ultimate rates.

Unfunded actuarial accrued liability (unfunded actuarial liability)

See paragraph 41, A-6.

Unprojected unit credit actuarial cost method

See paragraph 41, B-1.

Year-based assumptions

See Select and ultimate rates.

ACTUARIAL TERMINOLOGY

41. This paragraph contains terms and definitions adopted by the Interim Actuarial Standards Board (now the Actuarial Standards Board) of the American Academy of Actuaries in 1988. The terms and definitions are reproduced, with permission, including the original section headings and item numbers, as published in "Appendix II: Pension Actuarial Terminology" of Actuarial Standard of Practice No. 4, *Measuring Pension Obligations,* approved for publication by the Actuarial Standards Board in October 1993.[32] Although specifically adopted in relation to pensions, these terms and definitions also are generally applicable to other postemployment benefits. Five items in the original (B-7, B-8, B-9, C-1, and C-6) are not included in this paragraph because they describe actuarial cost methods not included in the parameters or define terms not used in this Statement or Statement 43. Terms with an asterisk are not used in this Statement or Statement 43 but have been included because they are used in the definitions of other terms.

Section A

CORE TERMS

A-1* Actuarial Present Value

The value of an amount or series of amounts payable or receivable at various times, determined as of a given date by the application of a particular set of Actuarial Assumptions. For purposes of this standard, each such amount or series of amounts is:

a. adjusted for the probable financial effect of certain intervening events (such as changes in compensation levels, Social Security, marital status, etc.),

b. multiplied by the probability of the occurrence of an event (such as survival, death, disability, termination of employment, etc.) on which the payment is conditioned, and

c. discounted according to an assumed rate (or rates) of return to reflect the time value of money.

A-2 Actuarial Cost Method or Funding Method

A procedure for determining the Actuarial Present Value of pension plan benefits and expenses and for developing an actuarially equivalent allocation of such value to time periods, usually in the form of a Normal Cost and an Actuarial Accrued Liability.

Note: An Actuarial Cost Method is understood to be a Closed Group Actuarial Cost Method unless otherwise stated.

A-3 Normal Cost or Normal Actuarial Cost

That portion of the Actuarial Present Value of pension plan benefits and expenses which is allocated to a valuation year by the Actuarial Cost Method.

Note 1: The presentation of Normal Cost should be accompanied by reference to the Actuarial Cost Method used.

Note 2: Any payment in respect of an Unfunded Actuarial Accrued Liability is not part of Normal Cost (see Amortization Payment).

Note 3: For pension plan benefits which are provided in part by employee contributions, Normal Cost refers to the total of employee contributions and employer Normal Cost unless otherwise specifically stated.

A-4 Actuarial Accrued Liability, Actuarial Liability, Accrued Liability, or Actuarial Reserve

That portion, as determined by a particular Actuarial Cost Method, of the Actuarial Present Value of pension plan benefits and expenses which is not provided for by future Normal Costs.

Note: The presentation of an Actuarial Accrued Liability should be accompanied by reference to the Actuarial Cost Method used; for example, by hyphenation ("Actuarial Accrued Liability—XYZ," where "XYZ" denotes the Actuarial Cost Method) or by a footnote.

A-5 Actuarial Value of Assets or Valuation Assets

The value of cash, investments and other property belonging to a pension plan, as used by the actuary for the purpose of an Actuarial Valuation.

Note: The statement of Actuarial Assumptions should set forth the particular procedures used to determine this value.

A-6 Unfunded Actuarial Accrued Liability, Unfunded Actuarial Liability, Unfunded Accrued Liability, or Unfunded Actuarial Reserve

The excess of the Actuarial Accrued Liability over the Actuarial Value of Assets.

Note: This value may be negative in which case it may be expressed as a negative Unfunded Actuarial Accrued Liability, the excess of the Actuarial Value of Assets over the Actuarial Accrued Liability, or the Funding Excess.

A-7* Unfunded Frozen Actuarial Accrued Liability or Unfunded Frozen Actuarial Liability

An Unfunded Actuarial Accrued Liability which is not adjusted ("frozen") from one Actuarial Valuation to the next to reflect Actuarial Gains (Losses) under certain Actuarial Cost Methods. Generally, this amount is adjusted by any increments or decrements in Actuarial Accrued Liability due to changes in pension plan benefits or Actuarial Assumptions subsequent to the date it is frozen. Adjustments are made from one Actuarial Valuation to the next to reflect the addition of interest and deduction of Amortization Payments.

A-8 Actuarial Gain (Loss) or Experience Gain (Loss)

A measure of the difference between actual experience and that expected based upon a set of Actuarial Assumptions, during the period between two Actuarial Valuation dates, as determined in accordance with a particular Actuarial Cost Method.

Note 1: The effect on the Actuarial Accrued Liability and/or the Normal Cost resulting from changes in the Actuarial Assumptions, the Actuarial Cost Method or pension plan provisions should be described as such, not as an Actuarial Gain (Loss).

Note 2: The manner in which the Actuarial Gain (Loss) affects future Normal Cost and Actuarial Accrued Liability allocations depends upon the particular Actuarial Cost Method Used.

Section B
ACTUARIAL COST METHODS

B-1 Unit Credit Actuarial Cost Method

A method under which the benefits (projected or unprojected) of each individual included in an Actuarial Valuation are allocated by a consistent formula to valuation years. The Actuarial Present Value of benefits allocated to a valuation year is called the Normal Cost. The Actuarial Present Value of benefits allocated to all periods prior to a valuation year is called the Actuarial Accrued Liability.

Note 1: The description of this method should state the procedures used, including:

(a) how benefits are allocated to specific time periods;

(b) the procedures used to project benefits, if applicable; and

(c) a description of any other method used to value a portion of the pension plan's benefits.

Note 2: Under this method, the Actuarial Gains (Losses), as they occur, generally reduce (increase) the Unfunded Actuarial Accrued Liability.

B-2 Entry Age Actuarial Cost Method or Entry Age Normal Actuarial Cost Method

A method under which the Actuarial Present Value of the Projected Benefits of each individual included in an Actuarial Valuation is allocated on a level basis over the earnings or service of the individual between entry age and assumed exit age(s). The portion of this Actuarial Present Value allocated to a valuation year is called the Normal Cost. The portion of this Actuarial Present Value not provided for at a valuation date by the Actuarial Present Value of future Normal Costs is called the Actuarial Accrued Liability.

Note 1: The description of this method should state the procedures used, including:

(a) whether the allocation is based on earnings or service;

(b) where aggregation is used in the calculation process;

(c) how entry age is established;

(d) what procedures are used when different benefit formulas apply to various periods of service; and

(e) a description of any other method used to value a portion of the pension plan's benefits.

Note 2: Under this method, the Actuarial Gains (Losses), as they occur, reduce (increase) the Unfunded Actuarial Accrued Liability.

B-3 Attained Age Actuarial Cost Method

A method under which the excess of the Actuarial Present Value of Projected Benefits over the Actuarial Accrued Liability in respect of each individual included in an Actuarial Valuation is allocated on a level basis over the earnings or service of the individual between the valuation date and assumed exit. The portion of this Actuarial Present Value which is allocated to a valuation year is called the Normal Cost. The Actuarial Accrued Liability is determined using the Unit Credit Actuarial Cost Method.

Note 1: The description of this method should state the procedures used, including:

(a) whether the allocation is based on earnings or service;

(b) where aggregation is used in the calculation process; and

(c) a description of any other method used to value a portion of the pension plan's benefits.

Note 2: Under this method, the Actuarial Gains (Losses), as they occur, reduce (increase) the Unfunded Actuarial Accrued Liability.

Note 3: The differences which regularly arise between the Normal Cost under this method and the Normal Cost under the Unit Credit Actuarial Cost Method will affect the determination of future Actuarial Gains (Losses).

B-4 Aggregate Actuarial Cost Method

A method under which the excess of the Actuarial Present Value of Projected Benefits of the group included in an Actuarial Valuation over the Actuarial Value of Assets is allocated on a level basis over the earnings or service of the group between the valuation date and assumed exit. This allocation is performed for the group as a whole, not as a sum of individual allocations. That portion of the Actuarial Present Value allocated to a valuation year is called the Normal Cost. The Actuarial Accrued Liability is equal to the Actuarial Value of Assets.

Note 1: The description of this method should state the procedures used, including:

(a) whether the allocation is based on earnings or service;

(b) how aggregation is used in the calculation process; and

(c) a description of any other method used to value a portion of the pension plan's benefits.

Note 2: Under this method, the Actuarial Gains (Losses), as they occur, reduce (increase) future Normal Costs.

B-5 Frozen Entry Age Actuarial Cost Method

A method under which the excess of the Actuarial Present Value of Projected Benefits of the group included in an Actuarial Valuation, over the sum of the Actuarial Value of Assets plus the Unfunded Frozen Actuarial Accrued Liability, is allocated on a level basis over the earnings or service of the group between the valuation date and assumed exit. This allocation is performed for the group as a whole, not as a sum of individual allocations. The Frozen Actuarial Accrued Liability is determined using the Entry Age Actuarial Cost Method. The portion of this Actuarial Present Value allocated to a valuation year is called the Normal Cost.

Note 1: The description of this method should state the procedures used, including:

(a) whether the allocation is based on earnings or service;

(b) how aggregation is used in the calculation process; and

(c) a description of any other method used to value a portion of the pension plan's benefits.

Note 2: Under this method, the Actuarial Gains (Losses), as they occur, reduce (increase) future Normal Costs.

B-6 Frozen Attained Age Actuarial Cost Method

A method under which the excess of the Actuarial Present Value of Projected Benefits of the group included in an Actuarial Valuation, over the sum of the Actuarial Value of Assets plus the Unfunded Frozen Actuarial Accrued Liability, is allocated on a level basis over the earnings or service of the group between the valuation date and assumed exit. This allocation is performed for the group as a whole, not as a sum of individual allocations. The Unfunded Frozen Actuarial Accrued Liability is determined using the Unit Credit Actuarial Cost Method. The portion of this Actuarial Present Value allocated to a valuation year is called the Normal Cost.

Note 1: The description of this method should state the procedures used, including:

(a) whether the allocation is based on earnings or service;

(b) how aggregation is used in the calculation process; and

(c) a description of any other method used to value a portion of the pension plan's benefits.

Note 2: Under this method, the Actuarial Gains (Losses), as they occur, reduce (increase) future Normal Costs.

Section C
SUPPLEMENTAL GLOSSARY

C-2 Actuarial Assumptions

Assumptions as to the occurrence of future events affecting pension costs, such as: mortality, withdrawal, disablement and retirement; changes in compensation and Government provided pension benefits; rates of investment earnings and asset appreciation or depreciation; procedures used to determine the Actuarial Value of Assets; characteristics of future entrants for Open Group Actuarial Cost Methods; and other relevant items.

C-3 Actuarial Valuation

The determination, as of a valuation date, of the Normal Cost, Actuarial Accrued Liability, Actuarial Value of Assets, and related Actuarial Present Values for a pension plan.

C-4* Actuarially Equivalent

Of equal Actuarial Present Value, determined as of a given date with each value based on the same set of Actuarial Assumptions.

C-5 Amortization Payment

That portion of the pension plan contribution which is designed to pay interest on and to amortize the Unfunded Actuarial Accrued Liability or the Unfunded Frozen Actuarial Accrued Liability.

C-7* Open Group/Closed Group

Terms used to distinguish between two classes of Actuarial Cost Methods. Under an Open Group Actuarial Cost Method, Actuarial Present Values associated with expected future entrants are considered; under a Closed Group Actuarial Cost Method, Actuarial Present Values associated with future entrants are not considered.

C-8 Pay-as-You-Go

A method of financing a pension plan under which the contributions to the plan are generally made at about the same time and in about the same amount as benefit payments and expenses becoming due.

C-9* Projected Benefits

Those pension plan benefit amounts which are expected to be paid at various future times under a particular set of Actuarial Assumptions, taking into account such items as the effect of advancement in age and past and anticipated future compensation and service credits. That portion of an individual' s Projected Benefit allocated to service to date, determined in accordance with the terms of a pension plan and based on future compensation as projected to retirement, is called the Credited Projected Benefit.

C-10 Terminal Funding

A method of funding a pension plan under which the entire Actuarial Present Value of benefits for each individual is contributed to the plan's fund at the time of withdrawal, retirement or benefit commencement.

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[32]Actuarial Standard of Practice No. 4 may be obtained from the Actuarial Standards Board, 1100

Seventeenth Street, NW, 7th Floor, Washington, DC 20036.

Appendix A

BACKGROUND

42. The other postemployment benefits (OPEB) project was placed on the GASB's technical agenda in 1988, principally because of growing concern about the potential magnitude of employer obligations to provide postemployment benefits other than pensions and the need for clear accounting and financial reporting standards regarding such benefits. In November 1984, the Financial Accounting Standards Board (FASB) had issued its Statement No. 81, *Disclosure of Postretirement Health Care and Life Insurance Benefits.* Although Statement 81 was level (b) in the hierarchy of generally accepted accounting principles (GAAP) under the 1984 "Agreement Concerning the Structure for a Governmental Accounting Standards Board (GASB)" in effect at that time, the GASB's research indicated that few governments were applying its requirements.

43. By 1988, the FASB was working on a project to develop more comprehensive standards on OPEB accounting and financial reporting (subsequently issued as FASB Statement No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions,* in December 1990), which would supersede Statement 81. Those standards were expected to reflect generally the same measurement concepts as FASB Statement No. 87, *Employers' Accounting for Pensions* (December 1985). In GASB Statement No. 4, *Applicability of FASB Statement No. 87, "Employers' Accounting for Pensions," to State and Local Governmental Employers* (September 1986), issued to address the applicability of FASB Statement 87 to governments, the Board stated that state and local governments should not change their pension accounting and reporting as a result of that Statement, because the Board was making progress on the subject of pension accounting and reporting and expected to issue one or more pronouncements on the subject in the near future. With the addition of OPEB to the technical agenda in 1988, the GASB expanded its focus to include consideration of other postemployment benefits, as well.

44. The Board's initial efforts on OPEB reporting were an Exposure Draft in November 1989 and a final Statement in May 1990 on employer disclosure requirements. Statement No. 12, *Disclosure of Information on Postemployment Benefits Other Than Pension Benefits by State and Local Governmental Employers* (effective for fiscal years beginning after June 15, 1990), was issued as an interim Statement pending completion of more definitive OPEB accounting and financial reporting standards—the objectives of the current OPEB project. The disclosure requirements of Statement 12 applied to all employers that finance all or part of the cost of OPEB for their retirees or terminated employees. However, employers that advance-fund OPEB on an actuarially determined basis through a public employee retirement system (PERS) or pension plan were given the option of applying the disclosure requirements of Statement No. 5, *Disclosure of Pension Information by Public Employee Retirement Systems and State and Local Governmental Employers,* instead. Subsequently, Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers* (November 1994), superseded both Statement 5 and the option to apply Statement 5 disclosure requirements to advance-funded OPEB plans.

45. Statement 12 required no change in the recognition and measurement of OPEB in employers' financial statements, pending completion of the GASB's planned project on the subject, and specifically stated that governmental employers were not required to adopt the forthcoming FASB Statement 106. (However, Statement 12 did not preclude the possibility of employers' voluntarily adopting FASB Statement 106 on an interim basis.) Subsequently, the Board provided employers with the option of applying the standards of Statement 27 to postemployment healthcare as well as pensions, on an interim basis. Statement 27 became effective for fiscal years beginning after June 15, 1997. Paragraph 24 of that Statement required that a sole or agent employer that applies the measurement and recognition requirements of that Statement to healthcare should also apply its disclosure requirements, rather than those of Statement 12, and provided additional guidance specific to healthcare disclosures.

46. In November 1994, the Board issued a second interim standard, Statement No. 26, *Financial Reporting for Postemployment Healthcare Plans Administered by Defined Benefit Pension Plans,* to address certain plan reporting situations pending completion of the OPEB project. Specifically, in situations where a postemployment healthcare plan is administered by a defined benefit pension plan, Statement 26 required separate financial reporting of information about the healthcare plan, applying the requirements of Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans* (also issued in November 1994), pertaining to financial statements. The required note disclosures in that case were similar to those for pension plans but also included certain disclosures required by Statement 12 for employers. Similar to Statement 12, Statement 26 did not require the use of actuarially determined information about postemployment healthcare benefit obligations; however, it included guidance for preparers that elected to provide that information. Statements 25 and 26 became effective for fiscal years beginning after June 15, 1996.

47. In September 1995, the Board began broader discussions of OPEB financial reporting issues. An OPEB task force was formed to advise on the project. After much discussion, the Board tentatively decided to pursue an approach to OPEB reporting based on the approach established for reporting pensions in Statement 27 for employers and Statement 25 for plans. The Board also agreed that the scope of the project would initially focus on postretirement healthcare benefits; however, before the issuance of an Exposure Draft, the Board agreed to consider expanding the scope to include other benefits, as well. The Board reached several additional tentative decisions at its February 1996 meeting, and the staff continued to work with the task force members on specific recognition and measurement issues throughout 1996. However, the OPEB project was placed on hold in early 1997 pending completion of Statements No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments,* and No. 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities* .

48. The Board resumed discussions of OPEB reporting issues at its August 1999 Board meeting. Those discussions led to the issuance of two Exposure Drafts of proposed Statements, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* (the employer Exposure Draft) and *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans* (the plan Exposure Draft), in February 2003. The Board received eighty-five responses to the employer Exposure Draft, held two public hearings, and sponsored a user forum in conjunction with a meeting of the National Federation of Municipal Analysts. As explained in Appendix B, "Basis for Conclusions," the Board's redeliberation of certain issues in light of comments received resulted in a number of changes, including one change—to eliminate the proposed "implicit rate subsidy" exemption in paragraph 6a of the employer Exposure Draft—that extended the applicability of the proposed Statement to additional employers. Accordingly, the Board decided to issue a revised employer Exposure Draft to provide an opportunity for comments on that issue.

49. The revised Exposure Draft was issued in January 2004. The Board received fifty comment letters. After reviewing comments received, the Board reaffirmed its conclusion that implicit rate subsidies should be included in calculations of employers' OPEB costs and obligations, whether or not the employer also makes an additional contribution in explicit form.

50. The staff and Board have been assisted in their research and deliberation of issues by a reconstituted and expanded OPEB task force that includes actuaries, auditors, benefit consultants, financial report users of several types, state and local governmental employers, and state and local plan administrators. The staff and Board also received additional assistance during the course of the project from members of the actuarial community, as committee members of the American Academy of Actuaries or as individuals, in understanding and considering alternative treatments of technical aspects of OPEB measurement, including issues related to the Board's decision to develop an alternative measurement method for small plans.

Appendix B

BASIS FOR CONCLUSIONS

CONTENTS

Appendix B

BASIS FOR CONCLUSIONS

Introduction

51. This appendix summarizes factors considered significant by Board members in reaching the conclusions in this Statement. It includes discussion of the alternatives considered and the Board's reasons for accepting some and rejecting others. Individual Board members gave greater weight to some factors than to others.

52. The overall approach taken in this Statement to employers' reporting of OPEB is based on the approach taken in Statement 27 and generally parallels that Statement, resulting in a consistent approach to the requirements for financial reporting of all postemployment benefits by state and local governmental employers. The Board has, however, made certain modifications for OPEB that it believes are necessary to appropriately address differences between OPEB and pension benefits.

53. This Statement was considered jointly with Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans,* and the two Statements provide for consistent measurement of OPEB information reported by OPEB plans and participating employers and for coordination of disclosure requirements. Many of the measurement and disclosure requirements of the two Statements are the same or are closely related, as are the illustrations and other appendixes. The Statements originally were exposed for comment at the same time, in February 2003, so that preparers, auditors, and users could give joint consideration to plan and employer financial reporting of OPEB information.

Definitions and Scope

54. The Board previously defined *pension benefits* and *other postemployment benefits* in Statement 12 and adopted the same definitions and distinctions in Statements 25 and 27. The Board concluded that those definitions and distinctions remain appropriate and should be carried forward for the purposes of this Statement and Statement 43 on OPEB plan reporting. As used in these and preceding Statements:

a. *Retirement income* is classified as a pension benefit and should be reported in accordance with standards for pension reporting.

b. *Postemployment healthcare* —for example, medical, dental, vision, and hearing (not necessarily all-inclusive)—is classified as OPEB and should be reported in accordance with standards for OPEB reporting.

c. Except for retirement income and postemployment healthcare, the classification of postemployment benefits for financial reporting purposes depends on whether the benefits are provided through plans that also provide retirement income (pension plans). Postemployment benefits such as death benefits, disability, long-term care, and life insurance (not necessarily all-inclusive) are classified as pension benefits if provided through a pension plan and as OPEB if provided separately from a pension plan.

Distinction between OPEB and Termination Offers and Benefits

55. As discussed in the following paragraph, the Board concluded that OPEB is compensation for employees' services. In contrast, the Board concluded that benefits such as special termination benefits, as the term is used in National Council on Governmental Accounting (NCGA) Interpretation 8, *Certain Pension Matters,* as amended, and benefits provided under "early-retirement incentive programs" (examples not all-inclusive) are intended to induce *an early termination of services.* Accordingly, the Board has excluded payments made or benefits offered for that purpose or as compensation or settlement for the early termination of services (collectively referred to as *termination offers and benefits*) from the scope of this Statement. However, any effect on an existing defined benefit OPEB that is included in, and results from the acceptance of, special termination benefit offers should be accounted for in accordance with the requirements of this Statement, rather than the requirements of NCGA Interpretation 8, as amended.

Nature of Postemployment Benefit Transactions

56. To be reliable, information in financial reporting should, among other attributes, "faithfully represent what it purports to represent"—that is, "the underlying events and conditions" (Concepts Statement No. 1, *Objectives of Financial Reporting,* paragraph 64). When developing standards of financial reporting for OPEB, it was therefore of primary importance to consider the nature of the underlying transactions. The Board concluded that postemployment benefits—OPEB as well as pensions—are part of the *compensation for services* offered by employers in order to attract and retain qualified employees, often in competition with other potential employers. That is, postemployment benefits, including OPEB, are part of an *exchange* of salaries and benefits for services rendered. Of the total package of benefits offered by employers, some benefits (including salaries and active-employee healthcare) are taken while employees are in active service, whereas other benefits (including pension benefits and postemployment healthcare and other OPEB) are taken after employees' services have ended. Nevertheless, both types of benefits constitute compensation for employee services. A crucial implication of this understanding for financial reporting is that the *cost* of OPEB—like the cost of pension benefits—generally should be associated with the periods in which the exchange occurs, rather than with the periods, often many years later, when benefits are paid or provided. The Board also considered but rejected the view that OPEB is a serial gratuity for which the employer receives no compensating value—that is, that it arises from a series of nonexchange transactions.

Financial Reporting Standards and Practice

Previous Standards

57. Previously, employers that provide OPEB were subject to the disclosure requirements of Statement 12. That Statement, issued in 1990 as an interim Statement pending the issuance of more comprehensive financial reporting standards, required employers to disclose descriptive information for each type of OPEB provided, or for all OPEB in the aggregate, as well as information about OPEB expense or expenditures. The latter disclosure requirements were conditioned on the method by which OPEB is

financed (that is, requirements differed depending on whether benefits are financed on a pay-as-you-go basis or are advance-funded on an actuarially determined basis) and, for pay-as-you-go plans that include both active employees and retirees, the ability to readily separate the expense or expenditures related to retirees and active employees or reasonably estimate the amount for retirees.

58. Prior to this Statement, there has been no comprehensive standard for state and local governments requiring accrual-basis measurement of OPEB expense or expenditures or providing guidance on how that should be done. Paragraph 24 of Statement 27, which required accrual-basis measurement of employers' pension expense/expenditures and related liabilities (or assets), alluded to the *possibility of voluntary application* to postemployment healthcare benefits when it stated:

Employers are not required to apply this Statement to postemployment healthcare benefits. A sole or agent employer that applies the measurement and recognition requirements of this Statement to health care also should provide the notes to the financial statements required by this Statement instead of the note disclosures required by Statement 12. . . .

Similarly, paragraph 13 of Statement 12 did not require governmental employers to change their accounting and financial reporting of OPEB pending the completion of the GASB's project on recognition and measurement of OPEB—for example, to implement the then-forthcoming FASB Statement 106. However, governmental employers were not explicitly prohibited from voluntarily applying the requirements of FASB Statement 106 to OPEB on an interim basis. Nevertheless, few governmental employers have chosen to apply the measurement requirements of Statement 27 or FASB Statement 106 to OPEB, leaving OPEB as one of the most prominent types of transactions for which the economic resources measurement focus and accrual basis of accounting have not been uniformly required or commonly applied.

Current Practice

59. The Board's research prior to the issuance of Statement 12 in 1990, during 1995, and most recently in 1999 has indicated that many governmental employers offer OPEB—most prominently postemployment healthcare benefits, but others as well—for which the employer pays all or a substantial part of the cost, and that the employer's costs and the accrued obligations related to OPEB frequently are potentially significant. Practices with regard to accounting and financial reporting for OPEB vary and often are related to how OPEB is financed. Currently, most OPEB plans are financed on a pay-as-you-go basis, and employers' accounting generally focuses on measuring the outflows of *current financial resources* for the payment of benefits or premiums as they come due, rather than measuring the annual cost of benefits earned (outflow of *economic resources*). Recognition of the resulting amounts is on the modified accrual or accrual basis, depending on the fund used. Because of this, most governments do not report information needed to assess the *long-term financial implications* of OPEB transactions, including the actuarial accrued obligations related to service to date and the potential demands on future cash flows.

Financial Reporting Objectives of This Statement

60. The Board's principal financial reporting objectives in developing this Statement are:

a. To require financial reporting that more faithfully represents OPEB transactions, as discussed in paragraph 56, and that provides more complete and useful information to users of governmental financial reports about the financial implications of those transactions. Financial report users having a potential interest in information about employers' costs and obligations with regard to OPEB include elected public officials of employer or sponsor governments; investors, creditors, and financial-market service agencies such as bond rating services; citizens and those who analyze and communicate governmental financial information on their behalf; employees and retirees or surviving beneficiaries and their representatives; and others.

b. To require and provide standards for the *measurement and disclosure* of employers' OPEB costs and related liabilities (or assets), such that costs are allocated for these purposes in a systematic and rational manner over periods approximating the service life of an active employee group, whether recognition in the financial statements is on the accrual basis (OPEB expense in government-wide financial statements and in proprietary and fiduciary fund financial statements) or on the modified accrual basis (OPEB expenditures in governmental fund statements).

c. To require and provide standards for the reporting of relevant information about (1) accrued OPEB obligations related to employees' services in current and prior periods, (2) the employer's cost of OPEB, and (3) the current funded status of the plan and the progress being made in accumulating plan net assets to pay benefits as they come due in future periods.

d. To achieve a consistent approach to requirements for reporting all postemployment benefits (pensions and OPEB).

61. To achieve these objectives, the Board concluded that OPEB should be measured and disclosed using an economic resources measurement focus. The Board concluded that the pay-as-you-go (current financial resource outflows) approach to accounting for OPEB currently used by most employers does not faithfully represent the underlying transactions or otherwise achieve the objectives set by the Board. The Board also considered but rejected **terminal funding** approaches, in which accrued obligations associated with each plan member are first considered in calculations for financial reporting purposes at the time the member terminates active employment, because such approaches fail to account for costs and accrued obligations related to active employees.

Approach

62. In Statement 43 and in this Statement, the Board has adopted the same overall approach to accounting and financial reporting for OPEB that it previously adopted for pension benefits in Statements 25 and 27. The development of that approach was based on the view that resource-allocation decisions and other decision-making needs of users, preparers, and attestors are best served when pension information is measured (a) on the accrual basis of accounting, (b) consistently, when similar information is reported by a pension plan and its participating employers, and (c) using the same measurement methods and assumptions for both financial reporting and plan funding, when those methods and assumptions are consistent with accrual-basis accounting principles. The Board believes that it is important to avoid situations in which decision makers are provided with two amounts that purport to represent the same phenomenon, such as the funded status (assets less actuarial accrued liabilities) of a pension plan, but that differ significantly solely because one amount was calculated for funding purposes and the other for financial reporting. Based on experience with a standardized funding progress disclosure required by GASB Statement 5 (superseded by Statements 25 and 27), the Board concluded that dual measurement systems add unnecessary complexity to an already complex process, invite confusion as to which amount may be "correct," and enhance the risk that decision makers may select one of the amounts solely because it better supports a predetermined result.

63. When this Statement and Statement 43 were being developed, the primary and most far-reaching issue discussed by the Board was whether to apply the GASB pension reporting approach to OPEB. The Board concluded that, similar to the pension standards, the funded status of OPEB plans and the annual OPEB cost of employers participating in single-employer or agent multiple-employer OPEB plans should be determined using the same actuarial methods and assumptions that are applied in determining the plan's funding requirements, provided that those methods and assumptions meet certain accounting requirements (parameters) designed to ensure consistency with the concepts of accrual-basis accounting. If the plan's funding methods or assumptions do not meet the parameters, or if the plan is financed entirely on a pay-as-you-go basis, the parameters nevertheless apply for financial reporting. (Paragraphs 169–196 discuss the optional application of different measurement methods for certain small plans and their participating employers.)

64. In reaching its decision, the Board considered whether OPEB is significantly different from pension benefits in ways that would support a different approach to measuring or reporting them. For example, pension benefits are generally paid in cash, and the payments are similar in amount each period and

continue throughout the retirement period. In contrast, OPEB (for example, postemployment healthcare benefits) often is provided "in kind" as needed, may increase in amount as a retiree ages, or may decrease or terminate when a retiree becomes eligible for Medicare. The two types of benefits also frequently differ in provisions regarding the vesting of benefits and the amendment of plan terms. The Board concluded that these differences tend to make OPEB information more difficult to measure and more volatile than pension information because of the need for more assumptions about future events. However, the greater complexity of measurement does not alter the conclusion that OPEB and pension benefits are conceptually similar transactions—both involve deferred compensation offered in exchange for current services—and should be accounted for in a similar way.

65. The Board also considered whether differences in funding or financing approaches between pensions and OPEB justify different accounting standards. Prior to the issuance of Statement 27, most governmental pension plans were administered in trust, were prefunded on an actuarially determined basis, and obtained actuarial valuations either to establish the amounts to be contributed or to assess the adequacy of contributions if determined in another way. As discussed in paragraph 59, most governmental postemployment healthcare plans are financed on a pay-as-you-go basis (or are partially advance-funded but not necessarily on an actuarially determined basis), and many have never obtained an actuarial valuation. The Board considered whether the widespread lack of full, actuarially determined prefunding of OPEB supports the adoption of either a nonactuarial methodology to account for OPEB or a significant reduction in the range of actuarial methods available for OPEB compared with those available under the pension standards. The Board decided against these approaches, except as provided in paragraphs 33 through 35 for certain small plans and their participating employers. The provisions of paragraphs 33 through 35 are further discussed in paragraphs 169 through 196.

66. Similar to its earlier conclusion for pensions, the Board concluded that, given the nature of postemployment benefit transactions, estimating the funded status of an OPEB plan and the total and periodic cost of OPEB on an accrual basis necessarily involves the application of actuarial methods and assumptions (collectively, an actuarial methodology). Moreover, the Board concluded that a variety of different methodologies—those consistent with both Actuarial Standards of Practice and GASB parameters—would meet the objectives of accrual-basis reporting of OPEB, including reasonable and systematic allocation of benefit costs to financial reporting periods, regardless of the way in which a plan is financed. Regardless of the methodology selected, actuarial measures are estimates of future events and are inherently imprecise, and the Board is not persuaded that any single methodology produces better estimates than all others or that the advantages of prescribing a single methodology for financial reporting purposes would outweigh the disadvantages.

67. The Board's decision to permit generally the same range of actuarial methods for OPEB as for pension benefits also was strongly affected by the Board's broader objective of developing an internally consistent approach to standards of reporting for all postemployment benefits—pensions and OPEB—by state and local governmental employers. The Board concluded that a consistent approach would improve the understandability of the standards, ease their application by financial report preparers and auditors, and make reported financial information about postemployment benefits more readily understandable and useful to report users.

68. Moreover, the Board believes that governments' approaches to financing OPEB are evolving and will continue to evolve. Although few governments currently prefund their OPEB plans on a full actuarially determined basis, some others may choose to adopt that approach in the future. If the Board were to require a single methodology for accounting, and a government concluded that a different methodology would be more appropriate for funding purposes, then the goal of general consistency between accounting and funding measures of similar information would not be achieved. The Board continues to believe that reporting the same measures for both financial reporting and funding decisions is important for users and, in furtherance of that goal, has provided a choice of actuarial methodologies that are consistent with accrual-basis accounting.

Respondents' Comments regarding the Overall Approach

69. The Board received numerous comments regarding its proposal to apply the same overall approach to employers' accounting and financial reporting for OPEB that it adopted in Statement 27, with modifications as necessary to reflect differences between pension benefits and OPEB. Respondents' comments and the Board's conclusions on that issue and others closely interrelated with or forming the basis for the Board's proposal to follow that approach are discussed in paragraphs 70 through 85.

Respondents Who Agreed with the Overall Approach

70. Many respondents agreed with the view expressed in the Exposure Draft that "OPEB is, in substance, part of the compensation that employers offer and arises from an exchange of salaries and benefits for employee services rendered" (paragraph 6). Those respondents:

a. Were generally supportive of the view that, despite differences in form and practice, OPEB and pension benefits are essentially similar postemployment benefits for which a consistent overall approach to accounting and financial reporting is appropriate

b. Were generally supportive of the financial reporting objectives of requiring accrual-basis accounting for OPEB costs and measurement and disclosure of information about actuarial accrued liabilities related to past services and the status and progress of funding of the benefits

c. Generally accepted as reasonable and appropriate the application of the pension measurement approach,[33] with modifications as necessary to reflect differences between OPEB and pension benefits—for example, the proposals to project benefits based on the current substantive plan and the historical pattern of division of OPEB costs between the employer and plan members.

71. Participants in the OPEB user forum—principally financial analysts—also were generally supportive of the Board's overall philosophy and approach, although a few would prefer a reduction of actuarial measurement options, which they believe would enhance comparability of reporting among governments. Most believe that the standards would reduce the uncertainty about the extent and financial implications of governmental employers' commitments to provide OPEB that exists with current reporting practice and that it would provide useful analytical information.

Respondents Who Disagreed with the Overall Approach

72. Other respondents disagreed with the overall approach reflected in the Exposure Draft. Their comments were of two distinct types—comments on *accounting issues* and comments on the *potential effects of financial reporting on decisions regarding benefits.*

Comments on accounting issues

73. Respondents who objected based on *accounting issues* generally focused on differences between employers' commitments to provide pension benefits and OPEB, as support for their view that OPEB should not be accounted for in a manner similar to pension benefits. Essentially, those respondents questioned whether a long-term *liability* for OPEB should be considered to exist—or, if it exists, whether it is sufficiently measurable to be recognized in financial statements. Key arguments in support of that view included the following. Not all respondents necessarily emphasized or supported the same points.

a. OPEB that is not guaranteed or vested is contingent on periodic authorization by the employer, which often stipulates its right to modify or discontinue benefits, and therefore should not be accounted for as a long-term commitment. Respondents who made this argument emphasized the possibility that an employer might, at some time in the future, discontinue its pattern of providing OPEB.

b. The amounts of future OPEB payments are affected by a number of demographic and economic variables, including the healthcare trend rate for postemployment healthcare, that make them inherently difficult to estimate. In addition, employers generally can, and do, modify OPEB plan designs from time to time, so that the plan design cannot be expected to remain static over time. For these reasons, some respondents argued that projected benefits are too imprecise, and too much of a moving target, to be taken into consideration in the measurement and recognition of OPEB liabilities and expense for financial reporting purposes.

c. Because OPEB is financed or administered differently in some cases, in comparison to pension benefits, different accounting and financial reporting for OPEB is warranted. For example, some respondents questioned the requirement to account for postemployment healthcare on an accrual basis, using a measurement approach that incorporates funding concepts, if the benefit is being financed on a pay-as-you-go basis. Others cited administrative arrangements in which retirees are included in the same group as active employees, and the entire group is accounted for under Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues,* as amended. Those respondents would prefer to continue accounting for such arrangements in the same manner—which would amount to a continuation of pay-as-you-go accounting for the retiree portion.

74. Respondents who disagreed with the overall approach on accounting grounds generally challenged the proposal to require accrual-basis accounting for OPEB by citing difficulties with the recognition or measurement of an employer liability related to those benefits. The principal lines of argument presented—that nonpension postemployment benefits frequently are not vested or guaranteed and therefore could potentially be amended or discontinued, and that OPEB obligations are inherently difficult to measure—were considered by the Board previously in the process of developing the OPEB Exposure Drafts. In previous projects the GASB also considered and rejected similar arguments. Other standards setters, including the FASB, International Accounting Standards Board (formerly the International Accounting Standards Committee), and NCGA, also had considered and rejected those types of arguments. The Board's conclusions as expressed in the Exposure Draft generally were consistent with its own previous decisions in the pensions project and with those of the other standards setters on the same or related matters.

75. The Board considered but did not accept the argument that if OPEB is not vested or guaranteed, or requires periodic authorization by the employer, it should not be accounted for as a long-term commitment. Rather, the Board affirmed its conclusion that postemployment benefit transactions are an *exchange of promised benefits for employee services.* The total compensation to employees in exchange for their services includes *both* (a) benefits such as salaries and active-employee healthcare, which are taken in the period(s) of employee service, *and* (b) other benefits (for example, pensions and postemployment healthcare), which are deferred and are not taken until after retirement or another future event, such as disability, occurs. The Board also affirmed, as implications of this view, that:

a. The cost associated with an employee's postemployment benefit is deemed to be incurred, and conceptually should be recognized, in the years during which the employer receives services rather than during the postemployment period when payments are made.

b. The employer has a constructive, if not legal, obligation for promised benefits to the extent the benefits are attributable to services already received and it is probable that conditions for an employee's eligibility to receive benefits will be met.

c. Pay-as-you-go and terminal funding approaches do not faithfully represent the transactions or their financial effects, and employers should account for their expenses and obligations associated with providing OPEB on the accrual basis.

76. The Board also affirmed its belief that the Exposure Draft appropriately emphasized an approach to accounting for OPEB that incorporates a going-concern assumption, notwithstanding the possibility that an employer that stipulates its legal right to terminate benefits might at some time exercise that right. A precedent for that approach can be seen in NCGA Statement 5, *Accounting and Financial Reporting Principles for Lease Agreements of State and Local Governments.* In that Statement, the NCGA concluded that most lease agreements are long-term in nature, notwithstanding the inclusion of fiscal

funding clauses. The NCGA based the accounting standards for capital leases on the more probable assumption—that the transaction would be carried through to completion—rather than on the requirement for annual authorization of lease payments.

77. The Board further affirmed its conclusion that, as a practical matter, it is unlikely that an employer ordinarily could terminate a plan to avoid the related obligation without potentially suffering adverse consequences, or incurring compensating cost, in some way. Therefore, the Board affirmed its general presumption, and that of other standards setters, that an employer that has established a *pattern of providing* postemployment benefits has accepted *responsibility to provide* those benefits. Consequently, the Board continues to believe that it would be inappropriate to assume for accounting purposes that benefits for members currently in the plan will be terminated in the absence of evidence that termination is likely to occur. Rather, the Board believes that accounting for OPEB arrangements generally should be based on the presumption that the plan will continue and that the benefits promised by the employer will be provided—that is, based on a going-concern assumption.

78. The Board recognizes that the measurement of an employer's obligations and costs resulting from a defined benefit OPEB plan requires estimates of future events, and that the result is inherently less precise than some other measurements included in financial statements. Also, as some respondents pointed out, the amounts of OPEB obligations and costs are potentially affected by changes in the nature and price of medical services, changes in plan design in response to changing conditions and constraints, and changes in government programs such as Medicare. Uncertainty and the prospect of continual change obviously are factors that affect the ability to project future events with precision. However, the Board rejected the notion that those characteristics defeat the possibility or usefulness of measurements of OPEB obligations and costs, based on estimates at a given point in time, for financial reporting purposes. Nor does the inability to obtain a precise measure justify reporting as if no cost or obligation has been incurred prior to the disbursement of cash. The Board continues to believe that a reasonable estimate based on available evidence and current expectations will provide more useful information than no estimate at all. Moreover, the Board believes that the measurement approach, involving periodic actuarial valuations,[34] would appropriately address relevant changes affecting the measurement of OPEB by requiring periodic updates of assumptions and estimates as changes occur.

79. The Board also believes that the note disclosure requirements of this Statement will adequately inform financial report users of the nature and inherent difficulties of making OPEB calculations. Those requirements will include disclosure of the fact that the calculations require estimates of complex economic and demographic factors far into the future, which are inherently imprecise and are subject to continual change as more information becomes available.

Comments regarding potential effects on benefits

80. Other respondents opposed the issuance of the OPEB Statements or recommended substantial changes to soften the reporting requirements because of concerns related to potential effects they believe the measurement and financial reporting of accrual-basis OPEB information could have on policy decisions by government officials or others. Those respondents were concerned that if accrual-basis information were developed, that information potentially would affect the process of making policy decisions related to the continuation, level, design, and method of financing of benefits. The policy decisions made by government officials might, in some cases, be less favorable to policy positions advocated by the respondents (for example, as advocates for employees and retirees) than the decisions officials *otherwise might make* if current accounting and financial reporting practice were allowed to continue. Some respondents suggested, further, that by issuing standards that would provide more comprehensive accounting and reporting of information about employers' OPEB costs and obligations—and for that reason could potentially affect policy makers' decision processes—the Board would be going beyond its mission of setting accounting standards and into the arena of public policy.

81. Although some respondents suggested that the Board should subordinate financial reporting objectives to considerations of public policy, the Board strongly affirmed that it should address OPEB accounting and financial reporting in order to achieve its mission. The GASB's first guiding principle is that

the Board should be *objective* and *neutral (free from bias)* in its decision making and should strive for financial reporting that *faithfully represents* the activities reported. That principle also precludes "placing any particular interest above the interests of the many who rely on the information contained in financial reports" (*GASB Rules of Procedure,* December 1, 2002, p. 3). The Board focuses on the public reporting of information to a variety of interested parties about the activities of a government affecting its financial position and operating results. The broad range of and potential conflicts among the interests of different user groups are amply described in Concepts Statement 1.

82. Faithful representation of the matters reported also is an essential component of the qualitative characteristic of *reliability* that information in financial reporting (including information about OPEB) should have, as discussed in paragraph 64 of Concepts Statement 1. To be reliable, financial reporting also should be *comprehensive,* with *nothing material omitted,* nor should anything be included that would make the reported information misleading. These characteristics would, for example, preclude selective reporting of costs and liabilities based on consideration of the effect that the resulting financial statements might have on users' judgments and decisions.

83. The qualitative characteristic of *relevance* reinforces the point that financial information should be relevant to users' needs for information and to users' decisions. "Information is relevant if it is capable of making a difference in a user's assessment of a problem, condition, or event" (Concepts Statement 1, paragraph 65). The Board is concerned with governments' reporting of general purpose financial information that will assist users to hold governments accountable for their actions and will aid in users' decision making on a variety of economic, social, and political issues. GASB standards are intended to provide information for those purposes, and not to exert a direct influence on public policy decisions. Such decisions are subject, in a democracy, to public debate; nevertheless, such decisions may appropriately be informed by disclosures made in conformity with GASB standards. The Board's attention to standards setting for OPEB is appropriate precisely because the information *is* decision useful; moreover, it is natural that the information that will result from the application of the standards will be *capable of making a difference* in users' judgments and decisions. The potential impact of the OPEB standards on decision making is a function of the significance of the matters reported, and not of any agenda by the GASB to promote or oppose any particular interest, policy position, group, or outcome.

84. Most respondents who disagreed with the Board's proposal to follow a Statement 27 approach opposed accrual accounting for OPEB. A few, however, favored accrual accounting but recommended immediate recognition of the employer's unfunded OPEB obligation as a liability of the employer, rather than the gradual recognition provided for under the Statement 27 approach as a byproduct of expense accrual based on the annual required contribution of the employer (ARC). The approach recommended by those respondents is similar to that taken in Financial Reporting Standard 17, *Retirement Benefits,* issued by the Accounting Standards Board of the United Kingdom.

85. The preceding approach—recognition of the entire unfunded actuarial accrued liability (UAAL) as a liability of the employer and of all changes in the UAAL as changes in the employer's net assets—is one of several approaches considered by the Board but rejected prior to adopting the approach proposed in the Exposure Draft. In discussing the respondents' recommendation, the Board reiterated its objective to maintain consistency between the standards for reporting pension benefits and OPEB. The Board also continues to have concerns about the magnitude and volatility of potential changes in the UAAL from year to year that are not due to the economic consequences of the employee benefit itself and the effect that recognition of those changes in full each year in change statements would have on the nature and interpretation of those statements as presently constituted. The Board concluded that consideration of a proposed change as fundamental as that suggested by the respondents would be premature in the context of this project and prior to consideration of broader issues including elements of financial statements and measurement attributes.

Parameters for Actuarial Valuations

86. As is true for pensions, the process required for measuring the ARC and for calculating information

reported by the employer(s) about the plan's funding progress involves the following broad steps:

a. Projecting future cash outflows for benefits—a process that involves analysis of plan terms (the substantive plan, as defined in paragraph 13a) and the covered group and the use of actuarial methods and assumptions about future events

b. Discounting projected benefits to present value

c. Allocating the present value of projected benefits to periods using an acceptable actuarial cost method.

The purpose of the parameters is to ensure that the measurement process is carried out in a way that is appropriate for purposes of accrual accounting and general purpose external financial reporting. The Board generally concluded that the parameters for actuarial valuations of pension plans set forth in Statement 27 also are appropriate for valuations of OPEB for financial reporting purposes, with certain modifications discussed below.

87. Because the parameters permit several alternatives, it would be possible for a plan and its participating employer(s) to select different alternatives for reporting similar or related information. Although this possibility is unlikely to occur in the majority of situations, the Board has specifically precluded it in both Statements because of the importance to users of consistency between plan and employer reporting of similar information.

Frequency and Timing of Actuarial Valuations

88. In deliberations leading to the issuance of the 2003 Exposure Drafts, the Board discussed at length cost–benefit issues related to the potential administrative cost of applying the requirements of this Statement, principally the cost of actuarial valuations, for small single-employer OPEB plans and participating employers. The Board also explored possible means of making the requirements as cost-effective as possible, including the possibility of extending the interval between actuarial valuations of OPEB plans, in comparison with the requirement of Statements 25 and 27 that pension plans be valued at least biennially. The Board concluded that the nature of OPEB transactions, particularly for postemployment healthcare benefits, and the achievement of the financial reporting objectives of this Statement necessitate a measurement process that includes the steps discussed in paragraph 86. Moreover, the Board found nothing inherent in postemployment healthcare plans that would suggest that valuations of such plans should be less frequent than valuations of pension plans (that is, at least biennially). On the contrary, some would say that the greater volatility of the OPEB information is a reason that valuations should *not* be less frequent. On the other hand, the Board's research indicated that many governmental postemployment healthcare plans are small single-employer plans and, further, that many plans (perhaps more frequently the smaller plans) currently do not obtain actuarial valuations. Consequently, for many plans, the cost of actuarial valuations when viewed on a per-member basis, or in comparison with the amount currently paid out for benefits, could seem relatively high. Moreover, that cost would be an incremental cost, whereas most pension plans already were obtaining actuarial valuations prior to the issuance of Statements 25 and 27.

89. Balancing the financial reporting objectives of this Statement, and the need for reliable information, against the cost of measurement for smaller plans, the Board concluded that a two-tiered parameter regarding the minimum frequency of actuarial valuations is appropriate. As proposed in the 2003 employer Exposure Draft, this Statement requires actuarial valuations of OPEB plans with a total membership of 200 or more at least biennially and requires valuations of plans with a total membership of fewer than 200 at least triennially. (As used for this purpose, total membership includes active employees, separated employees who are eligible to begin receiving benefits at a future date, and retirees or their survivors currently receiving benefits.) The Board believes that valuations of the larger plans at least biennially are warranted by the volatility of OPEB and the size of the plans. The extended interval permitted for the smaller plans—three years—is the maximum interval provided for in Actuarial Standard of Practice No. 6, *Measuring Retiree Group Benefit Obligations* (ASOP 6). [35] The Board concluded that reported financial

information would not be sufficiently reliable if valuations were performed less frequently than that.

90. In the Basis for Conclusions to each of the 2003 Exposure Drafts, the Board acknowledged that the cutoff point of 200 members was somewhat arbitrary. Available information suggested that placing the cutoff at that level would provide a substantial portion of the total number of governmental plans with the possibility of obtaining valuations triennially. At the same time, the larger plans, which probably account for most of the total number of plan members covered by OPEB plans, would be required to obtain valuations at least biennially, as for pension plans. In either case, the Board concluded that the provision in Statement 27 requiring a new valuation if significant changes have occurred that would significantly affect the results also should be applied to OPEB.

91. After considering a variety of comments and suggestions from Exposure Draft respondents regarding the frequency of actuarial valuations, the Board decided to go forward with the required frequencies and cutoff points as proposed in the 2003 Exposure Draft, for the reasons previously stated. However, this Statement clarifies that the significant changes in "other factors" that would require a valuation to be performed sooner would be those that result in significant changes in *long-term assumptions.* The Board's intent is that a short-term fluctuation (for example, a decrease in investment earnings from one year to the next) would not necessarily require a new valuation.

92. As proposed in the 2003 Exposure Draft, the ARC for an employer's fiscal year should be derived from an actuarial valuation as of a date not more than twenty-four months before the beginning of that year, if valuations are annual, or before the beginning of the *first year* of the two-year or three-year period for which that valuation provides the ARC, if valuations are biennial or triennial. The twenty-four-month lead time is provided to allow for communication of the results of the valuation to the employer(s) and for budgeting of the employer's contributions to the plan in relation to the ARC, prior to the beginning of the first employer fiscal year to which the ARC applies.

93. After consideration of numerous comments, pro and con, from Exposure Draft respondents, the Board affirmed that employers with the *smallest* plans would be permitted to apply the alternative measurement method defined in paragraphs 33 through 35, at their option, in lieu of obtaining actuarial valuations in accordance with the parameters for financial reporting purposes. Requirements regarding the frequency and timing of calculations using the optional measurement method are the same as for actuarial valuations of plans with a total membership of fewer than 200, as proposed in the 2003 Exposure Draft. Issues regarding the alternative measurement method are discussed more fully in paragraphs 169 through 196.

Benefits to Be Included

Projection of Future Benefit Payments Based on the Substantive Plan

94. Although some OPEB plans may have a formal plan document that comprehensively sets forth the terms of the plan, frequently that is not the case. Anecdotal evidence from actuaries and benefit consultants indicates that it is not unusual to encounter situations in which (a) the plan document describes the nature of the benefits covered or the criteria for eligibility for benefits only in very general terms, (b) the terms described in the plan document differ from the benefits communicated to plan members and actually provided, or (c) there is no formal plan document. Accordingly, the parameter on benefits to be included embodies the broad principle that projection of future benefit payments should be based on the types of benefits covered by the plan *as understood by the employer(s) and plan members*— termed the *substantive plan* —at the time of each actuarial valuation. The parameter makes clear that determination of the substantive plan requires consideration of not only the plan document but also other communications between the employer(s) and plan members, as well as application of professional judgment in each set of circumstances. Although a few Exposure Draft respondents suggested a narrower standard of evidence, limited to the legal plan document or to written documentation generally, the Board believes that a more broadly worded standard is appropriate to deal with the variety of situations that may be encountered in practice.

Separate Accounting for Postemployment Benefits

95. This Statement requires that when an employer provides benefits to both active employees and retirees through the same plan, the retiree benefits should be segregated and measured independently. Further, future retiree benefits generally should be projected based on claims costs, or on age-adjusted premiums approximating claims costs, rather than on unadjusted premiums. This provision effectively amends paragraph 2 of Statement 10 by no longer permitting retiree healthcare benefits to be included with active employee healthcare benefits and accounted for under risk financing standards based on claims events that already have occurred.

Accounting for implicit rate subsidies as employer OPEB contributions

96. In the original Exposure Draft issued in February 2003, the Board proposed to exempt employers from accounting for *implicit rate subsidies* to retirees for postemployment healthcare benefits in specific circumstances stated as follows:

> . . . an implicit rate subsidy to retirees (that is, the difference between a premium rate charged to retirees for a particular benefit and the estimated rate that would be applicable to those retirees if that benefit was acquired for them as a separate group) resulting from their participation in postemployment healthcare plans that cover both active employees and retirees is not required to be accounted for as OPEB, if the employer does not otherwise contribute to the cost of the retirees' benefits. [paragraph 6a]

Although application of the parameters generally would require that such subsidies be included in accounting calculations as employer OPEB contributions, the Board proposed the exemption from OPEB measurement and reporting "for cost–benefit reasons" (paragraph 52).

97. The implicit rate subsidy issue drew numerous comments from Exposure Draft respondents. Respondents who agreed with the proposed exemption generally agreed with the Board's decision to provide it for cost–benefit reasons. Respondents who disagreed argued that the nature and potential magnitude of negative effects that the exemption would have on the reliability and usefulness of financial reporting would outweigh the cost savings.

98. The Board's redeliberation of the issue focused principally on reassessing the benefit and cost of exempting employers from measuring and reporting implicit rate subsidies to retirees as OPEB and resulted in a decision *not to go forward* with the exemption. Principal factors in that decision included the following:

a. The Board concluded that an employer's implicit subsidy and substantive commitment to continue providing that subsidy on an ongoing basis could be financially significant, because the claims costs for persons of retirement age generally are significantly higher than the claims costs for younger age groups. Therefore, application of the proposed exemption could significantly distort, by omission or understatement, information reported about an employer's costs and commitments related to OPEB in many cases. As with all GASB Statements, the provisions of the proposed Statement need not be applied in circumstances where the effect would be immaterial.

b. The Board concluded that providing an exemption based on the form in which an employer's contributions were cast (implicit or explicit) would create the possibility of unequal standards for employers whose OPEB commitments otherwise were comparable in their effect on the employers' economic resources. The Board had concluded previously that any excess of retiree claims costs over retiree contributions constitutes an employer OPEB contribution, whether that contribution is "explicit" or "implicit." After redeliberation, the Board concluded that the circumstances described in paragraph 6a of the original Exposure Draft did not provide sufficient grounds to exempt employers in those circumstances from reporting their contributions as OPEB, consistent with the financial reporting objectives and general measurement requirements of the proposed Statement.

c. The Board concluded that the omission of information about implicit rate subsidies would diminish the transparency of financial reporting of OPEB transactions and impair report users' ability to make informed assessments about OPEB costs and obligations, including potential demands on a government's future cash flows, in many cases.

99. In the revised Exposure Draft issued in January 2004, the previous paragraph 6a was deleted, and the parameter on "benefits to be included" in actuarial valuations was amended. The effect of this change is that, in situations in which employers contribute all or part of the cost of healthcare benefits for active employees and provide coverage to retirees at the blended premium rates, employers generally are required to calculate their OPEB costs and obligations based on the difference between (a) age-adjusted premiums for retirees (reflecting the generally higher expected claims costs of retirees) and (b) retirees' contributions at the blended premium rates.

100. The Board received and considered fifty comment letters regarding the revised Exposure Draft, most of which were in response to the Board's request for comments on the implicit rate subsidy issue. Some respondents agreed with the proposal to require accounting for implicit rate subsidies. Of these, some previously had disagreed with the proposed exemption in the original Exposure Draft and therefore supported the change, and others were persuaded of the need to account for implicit rate subsidies upon consideration of the reasons discussed in the revised Exposure Draft.

101. A majority of the respondents disagreed with the change. Some respondents believe that accounting should reflect the way in which governments *choose to structure* the premiums and the nominal contributions of the employer and plan members in healthcare plans that include both active employees and retirees. Many respondents, however, would favor adjusting the boundary between the risk financing model reflected in Statement 10 and the OPEB accounting model to the extent of including under the umbrella of risk financing the *particular* implicit rate subsidy situations in which the employer makes no additional explicit contribution. The inclusion of retirees in such situations may validly be viewed in either of two ways: (a) as an application of the principles of insurance (an extension of risk sharing to include retirees as well as active employees) or (b) as a postemployment benefit. The former, suggested by the respondents, undoubtedly is closer to the way in which many people would intuitively view the matter but is problematic from an accounting standpoint because it would result in pay-as-you-go accounting for the postemployment benefits. The deciding factor for the Board was consideration of the *effects* of exempting the situations in question from OPEB accounting.

102. Many of the respondents to the revised Exposure Draft expressed concern about the cost of applying the proposed accounting requirements, including the cost of actuarial valuations, to the situations in question—a concern that the Board shares. Generally, those respondents believe that the Board's original proposal to exempt "for cost–benefit reasons" implicit rate subsidies in situations where the employer makes no additional explicit contribution was appropriate. Some also questioned the Board's conclusion that OPEB provided entirely in the form of an implicit rate subsidy could be financially significant.

103. The Board's conclusion that implicit rate subsidies could be financially significant in many cases is based in large part on consideration of the *relationship between healthcare claims costs and age* and the potential effects of the age–cost relationship on financial reporting. A blended premium rate for a group that includes both active employees and retirees may be thought of as a rate that is age-appropriate to the average age of the *entire group* covered by that premium—and has been calculated to cover the expected claims costs of the group as a whole. A prime objective of this Statement, however, is accrual-basis accounting for one part of those claims costs—those associated with providing *retiree* benefits through the plan.

104. Information provided by actuaries, insurance companies, and regulators indicates that, as a general rule, healthcare claims costs can be expected to increase as a function of age. Tables 3 and 4 of paragraph 35, developed for use in age-adjusting blended premium rates in conjunction with the alternative measurement method, are based on the assumption, believed to be a reasonable midrange estimate, that claims costs increase on average about 4 percent per year of age for non-Medicare-eligible

persons. For each combination of *average age of plan members* and *expected midpoint age of retirees,* the tables provide a factor that represents the relationship between the blended premium rate for the group and the age-adjusted premium rate for retirees in that group. As the tables indicate, the age-adjustment factors increase as a function of the spread between the average age of the whole group and the expected midpoint age of retirees. Depending on the spread for a particular group, the age-adjusted premium rate approximating claims costs for retirees could exceed the blended premium rate by a significant factor. Accordingly, the Board believes that reliance on the blended premium could result in substantially underestimating both the cost of providing healthcare coverage to retirees in the group for the current period and the employer's share of that cost. Reliance on the blended premium also could result in overlooking the financial implications of the employer's substantive ongoing commitment to provide a subsidized benefit as a function of the employer's policy of providing coverage to retirees at the blended premium rate.

105. Accounting based on the blended premium would start with the assumption that the total cost of providing coverage to the retiree is reflected by the blended premium rate, and that the employer's contribution is zero. The implications of that view, and of the view that the total cost of coverage is more faithfully reflected by the age-adjusted premium, with the employer contributing the difference, may be significantly different in many cases. Moreover, the Board emphasizes that the employer's contribution is not an abstraction; the employer *pays it in cash,* by nominally paying the blended premium rate for healthcare coverage for each active employee, although the cost of that coverage is less.

106. If that "implicit" contribution were exempted from being reported as OPEB, the effect would be to overstate the employer's expense of providing healthcare benefits to active employees and to understate, by complete omission, the employer's expense and net OPEB obligation related to providing retiree healthcare benefits. It is important to note that the effects would not be offsetting. Application of the implicit rate subsidy exemption would result in overstating the employer's expense for active-employee healthcare benefits by the amount of the implicit rate subsidy to retirees. The effects on financial reporting of OPEB would be more significant:

a. There would be *no projection* of future cash outlays for OPEB. However, the Board emphasizes that the employer currently pays out an implicit rate subsidy (misclassified as part of the expense for active-employee healthcare). Moreover, the amount currently paid, generally would be expected to increase substantially over time with healthcare cost increases and additional employee retirements.

b. There would be *no measurement or financial reporting* of annual OPEB cost (expense), net OPEB obligation, or the actuarial accrued liability associated with services already received from employees in the plan.

(1) Annual OPEB cost is a calculated amount, independent of the amount actually paid, that consists of normal cost and a component for amortization of the UAAL—and could be several times as large as the implicit rate subsidy paid for coverage in the current period. Accordingly, the understatement of OPEB expense, which is derived from annual OPEB cost, could significantly exceed the overstatement of active-employee healthcare expense.

(2) The difference between annual OPEB cost and the amount paid creates a net OPEB obligation, or financial statement liability. That liability, if reported, would be expected to increase each year if the employer continued to finance the retiree benefits on a pay-as-you-go basis through the use of blended premiums.

(3) The unfunded actuarial accrued liability in a plan financed on a pay-as-you-go basis could be several times larger than annual OPEB cost for the current year.

107. The age–cost relationship and the potential effects of that relationship discussed in the preceding paragraphs played an important part in the Board's conclusion that implicit rate subsidies potentially are financially significant, even if the employer makes no additional explicit contribution, and therefore should not be exempted from OPEB accounting and financial reporting. The Board reaffirms that conclusion. The

Board considered but did not adopt a respondent suggestion to include a specified threshold below which employers would not be required to account for implicit rate subsidies. As with GASB Statements generally, and as noted by several respondents, the requirements of this Statement need not be applied to immaterial items. Application of that standard provision requires the exercise of professional judgment to assess the effects of applying or not applying standards in each set of circumstances.

108. Some respondents suggested that there is a conflict between the requirement to account for implicit rate subsidies as OPEB and some employers' policies to charge retirees the blended premium rate. The Board emphasizes that this Statement is not about an employer's financing policies—the timing of payments or the allocation of financing responsibilities among the employer, active employees, and retirees. If employer policy or state law requires that retirees pay at a certain rate, that is a matter of policy or law; it is outside the scope of this Statement. An employer may choose, for example, to continue contributing an amount computed as the blended premium rate times the number of active employees and to continue assessing retirees the blended premium rate. There is no requirement in this Statement that would prevent continuation of either or both of those policies or that would otherwise specify or prohibit a particular financing policy. However, the Board concluded that for *financial reporting purposes,* where the objective is to report the financial effects of the employer's commitments, it is important to reflect the age-adjusted premium and the employer's contribution for retiree healthcare coverage. To ignore the employer's contribution could significantly reduce the transparency of OPEB reporting.

Use of unadjusted premiums by employers in community-rated plans

109. Although this Statement generally requires the projection of future retiree benefits based on claims costs or age-adjusted premiums for retirees, an employer participating in a community-rated plan may use unadjusted premiums as the basis for the projection, to the extent permitted by actuarial standards. In the revised Exposure Draft, the Board stated that the use of unadjusted premiums is appropriate, to the extent permitted by actuarial standards, when an employer participates in a *community-rated plan,* in which both:

a. The premium rates reflect the projected health claims experience of all participating employers, rather than that of the individual employer

b. The insurer or provider organization charges the same unadjusted premium rates for both active employees and retirees.

The purpose of that mention was to underscore a practice possibility which also is referred to in Actuarial Standards of Practice. The Board's intent was to permit the use of unadjusted premiums in circumstances in which the claims experience of a single employer would have little or no impact on the premiums charged.

110. Subsequently, in the process of completing Statement 43, the Board discussed whether the description of community-rated plans developed for the revised Exposure Draft of this Statement would be sufficiently clear to be applied consistently and appropriately in practice. To clarify the qualifying phrase "to the extent permitted by actuarial standards," the Board added, as footnote 17 to paragraph 34a(2) of Statement 43, an excerpt from ASOP 6, as revised in December 2001, in regard to the use of premium rates in an actuarial valuation. The excerpt quoted states, in part:

> . . . The actuary should consider that the actual cost of health insurance varies by age . . . , but the premium rates paid by the plan sponsor may not. For example, the actuary may use a single unadjusted premium rate applicable to both active employees and non-Medicare-eligible retirees if the actuary has determined that *the insurer would offer the same premium rate if only non-Medicare-eligible retirees were covered.* [paragraph 3.4.5; emphasis added]

111. A respondent to the revised Exposure Draft of this Statement, issued prior to the Board's decision to add the excerpt from ASOP 6, expressed concern that the reference to and proposed description of community-rated plans could be applied inconsistently in practice. In particular, the respondent referred to

plans in some states that are described as community rated, where the base premium rates nevertheless are age adjusted to each participating employer based on the average age of that employer's group. The result would be not unlike blended premium rates developed on an experience-rated basis. The respondent suggested alternate language to clarify that the use of unadjusted premiums is not intended to apply to employers in such plans.

112. The Board believes that the addition of the excerpt from ASOP 6 discussed in paragraph 110 as footnote 9 of this Statement will help to clarify the limitations of the appropriate use of unadjusted premiums by employers in community-rated plans. However, the Board anticipates that practice questions related to the application of that provision are likely to arise. The Board plans to address those issues through implementation guidance.

Projected Continuation of the Historical Pattern of Allocation of Benefit Costs

113. The parameter also requires that the assumed allocation of projected benefit costs between the employer(s) and plan members on an ongoing basis should be based on consideration of the employer's pattern of practice to the valuation date. Again, the Board understands, and intends, that the interpretation of the employer's pattern of practice with regard to the sharing of benefit costs will require the application of professional judgment in the circumstances.

Accounting for Plan Changes When Made and Communicated to Plan Members

114. The Board considered but rejected suggestions to permit the use of methods that would adjust the projection of benefits for either or both of the following:

a. Specific amendments of plan terms contemplated, but not yet adopted, by the employer (other than continuation of the historical pattern of sharing of costs)

b. The general assumption that plan terms probably will be amended in some way, not specifically predictable, in future years.

Proponents of those suggestions argue that projecting postemployment healthcare benefits many years into the future based on current plan terms could tend to overstate what ultimately will happen. They point out that employers often stipulate, for example, that postemployment healthcare benefits are not vested or that the employer has a right to amend or discontinue benefits unilaterally. Also, some believe that there is a practical limit to the escalation of postemployment healthcare costs that makes it probable that *something* (although it may not be possible to predict precisely *what*) will change along the way to reduce costs.

115. The calculations required by this Statement necessarily involve estimates of future events, and the Board recognizes that there are inherent risks of overstating (or understating) obligations and costs, whatever assumptions one makes. However, the Board concluded that the current substantive plan—including any amendments made and communicated to plan members by the valuation date—and the employer's historical pattern of actions up to the time of the valuation with regard to the sharing of benefit costs provide the most objective and reliable basis for projection of benefits for financial reporting purposes. The Board considered but rejected suggested techniques such as reducing projected benefits for specific contemplated plan amendments or discounting projected benefits at a higher rate to anticipate future reductions of benefits on general principle, because the application of such techniques would be subjective and would give recognition to changes that have not yet been effected or announced, and might or might not occur, regarding the terms of the employer's commitment to provide benefits. The Board noted that whether employers will continue to provide current types of benefits in the future may depend not simply on employers' stipulated rights with regard to amending or terminating benefits but on a broader array of factors that also include:

a. Economic factors related to attracting and retaining an appropriate workforce in competition with other employers, often in a collective-bargaining environment

b. The risk of incurring offsetting costs of some kind if OPEB were discontinued

c. Other communications with plan members regarding the terms of the employer's commitment to provide benefits.

Accounting for Caps on an Employer's Share of Postemployment Benefits

116. The Board also considered comments and questions from Exposure Draft respondents regarding the treatment of employer benefit caps in relation to the projection of future benefits. The Board previously had agreed in principle that caps on an employer's share of postemployment benefits would appropriately be taken into consideration when projecting future benefits for accounting and financial reporting purposes. However, the omission of discussion of that point from the Exposure Draft resulted in questions from a number of respondents. The Board therefore decided to add as an explicit requirement that a legal or contractual cap on the employer's share of the benefits to be provided to retirees and beneficiaries each period should be taken into consideration when projecting benefits to be provided by the employer in future periods, if the cap is assumed to be effective.

117. However, proper application of the preceding standard requires attention to two important considerations:

a. First, the Board concluded that the types of caps that should be considered in projecting benefits should be explicit legal or contractual caps on the employer's share of *benefits* as distinguished from limitations on the source or amounts of employer *contributions* to finance payments of defined benefit OPEB as they come due in the future. An example of a cap on employer benefits is a legal or contractual provision that an employer will pay retirees' health insurance premiums up to a maximum of $300 per retiree per month. In one sense, the benefits to be provided in the example are the types of services covered by the terms of the substantive plan. However, the employer's share of those benefits (the portion to be accounted for as OPEB) is capped at $300 of such benefits per retiree per month. The Board concluded that such a benefit cap should be taken into consideration when projecting future benefits (that is, the employer's share of future benefits) for the purposes of this Statement.

b. Second, the Board stipulated that the employer benefit cap should be deemed to be *effective.* That is, a judgment is required to be made based on consideration of all relevant factors and circumstances, and particularly the employer's previous pattern of behavior in maintaining the cap, that the cap is likely to be enforced at the existing level on an ongoing basis in the future.

118. The Board also considered issues related to funding limitations in a number of postemployment healthcare plans that are administered as Internal Revenue Code Section 401h accounts within defined benefit pension plans. Such limitations include:

a. Statutory limitations on the employer contribution rate (of which pension trustees may allocate a portion to fund healthcare benefits)

b. The primary duty of pension trustees to ensure that pension benefits are adequately funded—hence, the potential limiting effect of pension funding on the flow of contributions to the 401h account

c. Limitations imposed by the Internal Revenue Code in regard to amounts contributed to fund postemployment healthcare benefits relative to pension contributions.

The Board concluded that such funding limitations are not equivalent to caps on benefits and should not be treated as such for purposes of this Statement. Rather, the projection of benefits for 401h plans, as for defined benefit plans generally, should be based on the current substantive plan and the historical pattern of allocation of benefit costs between the employer and plan participants. However, the Board realizes that the funding limitations of such plans, if maintained on an ongoing basis, could result in a change in the pattern of cost sharing at some point in the future—that is, increased shifting of the burden of cost increases to plan participants. The Board therefore also concluded that additional disclosures about such situations should be required. These are discussed further in paragraph 151.

Selection of Actuarial Assumptions

119. The Board concluded that the precedent established in Statements 25 and 27, that the selection of actuarial assumptions should be consistent with relevant standards promulgated by the Actuarial Standards Board of the American Academy of Actuaries, also should be applied to OPEB. Standards issued by the Actuarial Standards Board may be revised from time to time. The rules of procedure of the Actuarial Standards Board include the required exposure of proposed standards, including revisions, for comment before adoption. The GASB's intention is to review proposed changes that affect accounting and financial reporting for OPEB and to issue additional accounting guidance, if needed.

Discount Rate

120. The pension standards require that the discount rate used in discounting projected pension benefits to their present value should be the long-term expected-yield rate on current and expected future plan assets. Because most OPEB plans currently are not funded and therefore have few or no plan assets, the Board considered a number of potential approaches to the selection of a discount rate for OPEB benefits. Approaches considered but rejected include the use of the following:

a. A current-yield rate on high-quality, low-risk bonds—rejected as inconsistent with the long-term focus adopted in the GASB pension Statements and in this Statement

b. A long-term expected-yield rate on a surrogate portfolio, such as the employer's pension plan or a similar employer's funded OPEB plan—rejected as hypothetical and irrelevant to the employer's choice of a financing method for the OPEB plan

c. A settlement rate—rejected as not feasible because of the improbability that insurers would assume the risk of postemployment healthcare benefit commitments, given the highly uncertain dollar amounts.

The Board concluded that, for consistency, the same principle applied in the pension standards with regard to selection of a discount rate also should be applied to OPEB. However, the principle should be more broadly stated in order to fit an OPEB environment in which plans potentially could be unfunded (no assets), partially funded, or funded on a full actuarially determined basis. Accordingly, this Statement requires the use of the long-term expected yield on the investments that are expected to be used to pay benefits as they come due. These would be plan investments for a funded plan, the employer's investments for a pay-as-you-go plan, or a weighted average of expected plan and employer investments for a plan that is partially funded.

121. The Board recognizes that permissible investment options and yield opportunities for an employer's general investments may be more limited than those for a pension or employee benefit trust fund. As a result, discount rates for unfunded plans generally may be lower. The Board concluded that in either case the discount rate should reflect the expected yield on the assets expected to be used to finance the payment of benefits, and that pay-as-you-go employers generally could in fact expect to receive less help from asset earnings in financing the total cost of benefits.

122. Several Exposure Draft respondents commented that they believe the proposal to base the selection of a discount rate on the long-term expected rate of return on the assets expected to be available to pay or provide OPEB when due would be problematic in practice. Different respondents believe that this would be particularly true when an OPEB plan was partially funded, or when an employer had either no invested assets or two or more pools of invested assets. Others commented on the lack of relationship between employers' short-term investment objectives and OPEB funding considerations or on what they view as

inconsistency in the discount rates for funded and unfunded plans. Suggestions from respondents included clarifying the definitions of *funded, partially funded,* and *unfunded* plans; basing the discount rate on external benchmark securities; and requiring a discount rate that is "consistent for all entities"—at least to the extent that the discount rate for unfunded plans would be based on something other than the short-term investment portfolios that many employers have. A number of other respondents recommended allowing employers that have OPEB plans that are initially unfunded, but that are in the process of establishing trust funds in anticipation of funding, to select a discount rate reflecting the expected long-term rate of earnings on the *anticipated* diversified investment mix of the trust.

123. After discussion, the Board reaffirmed its original decision that the selection of a discount rate should be based on the expected long-term rate of return on the assets expected to be available to pay or provide OPEB when due. Additional research indicated that actuaries would be able to develop an estimate of a blended discount rate based on the expected long-term rates of return on plan and employer investments, as required for partially funded plans. However, the Board concurred with a respondent suggestion to clarify the conditions under which the relevant rate of return would be based on:

a. Plan assets—that is, *when the employer is contributing the ARC* [36] *on a regular basis* (previously referred to as funded plans)

b. Employer assets—that is, *when no plan assets have been accumulated* (previously referred to as unfunded plans)

c. A proportionate blend of plan and employer assets—that is, *when some plan assets have been accumulated, but the employer is contributing less than the ARC* (previously referred to as partially funded plans).

With regard to the *method* of developing a blended rate, the Board concluded that the rate should be proportional to the respective reliance expected to be placed on plan and employer assets to pay or provide OPEB when due. Research indicated that there are a number of reasonable approaches to determining a blended rate. These include what might be called a *funded ratio approach* (based on the extent to which a plan is funded) and an *ARC approach* (based on the percentage of the ARC actually being contributed). No single approach may be preferable in all circumstances. The Board concluded, therefore, that this Statement should not specify a particular approach for determining a blended rate; however, the approach used should be disclosed.

Actuarial Cost Methods and Special Requirement When the Aggregate Actuarial Cost Method Is Used

124. This Statement generally adopts the same requirements and options regarding the selection of an actuarial cost method included in the GASB pension Statements. Accordingly, any of six actuarial cost methods (entry age, frozen entry age, attained age, frozen attained age, projected unit credit, and aggregate) is acceptable for financial reporting purposes. However, an employer that uses the aggregate actuarial cost method to calculate the ARC for OPEB is required to present funding progress information using the entry age actuarial cost method, as discussed in paragraphs 162 through 164.[37] The same actuarial cost method used for funding purposes also should be used for financial reporting, including the use of the aggregate cost method for determination of the ARC, unless that method does not meet the parameters, in which case a conforming method should be used for financial reporting.

Actuarial Value of Assets

125. Consistent with its pension standards, the Board has concluded that the actuarial valuation of plan assets should be based on the standards promulgated by the Actuarial Standards Board. ASOP 6, which is applicable to OPEB plans, generally requires valuing dedicated plan assets using a method that takes into account market value, unless another asset valuation method is required by law or regulation.

126. Consistent with its view that the investment return assumption should be based on an estimated

long-term rate of return on the assets expected to be used to pay benefits, the Board reaffirmed its conclusion in Statements 25 and 27 that the valuation of plan assets for the purpose of determining the ARC and assessing the funding progress of the plan should be market related. That is, the valuation of assets for those purposes should reflect some function of market value. The term *market related* includes techniques that moderate short-term volatility in market values by allocating the appreciation (or depreciation) in market values over, for example, three to five years. The use of such techniques is designed to strike a balance between recognition of invested assets' market values at the time of valuation and the objective of stabilizing the recognition of short-term market value fluctuations, which have no significance from the long-term perspective of the valuations.[38] The term also includes current market values. However, current market values should not be used if those values would cause the ARCs for successive periods to fluctuate in a manner that would have little or no meaning from a long-term perspective. Nevertheless, the Board has not precluded use of current market values if, in the judgment of those familiar with the circumstances, use of those values is warranted considering the types and holding periods of particular investments.

Annual Required Contribution of the Employer (ARC): Components

127. As in the pension standards, the ARC includes two components: *normal cost* (the portion of the present value of total projected benefits assigned to the current year by the actuarial cost method used), less (or plus) an *amortization component.* The amortization component is the amount calculated as necessary to amortize the total UAAL or funding excess, using actuarial methods and assumptions that comply with the parameters.

Amortization of Unfunded Actuarial Accrued Liabilities (or Funding Excesses)

128. The Board has adopted the same general approach for the amortization of unfunded actuarial accrued liabilities (or funding excesses) of OPEB plans that applies for pension plans under Statements 25 and 27. Plans may amortize the total UAAL over a single period; alternatively, different components of the total (for example, the initial UAAL, changes due to the retroactive effect of plan amendments, and actuarial experience gains and losses) may be amortized over different periods. The amortization method may be either level dollar or level percentage of projected payroll and may be applied on either a closed or an open basis. Similar types of gains and losses (for example, actuarial experience gains and losses) generally should be amortized using similar methods and over similar periods.

Maximum Amortization Period

129. The maximum acceptable amortization period for an OPEB plan's unfunded actuarial accrued liabilities (or funding excesses) is thirty years, consistent with the ultimate maximum period for pension plans. The Board has not adopted for OPEB the transitional provision of Statements 25 and 27 that permitted an amortization period of up to forty years for not more than ten years from the effective date of Statement 25 (periods beginning after June 15, 1996). That provision was included in the pension standards because an existing acceptable standard for governments (Accounting Principles Board Opinion No. 8, *Accounting for the Cost of Pension Plans*) permitted amortization periods of up to forty years, and many governments were complying with that standard. The Board temporarily extended that provision of Opinion 8 (otherwise superseded by Statement 27) to allow entities using an amortization period between thirty and forty years time to gradually reduce the period to not more than thirty years and thereby avoid sudden large changes in contribution rates. That situation does not apply for OPEB, and the Board therefore has concluded that the temporary acceptance of amortization periods between thirty and forty years for pension plans is not necessary for OPEB plans.

130. When different components of the total UAAL are amortized over different periods, plans should calculate the *equivalent single amortization period,* using the calculation method specified in paragraphs 13f(1) and 13f(2) of this Statement. If the resulting equivalent single amortization period exceeds the maximum acceptable amortization period of thirty years, the amortization period for one or more of the separately amortized components of the total UAAL should be adjusted so that the equivalent single

amortization period is within the maximum.

Minimum Amortization Period

131. Similar to the pension standards, this Statement and Statement 43 require plans to amortize changes in unfunded actuarial accrued liabilities that result from changing the actuarial cost method or the method of determining the actuarial value of assets over at least ten years, unless the plan is closed to new entrants and all or almost all of the plan members have retired. In those circumstances, a required minimum amortization period would be inconsistent with the objective of phasing out the plan.

Contribution Deficiencies or Excess Contributions

132. The requirements of this Statement regarding amortization of contribution deficiencies or excess contributions generally are consistent with Statement 27. However, to clarify the application of those requirements to OPEB, this Statement specifically precludes counting as actual OPEB contributions (a) net assets of a governmental or proprietary fund that the employer has designated to be used for OPEB contributions or (b) internal transfers to a separate governmental or proprietary fund established to be used for OPEB contributions, as discussed more fully in paragraphs 140 through 143. Similarly, if an employer participates in a multiple-employer plan that is not administered as a qualifying trust,[39] or equivalent arrangement, amounts paid by participating employers to a third-party plan administrator should be counted as contributions *only to the extent* needed to provide benefits directly, pay premiums, or pay plan administrative expenses on a pay-as-you-go basis.

Measurement of Annual OPEB Cost

133. Similar to annual pension cost in Statement 27, *annual OPEB cost* is an accrual-basis measure of the annual cost to a sole or agent employer of providing OPEB that is required to be calculated and disclosed regardless of the basis of accounting (accrual or modified accrual) required for the fund(s) from which OPEB contributions are made. When an employer has no net OPEB obligation at the beginning of a year, the employer's annual OPEB cost is equal to the ARC for that year. This would be the case, for example, in the first year of implementation if an employer applies this Statement prospectively, or if an employer has regularly paid the ARC in previous years. When an employer has a net OPEB obligation at the beginning of the year, reflecting a cumulative difference between annual OPEB cost (expense) and actual contributions made to the plan in previous years, annual OPEB cost is equal to:

a. The ARC

b. Plus one year's interest on the beginning net OPEB obligation (or minus the interest if there is a beginning net OPEB asset) at the rate of return that was assumed when determining the ARC for the current year

c. Minus an *ARC adjustment* (or plus this adjustment if there is a beginning net OPEB asset).

134. The ARC adjustment is calculated by dividing the beginning net OPEB obligation (or net OPEB asset) by an amortization factor designed to offset, approximately, the actuary's amortization of the net experience losses (or gains) from past contribution deficiencies (or excess contributions) in relation to the ARC. The amortization factor incorporates the actuary's methodology for amortizing actuarial experience losses, including the amortization period, method, and discount rate used in determining the ARC that is to be adjusted. Together, the two adjustments to the ARC (interest and ARC adjustment) *prevent double accrual* of contribution differences as they are "billed" (or credited) back to the employer through the ARCs in periods after the differences occur and *maintain consistency* between actuarial and accounting measures.

135. As discussed in paragraphs 136 and 137, the amount calculated as annual OPEB cost also should be recognized as expense, in relation to the employer's ARC for OPEB, in financial statements prepared

on the accrual basis.

Recognition of OPEB Expense/Expenditures, Liabilities, and Assets

136. The requirements of this Statement with regard to the recognition of OPEB expense/expenditures, liabilities, and assets by sole and agent employers generally are parallel to the requirements of Statement 27 for pensions. Total OPEB expense/expenditures include contributions in relation to the ARC and amounts recognized (on the accrual or modified accrual basis, as applicable) in relation to OPEB-related debt (which is not included in the ARC or net OPEB obligation). When an employer contributes to more than one plan, all recognition requirements should be applied separately for each plan. Likewise, when an employer makes ARC-related contributions to the same plan from more than one fund, the employer should determine what portion of the ARC applies to each fund. In addition, when there is a net OPEB obligation (or asset) applicable to more than one fund, the employer should allocate the interest and ARC adjustment components of annual OPEB cost to each liability (or asset) based on its proportionate share of the beginning balance of the net OPEB obligation.

137. In financial statements prepared on the accrual basis of accounting, including the government-wide financial statements and proprietary and fiduciary fund financial statements, OPEB expense in relation to the ARC should be recognized in an amount equal to annual OPEB cost, regardless of the amount actually contributed to the plan in relation to the ARC. The cumulative difference between the amounts expensed (annual OPEB cost) and the amounts contributed in relation to the ARC creates a net OPEB obligation (liability or asset).

138. In governmental fund financial statements, which are required to be prepared on the modified accrual basis of accounting, the amount recognized as OPEB expenditures in relation to the ARC should be equal to the amount contributed to the plan or expected to be liquidated with expendable available financial resources. "Contributed to the plan" refers to payments during the period. An amount "expected to be liquidated with expendable available financial resources" generally refers to an OPEB premium or benefit payment due and payable as of the end of the period (for example, the amount due for the last month of the period) that is liquidated after year-end.[40]

139. Although the Board has not completed work on its conceptual framework regarding elements of the financial statements, it believes that the UAAL for OPEB meets *certain* characteristics of a liability of a sole or agent employer. However, because of the factors noted below, the Board has concluded that employers should *not* recognize the entire UAAL as a liability on the employer's balance sheet (or recognize a negative UAAL, or funding excess, as an asset). Factors considered by the Board in reaching that decision include:

a. The long-term, funding-oriented approach—with emphasis on systematic and rational allocation of benefit costs over periods approximating employees' periods of active service—adopted by the GASB for accounting and financial reporting for OPEB

b. The necessity of making assumptions about events far into the future as part of the process of estimating the UAAL and the potential volatility of those estimates from year to year as a result of factors that generally would not be expected to persist in the long run

c. The desirability of treating the financial reporting of the UAAL for OPEB in a manner consistent with the requirements of Statement 27 for reporting the UAAL for pension benefits.

The measurement and recognition requirements of this Statement will have the effect of recognizing portions of the UAAL over time, through the amortization component of the ARC, while minimizing the inherent difficulties noted above.

Criteria for Employer Contributions to an OPEB Plan

140. This Statement and Statement 43 provide criteria, not considered necessary in the pension

standards, for determining whether an employer's actions in regard to financing OPEB should be counted as *employer contributions in relation to the ARC* (actual contributions)—and whether assets set aside or accumulated should be treated as plan assets—for financial reporting purposes. Because the amount recognized as OPEB *expense* in relation to the ARC is based on the annual OPEB cost, regardless of the amount actually contributed, the determination of the amount of actual contributions in relation to the ARC has no immediate effect on expense recognition in accrual-basis financial statements. However, the determination of the amount of actual contributions for the period in relation to the ARC, as discussed in paragraphs 141 through 143, does affect the measurement and recognition of:

a. The employer's net OPEB obligation—which arises from differences between annual OPEB cost and amounts contributed

b. OPEB expenditures in governmental fund (modified accrual) financial statements—which should be recognized in the amount contributed to the plan or expected to be liquidated with expendable available financial resources

c. Annual OPEB cost and OPEB expense in future periods, because of the effect on their calculation of amounts recognized as plan assets.

141. For the purposes of this Statement, an employer has contributed to an OPEB plan if the employer has (a) provided benefits directly to retired plan members or their beneficiaries, (b) paid insurance premiums to insure the payment of benefits, or (c) irrevocably transferred assets to a qualifying trust, or equivalent arrangement, in which plan assets are dedicated to providing benefits to retirees and their beneficiaries in accordance with the terms of the plan and are legally protected from creditors of the employer(s) or plan administrator. The preceding criteria preclude counting as contributions (a) designations of net assets of a governmental or proprietary fund to be used for OPEB or (b) internal transfers of assets to a separate governmental or proprietary fund for the same purpose. Rather, such actions should be regarded as *earmarking of employer assets* to reflect the employer's current intent to apply those assets to finance the cost of benefits at some time in the future and should be reported in accordance with existing standards for internal activity and for designations of net assets. Similarly, contributions to a third-party administrator of a multiple-employer plan should be accounted for as contributions only to the extent that the conditions discussed in the first sentence of this paragraph are met. If the plan is not administered as a qualifying trust, or equivalent arrangement, amounts paid to the plan administrator should be accounted for as contributions only to the extent needed to provide benefits, pay premiums, or pay plan administrative expenses on a pay-as-you-go basis. Statement 43 and this Statement require that any excess assets in the fund should be accounted for as assets of the employer(s).

142. The Board's decision to clarify whether an employer has contributed to an OPEB plan (and, from the standpoint of the plan, whether there has been an addition to plan net assets) reflects the current situation that most OPEB plans are not administered in trust or prefunded. Potentially, there are a variety of approaches that employers could take to financing OPEB. These include, for example, pay-as-you-go financing, earmarking of governmental or proprietary fund balances, transfers of assets to a governmental or proprietary fund, transfers of assets to a qualifying trust (or equivalent arrangement), and transfers of assets to a third-party administrator of a multiple-employer plan that is not administered as a qualifying trust (or equivalent arrangement). It is not within the Board's purview, nor is it the Board's intention, to require a particular method of financing for OPEB. However, the Board concluded that it is essential from the standpoint of financial reporting to distinguish whether assets accumulated or set aside for OPEB purposes, in a given set of circumstances, are *employer assets* or *plan assets.*

143. The criteria adopted in this Statement and Statement 43 reflect, in part, the Board's concern that it would be misleading to report as contributions and plan net assets earmarked resources over which an employer retains discretionary control and that potentially could be redirected to other purposes or that are subject to claims by the employer's creditors. The distinction drawn in this Statement and in Statement 43 also is consistent with the major distinction in Statement 34 between:

a. Funds that a government can use to finance its programs—classified as governmental and proprietary funds

b. Funds that a government cannot use to finance its programs but holds in trust or as agent for the benefit of others (the owners and beneficiaries of the funds)—classified as fiduciary funds.

Under the requirements of this Statement, contributions to an OPEB plan to prefund benefits necessarily would involve irrevocable transfers of assets from a government's funds to a qualifying trust, or equivalent arrangement, for the benefit of plan members and their beneficiaries. Plan net assets, if required to be reported by an employer or sponsor, always would be reported as fiduciary funds or component units and would be excluded from the employer's government-wide financial statements. In contrast, if earmarked fund balances/net assets of governmental or proprietary funds could be reported as contributions and additions to *plan* net assets, under the requirements of Statement 34, the same net assets would be included in the government-wide financial statements. In effect, they would be reported, simultaneously, as *plan* assets and as *employer* assets. The requirement that assets be transferred to a qualifying trust, or equivalent arrangement, to qualify as contributions to prefund an OPEB plan precludes that internally inconsistent result.

Recognition by Cost-Sharing Employers

144. Similar to Statement 27, this Statement requires cost-sharing employers to measure their OPEB expense/expenditures based on their *contractually required contributions* to the plan, rather than requiring a measure of annual OPEB cost derived from the application of the parameters. The obligations of employers participating in cost-sharing plans differ significantly from those of employers participating in single-employer or agent plans. For sole and agent employers, the cost of each employer's commitment to provide benefits is directly attributable to that employer. An actuarial valuation is performed for each employer, and each employer's contribution rate is based on the projected benefits of that employer's employees. Because the cost of future benefits is attributable to each employer, this Statement requires all sole and agent employers to measure and report that cost in accordance with the parameters and related provisions of this Statement. Those measurement requirements apply, even if the contributions assessed by the plan differ from the ARC and are legally required.

145. In contrast, in a cost-sharing plan, all assets and benefit obligations are pooled, all risks and costs are shared,[41] one actuarial valuation is performed, and the same contribution rate(s) applies to all participating employers. The contribution rate or amount charged to an individual employer may be higher or lower than the amounts that would result from a calculation based on the projected benefits of only that employer's employees. Moreover, the obligation or commitment for benefits is not directly attributable to any individual participating employer. For these reasons, the obligation of cost-sharing employers generally is limited to payment of their contractually required contributions, and the employers have little or no control over the amount of the required contributions or how they are determined.

146. The Board has concluded that allocation of any differences between the ARC and the sum of the required contributions assessed to participating employers would be arbitrary and inconsistent with the nature of a cost-sharing plan and of the employers' obligations, and that the resulting liabilities or assets would not provide useful information for users of the employers' financial statements. Therefore, this Statement requires cost-sharing employers to recognize OPEB expense/expenditures equal to their contractually required contributions and a liability to the plan for contributions due and unpaid.

147. The Board believes, however, that users need information about the cost of the commitment to provide benefits to members of OPEB plans and the extent to which the employers' contributions cover that cost, whether the cost is attributable to individual employers (single-employer and agent plans) or is pooled (cost-sharing plans), and regardless of how contributions assessed to the employers are determined. Therefore, Statement 43 requires cost-sharing *plans* to measure and report the total ARC (all employers) in the schedule of employer contributions in the same manner required of single-employer and agent plans. All plans should include in that schedule the percentage of the ARC recognized by the plan as contributions, for each year included in the schedule. Similarly, the Board believes that users need

information about the funded status and funding progress of the plan, regardless of the type of plan. For that reason, Statement 43 requires cost-sharing *plans* to report a schedule of funding progress in the same manner required of single-employer and agent plans.[42]

Notes to the Financial Statements

148. This Statement generally carries over and applies to OPEB the pension note disclosure requirements for employers, including basic disclosures regarding plan description and funding policy for each OPEB plan in which an employer participates (all employers) and disclosures regarding annual OPEB cost and its components, the net OPEB obligation, and actuarial methods and assumptions (sole and agent employers). However, the Board has added in this Statement certain note disclosure requirements that it believes are appropriate for employers in OPEB plans, even though they are not required for employers in pension plans. Generally, the additional requirements address either differences between OPEB and pension benefits or the fact that, whereas actuarially determined information about pension benefits already was generally reported when Statement 27 was adopted, equivalent information generally has not been reported in regard to OPEB. Additional note disclosures, discussed in paragraphs 149 through 160, include:

a. Disclosure by *sole and agent employers* of the funded status of the plan as of the most recent valuation date, and revised and expanded disclosures regarding the measurement process and actuarial methods and assumptions used in calculating OPEB costs and obligations

b. Disclosure by *cost-sharing employers* of the basis or method used to determine their contractually required contributions.

149. Proposed note disclosure requirements drew comments and suggestions from several Exposure Draft respondents. A few respondents expressed concern about the overall volume of proposed OPEB disclosures by employers. Of those, some thought that existing Statement 12 disclosure requirements, together with the proposed new accounting and financial reporting requirements, would be adequate. On the other hand, a few respondents suggested additional disclosure requirements or modifications to require disclosures other than those proposed.

150. Although sensitive to concerns expressed about the overall volume of disclosures proposed in the Exposure Draft, the Board does not agree that Statement 12 disclosures would be adequate to explain information reported in the financial statements about OPEB under the new measurement and recognition standards. To illustrate the difference, under Statement 12 disclosure requirements, readers of the financial report of an employer with an OPEB plan financed on a pay-as-you-go basis would have general descriptive information about the plan but would have no information about:

a. Elements of annual OPEB cost and the net OPEB obligation

b. The percentage of annual OPEB cost contributed in the three most recent years

c. The funded status and funding progress of the plan

d. Actuarial methods and assumptions used in estimating the recognized amounts.

The Board continues to believe that such information is essential to providing a context for understanding the liability and expense amounts reported in the financial statements.

151. The Board also considered but did not adopt several suggestions for additional or modified disclosures, including suggestions for disclosure of solvency projections, cash flows, and the components of the ARC. However, as discussed in paragraph 118, the Board decided to add disclosure requirements related to funding limitations affecting a postemployment healthcare plan that is administered as an Internal Revenue Code Section 401h account within a defined benefit pension plan. These requirements

are:

a. Disclosure of the existence and nature of such funding limitations as part of the required disclosure of funding policy.

b. Disclosure that the projection of benefits for financial reporting purposes does not explicitly incorporate the potential effects of legal or contractual funding limitations (as discussed in the disclosure of funding policy) on the pattern of cost sharing between the employer and plan members in the future. This Statement requires that if an employer also elects to include in the annual financial report pro forma *quantitative information* about postemployment healthcare benefits recalculated to take into consideration a funding limitation (for example, pro forma calculations of the ARC, annual OPEB cost, or the funded status of the plan), that information should be presented as supplementary information.

Additional Note Disclosure Requirements—Sole and Agent Employers

Funded Status of the Plan

152. Statement 27 requires sole and agent employers to disclose multiyear trend information about the funding progress of pension plans in which they participate as required schedules (RSI) immediately following the notes to the financial statements. This Statement applies that requirement to OPEB as well and, in addition, requires sole and agent employers to disclose in the notes to the financial statements the current funded status (as of the most recent actuarial valuation date) of each OPEB plan in which the employer participates. The Board considered but rejected the idea of applying to OPEB the reporting options offered to pension employers in footnote 17 of Statement 27. That footnote permits pension employers to present funded status/funding progress information about a single-employer or agent pension plan for one or more actuarial valuations in a note disclosure or as an additional financial statement, in addition to or, in some cases, instead of RSI. However, because most OPEB is financed on a pay-as-you-go basis, the Board concluded that note disclosure of the current funded status of the plan, including the actuarial accrued liability (AAL) and UAAL, should be required.

153. The funded status note should include all the same elements of information that are required to be presented as RSI as of the most recent actuarial valuation date, including the AAL, actuarial value of plan assets, UAAL, funded ratio, and other elements. The requirement to disclose both the AAL and the actuarial value of plan assets, as well as the funded ratio calculated using those measures, ensures that the measures reflect a consistent long-term perspective and maintains consistency of perspective between the note disclosure and the required multiyear schedule of funding progress, which also is required as RSI and to which the note should make reference.

Actuarial Measurement Process, Methods, and Assumptions

154. This Statement also requires revised and expanded note disclosures regarding the actuarial measurement process and significant actuarial methods and assumptions used in calculating OPEB costs and obligations for financial reporting purposes. These include the following changes from the requirements of Statement 27 for pension employers:

a. Requirements to include language of a general explanatory nature (1) disclosing the nature and limitations of OPEB measurements using actuarial methods and assumptions and (2) more explicitly linking funded status information disclosed in the notes to the financial statements and multiyear funding progress trend information presented as RSI.

b. A requirement to disclose that the projection of benefits is based on the substantive plan at the time of each valuation (with disclosure of the information considered in determining the substantive plan) and the pattern of sharing of benefit costs between the employer and plan members to that point. In addition, if applicable, an employer is required to disclose that the projection of benefits does not explicitly incorporate the potential effects of legal or contractual funding limitations on the pattern of cost sharing. (See discussion of the parameter underlying this disclosure in paragraphs 94–118.)

c. A requirement to disclose both the initial and ultimate rates, rather than ultimate rates only, when actuarial assumptions, such as the postemployment healthcare trend rate assumption, contemplate different rates for successive years (select and ultimate rates).

d. A requirement, specific to employers that use the aggregate actuarial cost method to calculate their ARC, to disclose their use of the entry age actuarial cost method for the purpose of presenting information about the funded status and funding progress of the plan, as required by this Statement (discussed further in paragraphs 161–164).

155. The Board concluded that additional disclosures of an explanatory nature should be required to help a broader range of financial report users better understand the nature of the calculations and the information presented. Most employers have been applying actuarial measures and reporting styles similar to those required by Statement 27 for several decades. They became mandatory for employers in single-employer and agent multiple-employer pension plans, and optional for employers in certain postemployment healthcare plans, at the effective date of Statement 27 (fiscal years beginning after June 15, 1997). However, the Board's research indicates that most employers have not adopted those measurement and reporting methods for reporting OPEB. Therefore, users generally are not familiar with their application to OPEB. Also, some present and potential users of OPEB information may not be familiar with pension reporting and, therefore, cannot use prior experience with pension reporting to help them understand OPEB reporting. The Board acknowledges that, because of the nature of the disclosures, these requirements are more than usually specific about the information to be disclosed, and that the required explanatory and linking language will add to the overall length of OPEB disclosures. However, the Board concluded that the benefit of making the reported information more broadly accessible to a variety of financial report users outweighs the cost of implementation.

156. This Statement requires that the projection of benefits include all benefits provided under the substantive plan (broadly defined as the plan as understood by the employer and plan members) at the time of each actuarial valuation, and specifies that the determination of what *is* the substantive plan requires consideration of other communications in addition to the primary plan document. This Statement also requires that assumptions regarding the sharing of benefit costs between the employer and plan members be based on the pattern of practice to that point. The Board concluded that disclosure of these requirements will provide essential information about significant accounting policies followed in calculating the AAL and the ARC.

157. The Board's decision to require disclosure of the initial as well as the ultimate assumption, when select and ultimate assumptions are used, was based on consideration of the importance of the healthcare cost trend rate assumption in actuarial valuations of postemployment healthcare plans. The healthcare cost trend rate assumption generally involves the use of select and ultimate assumptions, and the ultimate assumption generally approaches the assumed long-term rate of inflation. However, the initial assumption and the assumptions for subsequent years in the short term tend to be volatile and may be considerably higher or lower than the ultimate assumption. The Board concluded that disclosure of only the ultimate assumption would not convey sufficient information and that additional disclosure of the initial assumption would better convey the range of assumptions when select and ultimate assumptions are used.

158. The special disclosure requirement pertaining to employers that use the aggregate cost method is a byproduct of the requirements in paragraphs 25c and 26 that those employers provide funded status and funding progress disclosures using the entry age actuarial cost method. The Board concluded that this disclosure is necessary to explain the basis on which that information was prepared.

Additional Note Disclosure Requirement—Cost-Sharing Employers

159. Statement 27 requires all pension employers to disclose the required contribution rate(s) of the employer(s) in accordance with the funding policy for the plan, in dollars or as a percentage of the

current-period covered payroll. Also, Statement 27 requires cost-sharing employers to disclose the percentage of their *contractually required contribution* that they contributed for the current year and each of the two previous years. This Statement applies the same disclosure requirements to employers participating in cost-sharing OPEB plans. In addition, this Statement requires cost-sharing employers to disclose the basis for determination of the contractually required contribution (for example, the ARC or a statutorily determined rate).

160. The Board's research indicates that cost-sharing OPEB plans currently are not widespread. However, the Board noted that it is unknown to what extent cost-sharing OPEB plans may be formed in the future, or what the financing practices of those plans might be. Although the disclosure requirements of Statement 27, applied to OPEB, would result in disclosure of the extent to which cost-sharing employers have contributed their contractually required amounts, the additional disclosure is intended to help financial report users place the contractually required contribution in perspective by explaining how that requirement was determined.

Required Supplementary Information

161. The requirements of this Statement with regard to disclosure of RSI about OPEB by *sole and agent employers* generally are consistent with those of Statement 27. That is, sole and agent employers are required to present as RSI, for the current actuarial valuation and the two preceding valuations, the same elements of information that Statement 43 requires plans to present as their schedule of funding progress. However, an employer that uses the aggregate actuarial cost method is required to present a schedule of funding progress using the entry age actuarial cost method, as discussed in paragraphs 162 through 164.

Presentation of a Schedule of Funding Progress When the Aggregate Actuarial Cost Method Is Used

162. The aggregate actuarial cost method cannot be used to prepare a schedule of funding progress, because it does not separately determine actuarial accrued liabilities. (The total actuarial present value of projected benefits is amortized as normal cost over average remaining service life, rather than dividing the total into normal cost and actuarial accrued liabilities and separately amortizing the two amounts over, generally, different periods.) In Statement 27, the Board exempted employers in pension plans that use the aggregate method from preparing the schedule of funding progress, although preparation of the schedule of funding progress using another method, such as entry age, is acceptable. The Board concluded in that Statement that "a requirement to use a different method would be inconsistent with the general approach of [Statement 27] to require application of the method used to determine funding requirements, when that method meets the parameters." Moreover, the Board noted that "relatively few [pension] plans use the aggregate method; for example, 6 percent of 451 [pension] plans included in a survey conducted in 1993 by the Public Pension Coordinating Council reported using that method, and most are small plans. The Board is reluctant to impose additional costs on those [pension] plans" (paragraph 191, footnote omitted).

163. The Board notes, however, that when the pension standards were adopted, a large majority of pension plans had been advance-funding on an actuarially determined basis for many years. Thus, the unfunded actuarial accrued liabilities of plans using the aggregate actuarial cost method effectively were being included in funding requirement determinations, even though they were not separately calculated. In contrast, very few OPEB plans currently are advance-funded on an actuarially determined basis. It is not possible at this time to reliably estimate what proportion of OPEB plans might select the aggregate actuarial cost method (a) for funding purposes or (b) solely for financial reporting purposes, if they remain unfunded. The Board concluded that if an unfunded (for example, pay-as-you-go) OPEB plan selected the aggregate actuarial cost method solely for financial reporting purposes (that is, unfunded actuarial accrued liabilities were *not* effectively being included in funding requirement determinations), exempting the plan and employers from preparing a schedule of funding progress would leave users without sufficient information to assess the financial effects of the plan's method of financing. Therefore, the Board concluded that plans that elect to use the aggregate method, as well as sole and agent employers participating in such plans, should be required to prepare a schedule of funding progress using an

acceptable actuarial cost method that separately identifies actuarial accrued liabilities. The Board believes it is unnecessary to allow a choice of methods for that limited purpose. The Board selected the entry age method as the required method because it is conceptually similar to the aggregate method.

164. Some question the required use of the entry age actuarial cost method in this context because, in their view, the use of a surrogate method for this purpose would be contrary to the Board's general approach of harmonizing, as much as possible, the measurements made for accounting and funding purposes. The Board acknowledges that this requirement is a departure from the general approach of this Statement and Statement 43. Nevertheless, for the reasons stated above, the Board believes that funded status information based on the entry age method is more useful to users of OPEB financial reports than providing no information about funded status. Moreover, the potential for confusion for users due to the use of two different methods can be mitigated by disclosure of the reason the entry age method is used for the funding progress information only—that is, such information cannot be prepared using the aggregate method. The Board reiterates that *the aggregate method is required for determining the employer's ARC when that method is used for funding;* it is not acceptable under this Statement or Statement 43 to use entry age or another method for determining the ARC when the aggregate method is used for funding. Similarly, when the aggregate method is used for determining the ARC, the schedule of employer contributions should be computed using that method.

Presentation of Required Schedules by Cost-Sharing Employers When a Plan Report Is Not Issued

165. This Statement adds a requirement that *cost-sharing employers* present schedules of funding progress and employer contributions for the plan, *if* the plan does not issue and make publicly available a plan financial report prepared in accordance with the requirements of Statement 43 on OPEB plan reporting and the plan is not included in the financial report of a PERS or another entity. This requirement reflects consideration that the OPEB plan financial reporting laws and practices are in a formative stage and recognizes the possibility that some plans may not issue financial reports prepared in accordance with generally accepted accounting principles. If so, without the required disclosure in the employer's report, financial report users would not have access to information about the funded status and funding progress of a cost-sharing plan, or employer contributions in comparison to the ARC.

Employers Providing Insured Benefits

166. The Board believes that the most significant type of OPEB—postemployment healthcare benefits—is unlikely to be insured, as defined by this Statement, because of the uncertainties inherent in projecting the dollar amounts of benefits that will be due in future years. The Board concluded, however, that the requirements of Statement 27 generally are appropriate for any OPEB that is insured. Accordingly, this Statement establishes requirements for employers' reporting of OPEB that are parallel to those of Statement 27 regarding:

a. The criteria for an insured benefit—that is, an arrangement in which an employer accumulates funds with an insurance company (through the payment of contractually agreed contributions or premiums) *while employees are in active service,* in exchange for which the insurance company unconditionally assumes the obligation to pay the postemployment benefits of the employees or their beneficiaries under the terms of the plan

b. Recognition of the employer's OPEB expense/expenditures related to an insured benefit—that is, equal to the annual contributions or premiums required under the employer's agreement with the insurance company

c. Disclosures regarding the insured benefits—that is, descriptive information about the arrangement and the transfer of risk, as well as the current-year expense/expenditures and the amount paid.

If an employer's arrangement with an insurance company does not meet the criteria for an insured benefit, the employer should comply with all requirements of this Statement for sole and agent employers.

Employers in Defined Contribution Plans

167. As with pensions, employers in defined contribution plans that provide OPEB should base their recognition of annual OPEB expense/expenditures on their required contributions in accordance with the terms of the plan, on the accrual or modified accrual basis as applicable, and should recognize a liability (or asset) for the difference between contributions required and made. However, if a plan has characteristics of a defined contribution plan but provides defined benefits in some form, the employer should apply the requirements of this Statement applicable to defined benefit plans. The disclosure requirements for all defined contribution plans are the same.

Special Funding Situations

168. The Board is not certain to what extent special funding situations, in which one governmental entity is responsible for contributions to a plan that covers employees of another entity or entities, will occur in OPEB plans. If they occur, however, this Statement establishes requirements for such employers that are parallel to those in paragraph 28 of Statement 27. That is, the entity that is legally responsible for the contributions should follow all applicable requirements of this Statement. In addition, if the legally responsible entity is the only entity contributing to a defined benefit plan, that entity should follow the requirements for a sole employer, even if the plan is a multiple-employer plan (that is, the employees of multiple entities are covered by the plan).

Alternative Measurement Method for Employers with Fewer Than One Hundred Plan Members

169. This Statement and Statement 43 permit sole employers and single-employer OPEB plans, respectively, with fewer than one hundred members to apply the *alternative measurement method* set forth in paragraphs 33 through 35 instead of performing actuarial valuations in accordance with the parameters (the basic measurement standard). The alternative measurement method also may be used by agent employers with fewer than one hundred total plan members, if doing so would not conflict with applicable plan reporting requirements—that is, if the agent multiple-employer plan in which an employer participates *either*:

a. Is not required to obtain an actuarial valuation for financial reporting in conformity with the requirements of Statement 43, because (1) the plan has fewer than one hundred total plan members (all employers) and *also* is eligible to use the alternative measurement method or (2) the plan is not a qualifying trust, or equivalent arrangement, for which that Statement requires the presentation of actuarial information, *or*

b. Does not issue a financial report prepared in conformity with the requirements of that Statement.

The requirements of paragraphs 33 through 35, which permit certain modifications of the parameters, originally were developed with assistance from members of the OPEB task force and additional input from committees and individuals from the actuarial and auditing professions. Significant considerations related to the Board's decision to include the alternative method in the Statements are discussed in paragraphs 170 through 186 and 196. Issues raised by Exposure Draft respondents and modifications to the Exposure Draft that are incorporated into this Statement for the purpose of improving certain aspects of the method are discussed in paragraphs 187 through 195.

Concerns regarding Application of the Basic Measurement Standard to Small Plans

170. As discussed previously, the Board adopted an approach consistent with that of Statement 27 as the basic measurement standard for purposes of financial reporting of OPEB by employers. The Board believes that the approach adopted will result in more faithful representation of OPEB transactions in general purpose external financial reporting and a significant improvement in the reliability and usefulness of the reported information. However, as the Board acknowledged in paragraph 73 of Concepts Statement

1, the *cost of preparing, auditing, and using information* constitutes a practical constraint on financial reporting standards from an accountability perspective, which otherwise might be virtually without limits. In that paragraph, the Board affirmed its intention to maintain a broad perspective as to the meaning and implications of accountability reporting but *also* affirmed:

> . . . Cost-benefit relationships will be carefully considered by the Board, during its research and due process, when establishing individual standards. In assessing costs and benefits, the Board will consider such factors as . . . the intensity of the needs of all groups of users, the risks or costs to users of not having certain types of information, and the relative costs and benefits considering the size or type of governmental entities involved.

171. Efforts culminating in the development of the method set forth in paragraphs 33 through 35 were stimulated by the Board's concern regarding the cost of applying the basic measurement standard to small OPEB plans. Although comprehensive data are not available regarding the number, types, and sizes of OPEB plans offered by state and local governments, an examination of limited data indicates that a substantial number and percentage are single-employer plans with a small total membership.

172. The Board believes that application of the basic measurement standard, including actuarial valuations in accordance with the parameters, to such plans would result in improved financial reporting by the plans and the employers, and that the resulting information would be useful to financial statement users. However, the Board recognizes that the potential cost of actuarial valuations for small plans could be high in relation to the number of covered lives or the current cash outflows for benefits. At some point (for example, below some plan size cutoff point), that cost arguably would exceed the benefits of providing the information. The Board's purpose in exploring the feasibility of an alternative method was to see whether a workable method could be developed that would produce substantially more useful information, compared to current practice, at less cost than the cost of applying the basic measurement standard. In deciding whether, and in what ways, the basic measurement standard could appropriately be modified, and in what circumstances such modifications could appropriately be applied, the Board considered not only the cost to preparers but also:

a. The Board's *financial reporting objectives* in the OPEB project and the potential effects of a proposed modification on the achievement of those objectives

b. The *qualitative characteristics* that reported financial information should have and the potential effects of a proposed modification on the qualitative characteristics of reported OPEB information, especially the reliability of the information.

173. The Board also considered but rejected a proposal to further extend the maximum interval between actuarial valuations for the smallest plans (for example, to require actuarial valuations, made in accordance with the parameters, for such plans at least every fifth year). Advantages cited by proponents of that proposal were that it would require actuarial valuations in accordance with the parameters for all OPEB plans; however, valuations for the smallest plans would be required only infrequently, as a means of reducing the cost of applying the proposed standards for those plans. However, the Board concluded that if that alternative was adopted, the information and assumptions used in calculations of the ARC and the AAL for the smallest plans would become stale before a more current valuation was required. The infrequency of valuations of such plans also would diminish the ability of users to assess trends in funding progress.

Reliability, the Parameters, and the Alternative Measurement Method

174. In paragraph 64 of Concepts Statement 1, the Board stated that, among other qualitative characteristics, reported financial information should be *reliable.* To be reliable, the information should be verifiable and free from bias and should *faithfully represent underlying events and conditions,* omitting nothing material for that purpose. The notion of reliability does not, however, imply precision or certainty. Rather:

> . . . Reliability is affected by the *degree of estimation in the measurement process* and by *uncertainties inherent in what is being measured;* [therefore,] financial reporting may need to include narrative explanations about the underlying assumptions and uncertainties inherent in this process. Under certain circumstances some financial information is based on *reasonable estimates.* A properly explained estimate provides more meaningful information than no estimate at all. [Emphasis added.]

175. The nature of OPEB transactions and the inherent difficulty of measuring their financial implications, including the necessity of making demographic and economic assumptions about multiple relevant future events, preclude precision or certainty in the information reported. The Board recognizes that different individuals may arrive at different best-estimate assumptions about future events. Moreover, future events rarely if ever coincide precisely with the assumptions previously made about them. Nevertheless, the Board believes that actuarial valuations made in accordance with the parameters will provide reasonable estimates, consistent with the concept of reliability discussed in the previous paragraph.

176. In the circumstances, reliability rests not on the possibility of determining and reporting demonstrably precise or certain measures of OPEB costs and obligations, but principally on a *measurement process* that brings to bear logic, methodology, and disciplines developed by professionals who specialize in making estimates regarding such complex matters. Further, the Statements include parameters designed to ensure that the methods and assumptions used in actuarial valuations will be appropriate for financial reporting purposes, and that the information produced will meet relevant financial reporting objectives and will possess to a high degree the appropriate qualitative characteristics of accounting information.

177. The alternative measurement method set forth in paragraphs 33 through 35 requires estimates of the same elements of information, following the same broad measurement steps, as an actuarial valuation in accordance with the parameters. That is, the alternative method requires projecting future cash outflows for benefits, discounting projected benefits to present value, and allocating the present value of projected benefits to periods using an actuarial cost method. The principal difference is that the alternative method permits simplification of certain assumptions, for the purpose of making the method potentially feasible for application by nonspecialists. Paragraph 34 provides selection requirements for specific demographic and economic assumptions that may be simplified. (Assumptions also should be made for any other matters that are significant to the projection of OPEB costs and obligations for a particular plan.) For example, paragraph 34 permits using current insurance premium rates as the starting point for projection of postemployment healthcare benefits, rather than requiring analysis of underlying claims costs, if the premiums are age-adjusted. Paragraph 35 provides a simplified method for estimating age-adjusted premiums for retirees when an employer knows only average, or blended, premium rates covering both active employees and retirees in a plan.

178. In developing the simplified requirements for specific assumptions, the Board's goal was to make the selection and handling of the assumptions workable for nonspecialists. However, the Board also sought to make the selection of assumptions:

a. Objective—by, for example, requiring that select and ultimate assumptions regarding the healthcare cost trend rate be based on a published source, rather than estimated by the preparer

b. Unbiased as to results—avoiding intentional systematic understatement or overstatement of estimates, in comparison to the results that would be obtained if an actuarial valuation was performed.

179. Although actuarial valuations in accordance with the parameters and calculations made using the alternative measurement method would be similar in objectives, general approach, and some specifics, presumably there also would be differences in the information produced by the respective methods. To place such differences in context, it is important to consider that statistical inferences from very small populations, including OPEB plans of a size that would qualify to use the alternative method, are inherently less reliable than are those from larger populations. This inherent condition provides reason not to overestimate the precision or ultimate predictive value of *either* actuarial valuations *or* calculations using the alternative measurement method. Nevertheless, the alternative measurement method introduces

possibilities for error in addition to those present in an actuarial valuation, as a result of:

a. The simplifying assumptions that it permits—which could be less precisely tuned to the plan for which estimates are being made

b. Its potential application by nonspecialists—which could affect the level of skill or objectivity applied to selection of appropriate assumptions or the accuracy with which calculations are accomplished.

180. In the Exposure Drafts, the option to apply the alternative measurement method was limited to sole employers in plans with a total membership of fewer than one hundred. The eligibility criteria did not include employers in multiple-employer plans, because the Board believed that almost all plans of that size would be single-employer plans, and because the Board wanted to avoid potential complications if some employers in a multiple-employer plan met the eligibility cutoff but the plan did not. The Board has subsequently concluded that eligibility can be extended without complications to include agent employers with fewer than one hundred total plan members in circumstances where the agent multiple-employer plan does not have a conflicting requirement for an actuarial valuation, as discussed in paragraph 169. The Board believed that for employers in that size range, the potential costs of applying the basic measurement standard would be high enough, in relation to the size of the plan, to warrant this potentially lower-cost option. The Board concluded that any reduction in precision resulting from process differences introduced by the method was justified by the potential net reduction in the cost of preparing and auditing the information, for plans in that size range and their participating employers. For such employers, the Board believed that the method proposed would provide estimates for financial reporting purposes that would be reasonable in the circumstances and would result in a significant improvement in the usefulness of reported financial information, compared to current practice.

181. Although, as discussed previously, comprehensive information about existing governmental OPEB plans is not available, the Board believed that at the eligibility cutoff of fewer than one hundred plan members, the alternative measurement method afforded a potentially lower-cost alternative to a substantial number of plans and employers. However, that cutoff point also reflected the Board's conclusion that use of the alternative measurement method should be limited to small plans for which implementation cost considerations were likely to be severe. The Board concluded that plans with a larger total membership should be required to apply the basic measurement standard because it would provide a higher degree of process reliability.

Field Testing

182. Prior to the issuance of the Exposure Draft, the Board conducted a preliminary field test of the alternative measurement method, in which the GASB staff applied the method to a local government's postemployment healthcare plan, and a field test by local government volunteers. An actuary also provided the Board with comparative results of an actuarial valuation and calculations using the alternative measurement method for a postemployment healthcare plan. Although the results of testing were limited by the number of volunteer governments and in no way were conclusive, the Board judged that the method potentially could achieve the objectives set for it.

183. Testing by GASB staff and government volunteers tentatively indicated that for governmental entities with the staff resources to apply the alternative method, the cost of preparing information in-house potentially would be lower, in comparison to the cost of an actuarial valuation in accordance with the parameters. A potential for preparation cost savings appeared to exist in the initial application of the method, based on the hours required for completion of calculations in the limited number of tests. Also, testers estimated that the time required for subsequent applications of the method could be significantly less, as a result of the experience gained in becoming familiar with the requirements and formatting data and calculations.

184. The Board recognized that many entities with OPEB plans small enough to qualify for use of the alternative measurement method might not have the staff resources to apply the method in-house. Such

entities might, instead, retain the services of a professional (for example, an actuary or an accountant) to make the calculations. If professional services were used, potential cost savings presumably would be reduced. The extent to which cost savings, if any, would result would depend on the professional fees in the marketplace for applying the alternative measurement method compared with those for an actuarial valuation of the same plan.

185. The alternative measurement method was designed to be potentially applicable by nonspecialists. In that event, auditors presumably would not apply auditing literature pertaining to establishing a basis for reliance on the work of a specialist (Statement on Auditing Standards No. 73, *Using the Work of a Specialist*). Rather, auditors presumably would need to do additional, or different, audit work, in comparison to applying auditing procedures to the results of an actuarial valuation. Further, the extent of audit work could vary somewhat depending on the perceived skill and objectivity of the person who performed the calculations and the associated risk of errors or bias in the process. Members of the auditing community conveyed various impressions regarding the potential increased audit cost, ranging from negligible to more significant additional cost.

186. Comparative analysis of the results of an actuarial valuation and calculations using the alternative measurement method in a single case identified sources of difference in the allocation of costs between periods, based on the application of actuarial cost methods illustrated in the field test packet. The extent of resulting differences could vary depending on the demographics of the group. As discussed previously, additional differences could result from use of simplifying assumptions. Even so, the Board believed that estimates produced through the conscientious use of the alternative measurement method would represent a substantial improvement over current practice, and that the option to use the method was appropriate within the limited scope for which it was intended.

Comments from Exposure Draft Respondents

187. A number of comments were received from Exposure Draft respondents regarding the proposed alternative measurement method. Respondents' comments on the issue generally referred to, and in some cases elaborated on or provided additional information about, themes and factors considered by the Board in the process of developing the Exposure Draft and discussed in the Basis for Conclusions of the Exposure Draft. Individual respondents weighed the significance of specific factors differently.

General Comments regarding the Alternative Measurement Method

188. Many respondents shared the Board's concern about the cost of implementing OPEB standards for small plans and participating employers and supported the GASB's objective of making available an optional measurement method that can be applied by nonspecialists as a cost-saving alternative. Some believed that the method proposed in the Exposure Draft would achieve that objective, whereas others agreed with the underlying intention but questioned the efficacy of the proposed method or would have preferred a different method, specific or nonspecific (for example, a method that is simpler). Other respondents, however, expressed doubts and concerns about the proposed method and generally did not support the proposed inclusion of an alternative measurement method as part of the standards. Areas of concern regarding *the method generally* included:

a. Concerns about the perceived complexity of the method

b. Concerns about whether the method would be feasible for application by small-government personnel without professional assistance in some form

c. Concerns about the reliability of the information produced by nonspecialists using the method for financial reporting purposes, as well as for other purposes for which it would not specifically be intended—including concerns that the method might be misapplied to plan designs more complex than those illustrated by the Board or in support of financial decisions for which it might not be sufficiently reliable

d. Concerns about potential increased costs of assurance and, consequently, about whether net cost savings would be achieved

e. Concerns about the application of any method created or applied without the involvement of an actuary—that is, with the attempt by the GASB to create and prescribe, as an option, a particular alternative measurement method intended to be potentially usable by nonspecialists.

Although each of these issues had been considered by the Board prior to issuing the Exposure Drafts, they were redeliberated as a result of concerns raised by respondents, as discussed in paragraph 196.

Comments regarding Specific Requirements and Illustrations

189. Before making an overall decision about whether to go forward with the proposed method, the Board also considered Exposure Draft respondents' comments on issues not discussed previously, related to specific proposed requirements and illustrations of the alternative measurement method. Several respondents raised significant technical issues that affected the illustrated method of allocation of OPEB costs to periods in connection with the entry age normal actuarial cost method. Two primary issues were identified—the entry age method *as illustrated* did not (a) discount the present value of benefits at entry age for the probability of termination between entry age and attained age or (b) reflect termination rates in the annuity factors applied at various stages of the allocation process. The Board concluded that it was important to find a practical solution to these issues to:

a. Improve the method, including correcting an apparent unintended tendency to understate the ARC and the UAAL

b. Support the Board's ability to provide illustrations, implementation guidance, and answers to technical inquiries regarding the method on an ongoing basis—including guidance regarding a *range of amortization methods,* including entry age, as proposed.

190. Accordingly, the Board retained the services of consulting actuaries to provide technical assistance in resolving these issues. To improve the cost method calculations, the actuaries recommended converting the proposed "qualification for benefits assumption" from a single "probability of qualifying," as proposed, to age-based probabilities (for example, the probability that an individual at age 20 will remain employed until age 21, and so on). Given the systematic understatement expected to result from the method proposed and illustrated in the Exposure Draft, the Board concluded that it was necessary to find a way to incorporate age-based probabilities into a revised standard and illustration but was concerned about the additional complexity that such a modification might create. Therefore, at the Board's request, the consultants explored ways in which the approach could be simplified for incorporation into the revised Exposure Drafts. The consultants ultimately recommended:

a. Modifying the default assumption as proposed in the Exposure Draft to utilize age-based turnover rates derived from public-sector experience, rather than basing the criteria on a plan-specific qualifying period. To provide default values, a table was developed from Federal Employees Retirement System experience data maintained by the U.S. Office of Personnel Management that presents probabilities of remaining employed from any age to assumed retirement age.

b. Using a derived measure of expected future working lifetime (which projects the future working lifetime of a member based upon age and considers the turnover probabilities developed in the Federal Employees Retirement System–based turnover table, discussed above) to calculate annuity factors.

191. The approach developed avoids the need for a complex additional spreadsheet(s) to calculate present value factors and, instead, provides preparers with tables of values based on attained or entry age and assumed retirement age to use in required calculations. The Board concluded that the combined use of the two tables would benefit preparers using the default method in two ways:

a. It would reduce complexity by framing the probability in terms of a single, defined element (age) rather than on qualification criteria. For plans with multiple qualifying criteria (for example, age and years of service), the need to calculate separate probabilities (and present value factors) for individual members would be eliminated.

b. Unlike the default probability specified in the Exposure Draft, the recommended approach would require no additional calculations, thereby resulting in fewer opportunities for error or misinterpretation. For preparers *not* using the default assumption, additional calculations would be necessary; however, the approach chosen would reduce the amount of calculation necessary.

192. Adoption of the project consultants' suggestions resulted in the following modifications in the Standards section of this Statement:

a. The parameter now is defined in terms of "turnover" rather than "probability of qualifying."

b. Employers that have experience-based turnover information for their own group should incorporate year-to-year, age-based turnover rates. For those employers, an explanation of how to calculate both the probability of remaining employed until the assumed retirement age and the expected future working lifetime is provided in paragraph 35a.

c. If experience-based turnover information for an employer's own group is not available, the employer may use the tables of default values for the probability of remaining employed until the assumed retirement age and for expected future working lifetimes provided in paragraphs 35b (Table 1) and 35c (Table 2), respectively.

The nonauthoritative illustration of the application of the alternative measurement method using the entry age actuarial cost method also has been amended accordingly.

193. The Board concluded that adoption of the approach developed with the assistance of consulting actuaries would both:

a. Mitigate known technical problems in the proposed standard and illustrations and improve the calculations of the actuarial accrued liability and the ARC, particularly when actuarial cost methods other than projected unit credit are used

b. Be approximately equivalent in terms of ease of use to the method proposed in the Exposure Draft.

194. Another suggestion from some respondents regarding a specific element of the calculations was that the alternative measurement method would be simpler for preparers and auditors if a *single amortization method* (projected unit credit and level dollar) was specified. The Board also considered the potential benefit of that suggested change in simplifying the Board's ongoing task of providing implementation guidance and technical support, by eliminating most combinations of actuarial cost method and amortization method. However, the Board concluded that going forward with the proposal to permit the use of six actuarial cost methods, in combination with either level dollar or level percentage amortization, remains supportable. The Board was encouraged, in regard to the feasibility of providing guidance regarding multiple methods, by the improvements discussed in the preceding paragraphs, including improvements to the entry age illustration. Also, the consulting actuaries indicated that they believed similar illustrations of other permitted cost and amortization methods could be developed.

195. The other significant issue considered by the Board in regard to a specific requirement is related to the use of health insurance premiums. That provision permitted employers using the alternative measurement method to use the plan's current premium structure as the initial per capita healthcare rates for the purpose of projecting future healthcare benefit payments. However, in response to comments received during due process, the Board added a qualification regarding circumstances in which the same premium rates are given for both active employees and retirees in an experience-rated healthcare plan. In

those circumstances, an employer should first attempt to obtain from the insurer the age-adjusted premium rates for the retirees in the plan and should use those adjusted rates as the starting point for projection of benefits. However, if information cannot be obtained from the insurer, age-adjusted premiums for retirees may be estimated using a default method and table(s) added as paragraph 35d (Tables 3 through 5)—which were developed with input from members of the actuarial community within the context of the Board's objective of providing an alternative method.

196. Having resolved issues related to specific aspects of the method, the Board reached the following conclusions regarding the proposed alternative measurement method as a whole, in light of concerns expressed by some respondents:

a. *Complexity of the method and feasibility for use by nonspecialists.* The Board affirmed that the nature of the measurement problem is inherently complex and requires a method that takes relevant factors into account in a manner suitable to the problem. Despite the preference of some respondents for a simpler method, neither respondents' comments nor the Board's efforts have identified a method that would satisfy that preference without detriment to the financial reporting objectives the project is intended to achieve. The Board reaffirmed its belief that the method developed would be feasible for use by many small plans and employers. Factors that the Board believes will favor successful use of the method include anticipated support for individual users from preparer organizations and other service providers—including, for example, training and software—and users' anticipated increasing facility and efficiency with the method with repeated use.

b. *Limitations of the method, in terms of technical precision.* The Board reaffirmed that the method is intended to provide useful information for general purpose financial reporting. The Board continues to believe that the method (with improvements discussed elsewhere) can be applied to produce a faithful representation of the financial implications of OPEB that would significantly improve upon present practice, at a reasonable cost, for that purpose. The Board's position is based, in part, on consideration of the degree of imprecision inherent in applying statistical methods to small populations, and on the sensitivity of the results to variations in key assumptions, even if the most precise techniques were applied.

c. *Increased costs of assurance and reduced net cost savings.* As discussed in paragraphs 184 and 185, the Board recognizes that costs associated with auditing may increase in some circumstances when the alternative measurement method is used by a nonspecialist. The extent to which that may occur, and whether increased costs of assurance would negate preparation cost savings, would depend on the circumstances of each engagement. For reasons discussed previously, the Board continues to believe that the alternative measurement method offers potential net cost savings—recognizing that savings may not occur in any particular case.

The Board believes it has developed a method that achieves an appropriate balance between the goals of reliable measurement and reasonable cost.

Effective Date and Transition

197. The Exposure Draft proposed that this Statement would become effective in three phases, based on a government's total revenues in the first fiscal year ending after June 15, 2003, using the same criteria as used previously for phased implementation of Statement 34. This Statement retains the provision for implementation in three phases using Statement 34 implementation criteria. However, to simplify, a government's phase for the purpose of implementing this Statement would be the same as that government's phase for the purpose of implementing Statement 34. That is, a new calculation based on a government's total revenues in the first fiscal year ending after June 15, 2003, would no longer be required.

198. Because many OPEB plans previously have not had actuarial valuations, this Statement and Statement 43 on OPEB plan reporting potentially could increase the demand for actuarial services to the extent that supply would become a problem if all plans had effective dates within the same year. Phased

implementation will enable spreading of the increased demand for services and assist adjustments of supply and demand.

199. The Board's intent, expressed in the Exposure Draft, was to provide a relatively long implementation period, to assist employers in planning for and implementing its measurement and reporting requirements and to minimize overlap with the extended period for implementation of the infrastructure reporting provisions of Statement 34. After assessing the effect of extensions of the projected issuance date of this Statement as a result of (a) work on the alternative measurement method and (b) reexposure, the Board concluded that the effective dates of the Statement also should be extended, in order to maintain adequate lead time for implementation. Accordingly, the effective dates have been extended from employers' fiscal years beginning after June 15, 2006, 2007, and 2008, to fiscal years beginning after December 15, 2006, 2007, and 2008. For most governments, that change will extend the effective date by one year. Earlier implementation continues to be encouraged.

200. The effective dates of Statement 43 (which were extended commensurate with the extensions discussed in the previous paragraph) and of this Statement are related but not the same. In planning for implementation, preparers should consider the effective dates of both Statements and the maximum acceptable periods between the actuarial valuation date and application of the results to information reported, respectively, in the financial reports of plans and participating employers for the first implementation year.

201. Several respondents made recommendations that would more extensively delay the implementation of the OPEB Statements, in order to delay the potential effect of the reporting of accrual-basis information about OPEB on decision makers' judgments and decisions regarding benefits and the financing of benefits. Those recommendations included:

a. Delaying the issuance of standards in order to study how the information might affect decision makers' judgments and decisions

b. Delaying the issuance of standards until all interested groups have reached a consensus about OPEB accounting and reporting issues

c. Applying the standards on a grandfathered basis, in which the benefits of retirees and senior employees would continue to be accounted for on a pay-as-you-go basis.

202. The Board concluded, however, that the financial significance of OPEB for many governments provides compelling reason to proceed to timely completion of the final Statements, so that all financial report users will have relevant, reliable information about the effects of those transactions. The Board does not believe it would be productive to further study the potential judgments and decisions that financial report users might make. In the end, the results of any additional study, if conducted, would be speculative at best and, more important, would not be relevant to the question of whether improved standards are needed. The judgments and decisions that the varied users of financial reports might make considering, in part, the information reported to them about OPEB are their legitimate province, and not that of the Board. Similarly, the Board rejected the proposition that the issuance of standards should be delayed until all parties agree—a condition which, if applied to standards setting generally, would practically ensure that improved financial reporting standards never would be issued. The Board also rejected the suggestion to permit implementation of the proposed standards on a grandfathered basis, because that treatment potentially would omit a substantial part of employers' total OPEB obligations from consideration and could result in understatement of OPEB expense for many years.

203. This Statement generally provides for prospective implementation (setting the initial net OPEB obligation, at the beginning of the transition year, at zero). The Board recognizes that many OPEB plans currently do not have actuarial valuations, and this Statement does not require information for years prior to implementation, except to the extent necessary to comply with the parameters regarding the timing and frequency of valuations in this Statement and Statement 43. However, an employer that has actuarial information for years prior to implementation, and that wishes to do so, may calculate and report a net

OPEB obligation (or asset) at transition. If so, the employer should apply the method set forth in paragraphs 30 through 35 of Statement 27 and should disclose the calculation period used. (The period specified in paragraph 32 of Statement 27 is not required for OPEB.)

204. Some respondents suggested that governments that have recognized an OPEB liability prior to the effective date of the Statement be allowed to retain the previously recognized liability, regardless of the manner in which it was calculated, as their net OPEB obligation balance at transition. Such a provision would permit a relatively small number of governments (principally governments that have been following FASB Statement 106) to avoid having to reverse an existing liability and implement prospectively or having to calculate a different beginning balance following the requirements of this Statement. However, the Board concluded that because of differences in measurement requirements and transition provisions between FASB Statement 106 and this Statement, the adoption of the respondents' suggestion potentially would affect the comparability of expense reporting among governments for a number of years. The Board believes that some governmental employers that currently apply FASB Statement 106 would have the information needed to apply the look-back procedure set forth in Statement 27 and referred to in this Statement and that, for them, application of that procedure would not require extensive effort. The Board realizes that others, by choice or because they do not have the necessary information, potentially would reverse liabilities previously recognized and would implement the requirements of this Statement prospectively. However, the Board believes that the potential loss of comparability in expense reporting among governments on an ongoing basis as a result of permitting a different starting point outweighs any benefit of making special provision for a relatively small number of governments.

Appendix C

ACCOUNTING PROCEDURES FOR ANNUAL OPEB COST WHEN AN EMPLOYER HAS A NET OPEB OBLIGATION

205. This appendix illustrates calculations that, if applicable, are required by this Statement for sole and agent employers. The facts assumed in the examples are illustrative only and are not intended to modify or limit the requirements of this Statement or to indicate the Board's endorsement of the policies or practices shown.

Accounting Procedures for Calculating Interest, Adjusting the ARC, and Computing Annual OPEB Cost [paragraphs 14–16]

1. Annual OPEB cost is the measure required by this Statement of a sole or agent employer's "cost" of participating in an OPEB plan. The measure should be calculated and disclosed, regardless of (a) the amount recognized as OPEB expense (in proprietary and fiduciary fund financial statements and in government-wide financial statements) or expenditures (in governmental fund financial statements) on the accrual or modified accrual basis and (b) the amount paid in relation to the employer's annual required contributions (ARC) in accordance with the parameters. *When an employer has no net OPEB obligation, annual OPEB cost is equal to the ARC.*

2. A net OPEB obligation is the cumulative difference since the effective date of this Statement between annual OPEB cost and an employer's contributions to a plan, including the OPEB liability (asset) at transition (if any) and excluding (a) short-term differences, as defined in paragraph 14, and (b) unpaid contributions that have been converted to OPEB-related debt. An employer may have a net OPEB obligation to more than one plan; net OPEB obligations to different plans should not be combined. *When a net OPEB obligation has a liability (positive) balance, annual OPEB cost is equal to (a) the ARC, plus (b) one year's interest on the beginning balance of the net OPEB obligation, less (c) an adjustment to the ARC to offset, approximately, the amount included in the ARC for amortization of the past contribution deficiencies.* (This summary assumes a liability balance. When a net OPEB obligation has an asset [negative] balance, the interest adjustment should be *deducted* from and the ARC adjustment should be

added to the ARC, to determine annual OPEB cost.)

3. When a contribution deficiency occurs, the next and subsequent ARCs include an amount for amortization of the deficiency (except for short-term differences, as defined in paragraph 14). The same accounting parameters apply for amortizing contribution deficiencies as for any other actuarial loss. The amount included in the ARC for amortization of the deficiency depends on the amortization methodology applied and generally is not precisely determinable. The accounting adjustments are designed to *estimate* the amortization amount, remove it from the ARC, and add back an appropriate amount for interest on the net OPEB obligation. The purpose of the interest and ARC adjustments is to avoid "double-counting" annual OPEB cost and liabilities. Without the adjustments, annual OPEB cost and the net OPEB obligation (liability) would be overstated by the portion of the amortization amount previously recognized in annual OPEB cost. With the adjustments, annual OPEB cost should be approximately equal to the ARC that would have been charged if all prior ARCs had been paid in full, plus one year's interest on the net OPEB obligation. The interest is an estimate of the investment earnings lost to the plan on the contributions that were not made. Making the adjustments also allows the employer to return to reporting annual OPEB cost equal to the ARC, either when amortization of the deficiency is complete or earlier upon full payment of the net OPEB obligation including interest.

4. Each year's adjustments should be calculated using the same amortization method, period, and assumptions applied in calculating the ARC *for that year.* Each year's adjustments apply only for that year; there is no amortization schedule to follow. In accordance with the parameters, the method should be either level percentage of projected payroll (level percent) or level dollar. The period should be the period applied by the actuary for amortizing actuarial experience gains and losses. In calculating the amortization amount, the actuary uses an amortization factor that incorporates the period and a discount rate. When level dollar is used, the discount rate is the investment return rate (assumed return on the investments that are expected to be used to finance the payment of benefits). When level percent is used, the discount rate is slightly less than the difference between the investment return rate and the inflation rate (assumed payroll growth rate). (One formula for calculating a level percent discount rate is: [(1 + investment return rate) / (1 + inflation rate)] – 1. For example, if the investment return and inflation assumptions are 5.5 percent and 4.5 percent, respectively, the discount rate is [1.055/1.045] – 1, or approximately 0.96 percent.)

5. To make the adjustments, the financial statement preparer needs to know the *investment return rate* and the *amortization factor* applicable to the year for which the adjustments are made. The investment return rate and the factor may vary from employer to employer and from year to year. However, the accounting *procedures* for calculating the adjustments are identical.

a. The interest adjustment equals the balance of the net OPEB obligation at the beginning of the year times the investment return rate.

b. The ARC adjustment equals the balance of the net OPEB obligation at the beginning of the year divided by the amortization factor.

6. Following are five examples of the accounting calculations:

Example No.	**Amortization Method**	**Amortization Period**	**Employer Contribution**
1	Level dollar closed	15 years	ARC, except year 0 (contribution less than the ARC)
2	Level percent closed	15 years	ARC, except year 0 (contribution less than the ARC)
3	Level percent	15 years	ARC, except year 0

	open		(contribution less than the ARC)
4	Level percent open	15 years	Irregular
5	Level percent closed	15 years	ARC, except year 0 (contribution greater than the ARC)

a. Each example assumes that (1) the employer has no net OPEB obligation at the beginning of year 0 and (2) without the effect of contribution deficiencies or excess contributions, the ARC for all years would be $7,500. (All other effects on the ARC are assumed to offset each other so that the effect of the deficiency or excess contribution can be seen.) *The accounting procedures are the same in each example.*

b. The assumptions are included at the top of each example. The amortization factors are based on the actuarial assumptions and the amortization method and period. (Use of a different formula for calculating the factors could produce slightly different factors. The financial statement preparer would use the same factors as the actuary.) *Simplified* actuarial calculations are included to the right of the accounting calculations *to illustrate the similarity of the two calculations.* However, the accounting and actuarial calculations are *independent* of each other, and the actuary generally would not separately amortize contribution deficiencies and excess contributions; they would be amortized with other actuarial gains and losses and may be fully or partially offset by those amounts. Therefore, neither the actuary nor the financial statement preparer would "see" the effect of a contribution deficiency or excess contribution on each year's ARC. The accounting procedures *approximate* the actuarial calculations; the results may not always be as similar as in these examples. As indicated in paragraph 16 of this Statement, each year's adjustments apply only for that year; a new calculation should be made each year. Therefore, each year's calculations in these examples have been rounded to the nearest dollar. The results for individual years could be slightly different if a complete amortization schedule was prepared in year 1.

c. The employer can return to reporting annual OPEB cost equal to the ARC in any year, if the net OPEB obligation balance is paid in full, plus interest. Examples 1 through 4 show the amount that should be paid, if the decision to pay the balance is made in year 11. Example 5 (initial overcontribution of the ARC) shows the amount that should be paid if the decision is made to reduce the *negative* net OPEB obligation (prepaid expense) to zero in year 11.

gasb_st45_examples.xls

Appendix D

ILLUSTRATIONS OF DISCLOSURES

206. This appendix illustrates disclosures required by this Statement. The facts assumed in these examples are illustrative only and are not intended to modify or limit the requirements of this Statement or to indicate the Board's endorsement of the policies or practices shown. Disclosures in addition to those illustrated also are required. Illustrations 2 and 4 are coordinated with Illustrations 1 and 2 of Appendix D to the related Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans.* In addition, Illustration 7 is coordinated with Illustrations 1 and 2a in Appendix F to this Statement.

Illustration 1 Summary of Note Disclosures and Required Supplementary Information (RSI) for

Employer Reporting

Illustration 2 Notes to the Financial Statements for an Employer Contributing to a Single-Employer Defined Benefit Healthcare Plan

Illustration 3 Notes to the Financial Statements and Schedule of Funding Progress for an Employer Contributing to an Agent Multiple-Employer Defined Benefit Healthcare Plan

Illustration 4 Notes to the Financial Statements for an Employer Contributing to a Cost-Sharing Multiple-Employer Defined Benefit Healthcare Plan

Illustration 5 Notes to the Financial Statements for an Employer Contributing to a Cost-Sharing Multiple-Employer Defined Benefit Healthcare Plan with Legal Funding Limitations

Illustration 6 Notes to the Financial Statements and Schedules of Funding Progress for an Employer Contributing to Three Single-Employer Defined Benefit OPEB Plans

Illustration 7 Notes to the Financial Statements and Schedule of Funding Progress for an Employer Using the Alternative Measurement Method

Illustration 1—Summary of Note Disclosures and Required Supplementary Information (RSI) for Employer Reporting[1]

Reporting Situation		Type of Plan						
		Single-Employer Plan		Agent Multiple-Employer Plan[2]			Cost-Sharing Multiple-Employer Plan[3]	
Employer Report Includes Other Employee Benefit Trust Fund or an Agency Fund	Plan Issues Stand-Alone Report	Employer	Other Employee Benefit Trust Fund	Employer	Other Employee Benefit Trust Fund	Agency Fund	Employer	Other Employee Benefit Trust Fund
YES	YES	Notes ¶24 and ¶25	Notes ¶30 (Reduced) RSI ¶31–¶37 (Reduced)	Notes ¶24 and ¶25 RSI ¶26	Notes ¶30 (Reduced)	Notes ¶41 (Reduced)	Notes ¶24	Notes ¶30 (Reduced)
YES	NO	Notes ¶24 and ¶25	Notes ¶30 (Full) RSI ¶31–¶37 (Full)	Notes ¶24 and ¶25 RSI ¶26	Notes ¶30 (Full) RSI ¶31–¶37 (Full)	Notes ¶41 (Full)	Notes ¶24	Notes ¶30 (Full) RSI ¶31–¶37 (Full)
NO	YES	Notes ¶24 and		Notes ¶24 and			Notes ¶24	

		¶25 RSI ¶26		¶25 RSI ¶26				
NO	NO	Notes ¶24 and ¶25 RSI ¶26		Notes ¶24 and ¶25 RSI ¶26			Notes ¶24 RSI ¶27	

1 Paragraph numbers in the *Employer* columns refer to this Statement; paragraph numbers in the *Other Employee Benefit Trust Fund* and *Agency Fund* columns refer to Statement 43. *Full* RSI comprises *a schedule of funding progress and a schedule of employer contributions* for at least three valuations and RSI notes. *Reduced* RSI (and ¶26 RSI for employers) comprises *a schedule of funding progress* for at least three valuations. (All stand-alone plan reports are required to include full notes and RSI.)

2 For agent employers, ¶26 RSI (employer) is for the employer's *individual* plan; ¶31–¶37 RSI (other employee benefit trust fund) is for the *aggregate* (all employers) plan.

3 Employers in multiple-employer plans that do not meet the conditions of ¶22a should apply the requirements of this Statement applicable to *agent employers* instead of the requirements of this Statement applicable to cost-sharing employers.

Illustration 2—Notes to the Financial Statements for an Employer Contributing to a Single-Employer Defined Benefit Healthcare Plan

[Note: This example assumes that the plan is included as an other employee benefit trust fund in the employer's financial reporting entity. Only those disclosures required by this Statement are illustrated. In accordance with footnote 21 of this Statement, the requirement to present a schedule of funding progress covering at least three actuarial valuations would be met by complying with paragraphs 31 through 35 of Statement 43. That schedule is not illustrated here. Information required by Statement 43 because the plan is reported as an other employee benefit trust fund would be shown in addition to the information illustrated below. If the plan was not included in the employer's financial reporting entity, the employer would be required to present a schedule of funding progress similar to those included in Illustrations 3, 6, and 7 of this appendix.]

State of Grande

Notes to the Financial Statements
for the Year Ended June 30, 20X2

Note X. Postemployment Healthcare Plan

Plan Description. State Retired Employees Healthcare Plan (SREHP) is a single-employer defined benefit healthcare plan administered by the Grande Retirement System. SREHP provides medical and dental insurance benefits to eligible retirees and their spouses. Article 37 of the Statutes of the State of Grande assigns the authority to establish and amend benefit provisions to the state legislature. The Grande Retirement System issues a publicly available financial report that includes financial statements and required supplementary information for SREHP. That report may be obtained by writing to Grande Retirement System, State Government Lane, Latte, GR 01000, or by calling 1-800-555-PLAN.

Funding Policy. The contribution requirements of plan members and the state are established and may be amended by the state legislature. The required contribution is based on projected pay-as-you-go financing requirements, with an additional amount to prefund benefits as determined annually by the legislature. For fiscal year 20X2, the state contributed $357.7 million to the plan, including $190.7 million for current premiums (approximately 84 percent of total premiums) and an additional $167.0 million to prefund benefits. Plan members receiving benefits contributed $35.4 million, or approximately 16 percent of the total premiums, through their required contribution of $50 per month for retiree-only coverage and $105 for retiree and spouse coverage.

Annual OPEB Cost and Net OPEB Obligation. The state's annual other postemployment benefit (OPEB) cost (expense) is calculated based on the *annual required contribution of the employer (ARC),* an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years. The following table shows the components of the state's annual OPEB cost for the year, the amount actually contributed to the plan, and changes in the state's net OPEB obligation to SREHP (dollar amounts in thousands):

Annual required contribution	$577,180
Interest on net OPEB obligation	90,437
Adjustment to annual required contribution	(95,258)
Annual OPEB cost (expense)	572,359
Contributions made	(357,682)
Increase in net OPEB obligation	214,677
Net OPEB obligation—beginning of year	1,349,811
Net OPEB obligation—end of year	$1,564,488

The state's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for 20X2 and the two preceding years were as follows (dollar amounts in thousands):

Fiscal Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
6/30/X0	$497,538	67.4%	$1,160,171
6/30/X1	538,668	64.8	1,349,811
6/30/X2	572,359	62.5	1,564,488

Funded Status and Funding Progress. As of December 31, 20X1, the most recent actuarial valuation date, the plan was 58.1 percent funded. The actuarial accrued liability for benefits was $8.8 billion, and the actuarial value of assets was $5.1 billion, resulting in an unfunded actuarial accrued liability (UAAL) of $3.7 billion. The covered payroll (annual payroll of active employees covered by the plan) was $2.2 billion, and the ratio of the UAAL to the covered payroll was 165 percent.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Actuarial Methods and Assumptions. Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

In the December 31, 20X1, actuarial valuation, the entry age actuarial cost method was used. The actuarial assumptions included a 6.7 percent investment rate of return (net of administrative expenses), which is a blended rate of the expected long-term investment returns on plan assets and on the employer's own investments calculated based on the funded level of the plan at the valuation date, and an annual healthcare cost trend rate of 12 percent initially, reduced by decrements to an ultimate rate of 5 percent after ten years. Both rates included a 4.5 percent inflation assumption. The actuarial value of assets was determined using techniques that spread the effects of short-term volatility in the market value of investments over a five-year period. The UAAL is being amortized as a level percentage of projected payroll on an open basis. The remaining amortization period at December 31, 20X1, was seventeen years.

Illustration 3—Notes to the Financial Statements and Schedule of Funding Progress for an Employer Contributing to an Agent Multiple-Employer Defined Benefit Healthcare Plan

City of Mocha

Notes to the Financial Statements
for the Year Ended June 30, 20X2

Note X. Postemployment Healthcare Plan

Plan Description . The city's defined benefit postemployment healthcare plan, Mocha Postemployment Healthcare Plan (MPHP), provides medical benefits to eligible retired city employees and their beneficiaries. MPHP is affiliated with the Municipal Retired Employees Health Plan (MREHP), an agent multiple-employer postemployment healthcare plan administered by the Robusta Retirement System. Article 39 of the Statutes of the State of Robusta assigns the authority to establish and amend the benefit provisions of the plans that participate in MREHP to the respective employer entities; for MPHP, that authority rests with the city of Mocha. The Robusta Retirement System issues a publicly available financial report that includes financial statements and required supplementary information for MREHP. That report may be obtained by writing to Robusta Retirement System, 399 Grocer Aisle, Caffe, RO 02000, or by calling 1-877-555-PLAN.

Funding Policy. The contribution requirements of plan members and the city are established and may be amended by the MREHP board of trustees. MPHP members receiving benefits contribute $75 per month for retiree-only coverage and $150 per month for retiree and spouse coverage to age 65, and $40 and $80 per month, respectively, thereafter.

The city of Mocha is required to contribute the *annual required contribution of the employer (ARC),* an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years. The current ARC rate is 13.75 percent of annual covered payroll.

Annual OPEB Cost. For 20X2, the city's annual OPEB cost (expense) of $870,517 for MPHP was equal to the ARC. The city's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for 20X2 and the two preceding years were as follows:

Fiscal	**Percentage of**	**Net**

Year Ended	Annual OPEB Cost	Annual OPEB Cost Contributed	OPEB Obligation
6/30/X0	$929,401	100%	$0
6/30/X1	910,042	100	0
6/30/X2	870,517	100	0

Funded Status and Funding Progress. The funded status of the plan as of December 31, 20X1, was as follows:

Actuarial accrued liability (AAL)	$19,490,482
Actuarial value of plan assets	15,107,180
Unfunded actuarial accrued liability (UAAL)	$ 4,383,302
Funded ratio (actuarial value of plan assets/AAL)	77.5%
Covered payroll (active plan members)	$ 6,331,031
UAAL as a percentage of covered payroll	69.2%

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information that shows whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Actuarial Methods and Assumptions. Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

In the December 31, 20X1, actuarial valuation, the entry age actuarial cost method was used. The actuarial assumptions included a 7.5 percent investment rate of return (net of administrative expenses) and an annual healthcare cost trend rate of 12 percent initially, reduced by decrements to an ultimate rate of 5 percent after ten years. Both rates include a 4.5 percent inflation assumption. The actuarial value of MPHP assets was determined using techniques that spread the effects of short-term volatility in the market value of investments over a three-year period. MPHP's unfunded actuarial accrued liability is being amortized as a level percentage of projected payroll on a closed basis. The remaining amortization period at December 31, 20X1, was twenty-two years.

REQUIRED SUPPLEMENTARY INFORMATION
Schedule of Funding Progress for MPHP

Actuarial Valuation	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)— Entry Age	Unfunded AAL (UAAL)	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll

Date	(a)	(b)	(b – a)	(a / b)	(c)	((b – a) / c)
12/31/W9	$10,138,007	$16,867,561	$6,729,55460.1%		$5,984,554112.4%	
12/31/X0	12,093,839	17,572,474	5,478,63568.8		6,182,35188.6	
12/31/X1	15,107,180	19,490,482	4,383,30277.5		6,331,03169.2	

Illustration 4—Notes to the Financial Statements for an Employer Contributing to a Cost-Sharing Multiple-Employer Defined Benefit Healthcare Plan

Brewer State University

Notes to the Financial Statements
for the Year Ended June 30, 20X2

Note X. University Retiree Health Plan

Plan Description . Brewer State University contributes to the State University Retiree Health Plan (SURHP), a cost-sharing multiple-employer defined benefit postemployment healthcare plan administered by the Grande Retirement System. SURHP provides medical benefits to retired employees of participating universities. Article 38 of the Statutes of the State of Grande assigns the authority to establish and amend benefit provisions to the SURHP board of trustees. The Grande Retirement System issues a publicly available financial report that includes financial statements and required supplementary information for SURHP. That report may be obtained by writing to Grande Retirement System, State Government Lane, Latte, GR 01000, or by calling 1-800-555-PLAN.

Funding Policy. Article 38 provides that contribution requirements of the plan members and the participating employers are established and may be amended by the SURHP board of trustees. Plan members or beneficiaries receiving benefits contribute $65 per month for retiree-only coverage and $135 for retiree and spouse coverage to age 65, and $35 and $75 per month, respectively, thereafter.

Participating universities are contractually required to contribute at a rate assessed each year by SURHP, currently 8.75 percent of annual covered payroll. The SURHP board of trustees sets the employer contribution rate based on the *annual required contribution of the employers (ARC),* an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) of the plan over a period not to exceed thirty years. The university's contributions to SURHP for the years ended June 30, 20X2, 20X1, and 20X0, were $58,717, $49,886, and $47,375, respectively, which equaled the required contributions each year.

Illustration 5—Notes to the Financial Statements for an Employer Contributing to a Cost-Sharing Multiple-Employer Defined Benefit Healthcare Plan with Legal Funding Limitations

Percolator School District

Notes to the Financial Statements
for the Year Ended June 30, 20X2

Note X. Retiree Health Plan

Plan Description . Percolator School District contributes to the state of Mezzo Teachers' Retiree Health Plan (MTRHP), a cost-sharing multiple-employer defined benefit postemployment healthcare plan administered by the Mezzo Teachers' Retirement System (MTRS). MTRHP provides medical benefits to retired teachers of participating school districts. Article 145(b) of the Statutes of the State assigns the authority to establish and amend benefit provisions to the MTRS board of trustees. MTRS issues a publicly available financial report that includes financial statements and required supplementary information for MTRHP. That report may be obtained by writing to Mezzo Teachers' Retirement System, State Circle, Cappuccino, MZ 01000, or by calling 1-800-555-PLAN.

Funding Policy. Article 145(b) provides that contribution requirements of the participating employers and of plan members to the MTRS (defined benefit pension plan) are established and may be amended by the MTRS board of trustees. Participating employers and active pension plan members are required to contribute to the pension plan at rates expressed as percentages of the payroll of active pension plan members, currently 15 percent and 7 percent of payroll, respectively. Article 145(b) states that the employer contribution rate may not exceed 17 percent of payroll and that the employee contribution rate may not exceed 8 percent.

The retiree health plan was established and is administered as an Internal Revenue Code Section 401h account within the defined benefit pension plan, under the authority granted by the state of Mezzo to the MTRS board of trustees. The board of trustees is authorized to allocate a portion of the total employer contributions made into the pension plan to the 401h account as the employer contribution for retiree healthcare benefits. For the year ended June 30, 20X2, the employer contribution allocated to the retiree healthcare plan was 5 percent of payroll. The amount of employer contributions allocated to the healthcare plan each year is subject to the trustees' primary responsibility to ensure that pension benefits are adequately funded and also is limited by the provisions of Section 401h.

The board of trustees also is authorized to establish requirements for contributions to the retiree healthcare plan by retirees or their surviving beneficiaries. For the year ended June 30, 20X2, retirees or their beneficiaries contributed $75 dollars per month for retiree-only coverage and $160 per month for retiree and spouse coverage to age 65, and $30 and $65 dollars per month, respectively, thereafter.

The district's contributions to MTRS for the years June 30, 20X2, 20X1, and 20X0, were $450,231, $423,185, and $398,657, respectively, of which $150,077, $126,955, and $127,570, respectively, was allocated to the healthcare plan.

Illustration 6—Notes to the Financial Statements and Schedules of Funding Progress for an Employer Contributing to Three Single-Employer Defined Benefit OPEB Plans

[Note: This illustration shows one way in which an employer with several plans can combine disclosures so that the required information is presented for each plan without unnecessary duplication. The illustration assumes that each plan issues a stand-alone report that complies with Statement 43. However, the plans are not included in the employer's financial reporting entity. Therefore, the employer is required to present a schedule of funding progress for each plan, in accordance with paragraph 26 of this Statement.]

City of Peaberry

Notes to the Financial Statements
for the Year Ended June 30, 20X2

Note X. Postemployment Benefits Other Than Pensions

Plan Descriptions. The city of Peaberry contributes to two single-employer defined benefit healthcare plans: Municipal Retired Employees Healthcare Plan (MREHP) and Fire and Police Retiree Healthcare Plan (FPRHP). Each plan provides medical benefits to eligible retired city employees and beneficiaries. The city also sponsors the Elected Officials Retiree Life Insurance Plan (EORLIP), a single-employer defined benefit life insurance plan that provides eligible retired elected officials with a death benefit equal to two times their final salary.

Benefit provisions for MREHP and FPRHP are established and amended through negotiations between the city and the respective unions. Article 64(a) of the Peaberry City Code assigns the authority to establish benefit provisions for EORLIP to the city council. Each plan issues a publicly available financial report that includes financial statements and required supplementary information for that plan. Those reports may be obtained by writing or calling the plans at the following addresses or numbers:

Municipal Retired
Employees Healthcare Plan
101 Municipal Lane
Peaberry, GR 01001
(999) 999-9999

Fire and Police Retiree
Healthcare Plan
105 Municipal Lane
Peaberry, GR 01001
(999) 999-9998

Elected Officials Retiree Life
Insurance Plan
108 Municipal Lane
Peaberry, GR 01001
(999) 999-9997

Funding Policy and Annual OPEB Cost. For MREHP, contribution requirements of the plan members and the city are established and may be amended through negotiations between the city and the union. For FPRHP, the board of trustees of the plan establishes and may amend the contribution requirements of plan members and the city. For EORLIP, contractual requirements for the city are established and may be amended by the city council. The city's annual other postemployment benefit (OPEB) cost (expense) for each plan is calculated based on the *annual required contribution of the employer (ARC),* an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and to amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years. The city's annual OPEB cost for the current year and the related information for each plan are as follows (dollar amounts in thousands):

	Municipal Retired Employees Healthcare Plan	**Fire and Police Retiree Healthcare Plan**	**Elected Officials Retiree Life Insurance Plan**
Contribution rates:			
City	Contractually determined 7.0%	Actuarially determined 10.0%	Pay-as-you-go
Plan members	N/A	4.0%	N/A
Annual required contribution	$ 433,664	$ 178,966	$ 1,750
Interest on net OPEB obligation	65,325	—	331
Adjustment to annual required contribution	(82,755)	—	(332)
Annual OPEB cost	416,234	178,966	1,749
Contributions made	(324,246)	(178,966)	(1,740)
Increase in net OPEB obligation	91,988	—	9
Net OPEB obligation—beginning of year	1,126,298	—	6,014
Net OPEB obligation—end of year	$1,218,286	$ —	$ 6,023

The city's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for 20X2 and the two preceding years for each of the plans were as follows (dollar amounts in thousands):

	Year Ended	Annual OPEB Cost	Percentage of OPEB Cost Contributed	Net OPEB Obligation
Municipal Retired Employees Healthcare Plan	6/30/X0	$511,047	65.6%	$ 990,462
	6/30/X1	470,023	71.1	1,126,298
	6/30/X2	416,234	77.9	1,218,286
Fire and Police Retiree Healthcare Plan	6/30/X0	173,561	100.0	—
	6/30/X1	171,991	100.0	—
	6/30/X2	178,966	100.0	—
Elected Officials Retiree Life Insurance Plan	6/30/X0	1,685	43.2	4,302
	6/30/X1	1,712	0.0	6,014
	6/30/X2	1,749	99.5	6,023

Funded Status and Funding Progress. The funded status of the plans as of June 30, 20X2, was as follows (dollar amounts in thousands):

	Municipal Retired Employees Healthcare Plan	Fire and Police Retiree Healthcare Plan*	Elected Officials Retiree Life Insurance Plan
Actuarial accrued liability (a)	$2,744,210	$1,972,660	$6,170
Actuarial value of plan assets (b)	361,790	1,982,749	—
Unfunded actuarial accrued liability (funding excess) (a) – (b)	$2,382,420	$ (10,089)	$6,170
Funded ratio (b) / (a)	13.18%	100.51%	0%
Covered payroll (c)	$4,632,086	$1,820,504	$4,400
Unfunded actuarial accrued liability (funding excess) as a percentage of covered payroll ([(a) – (b)] / (c))	51.43%	(0.55)%	140.23%

*The aggregate actuarial cost method is used for funding purposes. However, because the aggregate actuarial cost method does not identify or separately amortize unfunded actuarial liabilities, the entry age actuarial cost method has been used to provide required information about funded status and funding progress. The information presented in this schedule is intended to approximate the funding progress of the plan based on the use of the aggregate actuarial cost method.

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events in the future. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future. The required schedule of funding progress presented as required supplementary information provides multiyear trend information that shows whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Actuarial Methods and Assumptions. Projections of benefits are based on the substantive plan (the plan as understood by the employer and plan members) and include the types of benefits in force at the valuation date and the pattern of sharing benefit costs between the city and the plan members to that point. Actuarial calculations reflect a long-term perspective and employ methods and assumptions that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets. Significant methods and assumptions were as follows:

	Municipal Retired Employees Healthcare Plan	**Fire and Police Retiree Healthcare Plan**	**Elected Officials Retiree Life Insurance Plan**
Actuarial valuation date	6/30/X2	6/30/X2	6/30/X2
Actuarial cost method	Entry age	Aggregate	Entry age
Amortization method	Level percentage of pay, open	None†	Level percentage of pay, open
Remaining amortization period	15 years	None†	20 years
Asset valuation method	5-year smoothed market	5-year smoothed market	5-year smoothed market
Actuarial assumptions:			
Investment rate of return*	5.8%‡	7.5%	5.5%
Projected salary increases*	4.9–7.5%	6.2–10.1%	5%
Healthcare inflation rate*	12% initial 5% ultimate	12% initial 5% ultimate	N/A

*Includes an inflation assumption of 4.5 percent.
†The aggregate cost method does not identify or separately amortize unfunded actuarial liabilities.
‡Determined as a blended rate of the expected long-term investment returns on plan assets and on the city's own investments, based on the funded level of the plan at the valuation date.

REQUIRED SUPPLEMENTARY INFORMATION
Schedules of Funding Progress

(dollar amounts in thousands)

Municipal Retired Employees Healthcare Plan

Actuarial Valuation Date	**Actuarial Value of Assets (a)**	**Actuarial Accrued Liability (AAL)—Entry Age (b)**	**Unfunded AAL (UAAL) (b – a)**	**Funded Ratio (a / b)**	**Covered Payroll (c)**	**UAAL as a Percentage of Covered Payroll ((b – a) / c)**
6/30/X0	$202,060	$1,883,350	$1,681,290	10.73%	$ 4,789,238	35.11%
6/30/X1	298,400	2,445,810	2,147,410	12.20	4,774,084	44.98

6/30/X2	361,790	2,744,210	2,382,420	13.18	4,632,086	51.43

Fire and Police Retiree Healthcare Plan

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL)—Entry Age* (b)	Unfunded AAL (Funding Excess) (b – a)	Funded Ratio (a / b)	Covered Payroll (c)	Unfunded AAL (Funding Excess) as a Percentage of Covered Payroll ((b – a) / c)
6/30/X0	$1,509,215	$1,712,803	$203,588	88.11%	$1,681,001	12.11%
6/30/X1	1,813,858	1,919,724	105,866	94.49	1,758,820	6.02
6/30/X2	1,982,749	1,972,660	(10,089)	100.51	1,820,504	(0.55)

*The aggregate actuarial cost method is used for funding purposes. However, because this method does not identify or separately amortize unfunded actuarial liabilities, the entry age actuarial cost method has been used to provide required information about funded status and funding progress. The information presented in this schedule is intended to approximate the funding progress of the plan based on the use of the aggregate actuarial cost method.

Elected Officials Retiree Life Insurance Plan

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL)—Entry Age (b)	Unfunded AAL (UAAL) (b – a)	Funded Ratio (a / b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b – a) / c)
6/30/X0	—	$5,041	$5,041	0.00%	$4,001	125.99%
6/30/X1	—	5,531	5,531	0.00	4,191	131.97
6/30/X2	—	6,170	6,170	0.00	4,400	140.23

Illustration 7—Notes to the Financial Statements and Schedule of Funding Progress for an Employer Using the Alternative Measurement Method

[Note: This example assumes that there is no trust fund reported in the employer's financial reporting entity. Therefore, the employer is required to present a schedule of funding progress for the plan, in accordance with paragraph 26 of this Statement.]

Town of Espresso

Notes to the Financial Statements

for the Year Ended June 30, 20X2

Note X. Postemployment Benefits Other Than Pensions

Plan Description. The town of Espresso administers a single-employer defined benefit healthcare plan ("the Retiree Health Plan"). The plan provides lifetime healthcare insurance for eligible retirees and their spouses through the town's group health insurance plan, which covers both active and retired members. Benefit provisions are established through negotiations between the town and the union representing town employees and are renegotiated each three-year bargaining period. The Retiree Health Plan does not issue a publicly available financial report.

Funding Policy. Contribution requirements also are negotiated between the town and union representatives. The town contributes 85 percent of the cost of current-year premiums for eligible retired plan members and their spouses. For fiscal year 20X2, the town contributed $24,689 to the plan. Plan members receiving benefits contribute 15 percent of their premium costs. In fiscal year 20X2, total member contributions were $4,359.

Annual OPEB Cost and Net OPEB Obligation. The town's annual other postemployment benefit (OPEB) cost (expense) is calculated based on the *annual required contribution of the employer (ARC).* The town has elected to calculate the ARC and related information using the alternative measurement method permitted by GASB Statement 45 for employers in plans with fewer than one hundred total plan members. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and to amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years. The following table shows the components of the town's annual OPEB cost for the year, the amount actually contributed to the plan, and changes in the town's net OPEB obligation to the Retiree Health Plan:

Annual required contribution	$60,231
Interest on net OPEB obligation	3,565
Adjustment to annual required contribution	(2,946)
Annual OPEB cost (expense)	60,850
Contributions made	(24,689)
Increase in net OPEB obligation	36,161
Net OPEB obligation—beginning of year	64,815
Net OPEB obligation—end of year	$100,976

The town's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for fiscal year 20X2 and the two preceding fiscal years were as follows:

Fiscal Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
6/30/X0	$50,124	40.9%	$29,628
6/30/X1	56,748	38.0	64,815
6/30/X2	60,850	40.6	100,976

Funded Status and Funding Progress. As of June 30, 20X1, the actuarial accrued liability for benefits was $636,997, all of which was unfunded. The covered payroll (annual payroll of active employees covered by the plan) was $581,435, and the ratio of the unfunded actuarial accrued liability to the covered payroll was 109.6 percent.

The projection of future benefit payments for an ongoing plan involves estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Methods and Assumptions. Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

The following simplifying assumptions were made:

Retirement age for active employees— Based on the historical average retirement age for the covered group, active plan members were assumed to retire at age 62, or at the first subsequent year in which the member would qualify for benefits.

Marital status— Marital status of members at the calculation date was assumed to continue throughout retirement.

Mortality— Life expectancies were based on mortality tables from the National Center for Health Statistics. The 19W9 United States Life Tables for Males and for Females were used.

Turnover— Non-group-specific age-based turnover data from GASB Statement 45 were used as the basis for assigning active members a probability of remaining employed until the assumed retirement age and for developing an expected future working lifetime assumption for purposes of allocating to periods the present value of total benefits to be paid.

Healthcare cost trend rate— The expected rate of increase in healthcare insurance premiums was based on projections of the Office of the Actuary at the Centers for Medicare & Medicaid Services. A rate of 9.5 percent initially, reduced to an ultimate rate of 5.6 percent after six years, was used.

Health insurance premiums— 20X1 health insurance premiums for retirees were used as the basis for calculation of the present value of total benefits to be paid.

Inflation rate— The expected long-term inflation assumption of 3.3 percent was based on projected changes in the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) in *The 20X1 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds* for an intermediate growth scenario.

Payroll growth rate— The expected long-term payroll growth rate was assumed to equal the rate of inflation.

Based on the historical and expected returns of the town's short-term investment portfolio, a discount rate of 5.5 percent was used. In addition, a simplified version of the entry age actuarial cost method was used. The unfunded actuarial accrued liability is being amortized as a level percentage of projected payroll on an open basis. The remaining amortization period at June 30, 20X1, was thirty years.

REQUIRED SUPPLEMENTARY INFORMATION
Schedule of Funding Progress

for the Retiree Health Plan

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL)—Simplified Entry Age (b)	Unfunded AAL (UAAL) (b – a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b – a) / c)
6/30/W9	$0	$581,802	$581,802	0.0%	$572,879	101.6%
6/30/X0	0	608,254	608,254	0.0	564,860	107.7
6/30/X1	0	636,997	636,997	0.0	581,435	109.6

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[33]That is, in broad outline, projection of future benefit payments, discounting to determine the actuarial present value of benefits, and allocation of the actuarial present value of benefits to periods using an actuarial cost method.

[34]Or calculations using an alternative measurement method, if applicable.

[35] See footnote 8.

[36]At a minimum.

[37]The same requirement extends to the disclosure of plan funded status information in the notes to the financial statements, which is required by paragraph 25c of this Statement for employers participating in OPEB plans. There is no corresponding requirement for employers in regard to their participation in pension plans.

[38]Thomas P. Bleakney, F.S.A., *Retirement Systems for Public Employees* (Homewood, IL: Richard D. Irwin, Inc., 1972), p. 125.

[39]As used in this Statement, "qualifying trust" refers to a trust that meets the conditions specified in paragraph 4 of Statement 43. That is, employer contributions to the trust are irrevocable, the net assets are dedicated to providing benefits to retirees and their beneficiaries in accordance with the terms of the plan, and the net assets are protected from claims by creditors of the employer(s) or the plan administrator.

[40]Modified accrual recognition of governmental fund liabilities and expenditures related to OPEB contributions is excluded from the scope of Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements.*

[41]After consideration of issues raised by respondents to the plan and employer Exposure Drafts, the Board concluded that the conditions for pooling of plan assets—and, therefore, for meaningful cost sharing—*are not present* if the fund used to administer a multiple-employer plan *is not a qualifying trust,* or equivalent arrangement. Any assets accumulated by the plan administrator in those circumstances are required to be reported as *assets of the employers,* to the extent of each employer's share of the total, rather than as plan assets. Because the conditions do not exist for recognition of plan assets, each employer is viewed as remaining individually responsible to finance benefits pertaining to its own retirees, for financial reporting purposes. Accordingly, paragraph 22 of this Statement requires that employers participating in such a plan should report following the requirements for *agent employers,* rather than the requirements for cost-sharing employers.

[42]In addition, as discussed in paragraphs 159 and 160, this Statement requires cost-sharing *employers*

to disclose the basis on which contractually required contributions were determined. As discussed in paragraph 165, this Statement also requires cost-sharing employers to present schedules of funding progress and employer contributions for the plan (all employers) as required supplementary information (RSI) in the *employers'* reports, if the *plan* does not issue and make publicly available a GAAP-compliant financial report that includes that information and the plan is not included in the financial report of a PERS or another entity.

Appendix E

ILLUSTRATIONS OF EQUIVALENT SINGLE AMORTIZATION PERIOD CALCULATIONS

207. The following are examples of the calculations that, if applicable, are required by paragraphs 13f(1) and 13f(2). When components of the total loose unfunded actuarial liability are separately amortized over different periods, the individual periods are required to be selected so that the *equivalent single amortization period for all components combined* does not exceed the maximum acceptable amortization period. An equivalent single amortization period is a weighted average period calculated in accordance with paragraph 13f(2). For these illustrations, the maximum acceptable period is thirty years. The data included in the examples are hypothetical and are not intended to indicate endorsement of the amortization periods and methods shown. The amortization factors are based on the actuarial assumptions and the amortization method and period. Use of a different formula for calculating the factors could produce slightly different factors.

Example 1 Equivalent Single Amortization Period *within* the Maximum Acceptable Amortization Period

Example 2 Equivalent Single Amortization Period *outside* the Maximum Acceptable Amortization Period

Example 3 Recalculation of Example 2 So That the Equivalent Single Amortization Period Is *within* the Maximum Acceptable Amortization Period

Example 1—Equivalent Single Amortization Period *within* the Maximum Acceptable Amortization Period

Lines 1, 2, and 3 of the example are given. The total unfunded actuarial liability (UAL) comprises three components or bases (line 2). Each base is to be amortized as a level percentage of projected payroll over a different time period (line 3). The assumptions are 8 percent investment return and 5 percent inflation; based on those assumptions, the level percent discount rate is approximately 2.86 percent. Each amortization factor (line 4) incorporates that rate and the period.

The amortization calculations for each of the three bases result in a total (net) amortization payment of 4.82 percent of payroll (line 6, total column). If the employer continued to contribute at that rate and all else resulted as anticipated, the total unfunded actuarial liability would be fully amortized in twenty-six years (equivalent single amortization period, line 8). That period is within the maximum acceptable period of thirty years. Therefore, the amortization periods selected for each base are acceptable.

	Base 1 Initial UAL	Base 2 Plan Amendment	Base 3 Cumulative Loss (Gain)	Total
1. Covered payroll				$1,500,000
2. Amount of base	$1,000,000	$400,000	$(100,000)	$1,300,000
3. Remaining amortization years	30	15	10	

4. Amortization factor based on (3)	19.77	11.94	8.51	
5. Next year's payment (2)/(4)	$50,582	$33,501	$(11,751)	$72,332
6. Payment as a level percentage of payroll (5)/(1)	3.37%	2.23%	(0.78)%	4.82%
Equivalent single period				
7. Weighted average amortization factor (2)/(5)				17.97
8. Equivalent single amortization period (nearest whole year)*				26

*Number of years incorporated in the amortization factor (line 7) when the discount rate is 2.86 percent. An amortization factor incorporates a discount rate and a period. When one is known, the other can be calculated.

Example 2—Equivalent Single Amortization Period outside the Maximum Acceptable Amortization Period

Lines 1, 2, and 3 of the example are given. The total unfunded actuarial liability (UAL) comprises three components or bases (line 2). Each base is to be amortized as a level percentage of projected payroll over a different time period (line 3). The assumptions are 8 percent investment return and 5 percent inflation; based on those assumptions, the level percent discount rate is approximately 2.86 percent. Each amortization factor (line 4) incorporates that rate and the period.

The amortization calculations for each of the three bases result in a total (net) amortization payment of 2.14 percent of payroll (line 6, total column). If the employer continued to contribute at that rate and all else resulted as anticipated, the total unfunded actuarial liability would be fully amortized in fifty-nine years (equivalent single amortization period, line 8).

	Base 1 Initial UAL	**Base 2 Plan Amendment**	**Base 3 Cumulative Loss (Gain)**	**Total**
1. Covered payroll				$1,500,000
2. Amount of base	$1,000,000	$200,000	$(300,000)	$900,000
3. Remaining amortization years	30	15	10	
4. Amortization factor based on (3)	19.77	11.94	8.51	
5. Next year's payment (2)/(4)	$50,582	$16,750	$(35,253)	$32,079
6. Payment as a level percentage of payroll (5)/(1)	3.37%	1.12%	(2.35)%	2.14%
Equivalent single period				
7. Weighted average amortization factor (2)/(5)				28.06
8. Equivalent single amortization period (nearest whole year)*				59

*Number of years incorporated in the amortization factor (line 7) when the discount rate is 2.86 percent. An amortization factor incorporates a discount rate and a period. When one is known, the other can be calculated.

Based on the assumptions made, 2.14 percent of payroll is insufficient to amortize the total unfunded actuarial liability in thirty years. One or more of the amortization periods selected for the individual bases should be changed. One solution is to spread the cumulative gain over a longer period, thereby *reducing* the credit taken (lines 5 and 6, base 3) and *increasing* the total (net) amortization payment. Example 3 presents that solution.

Example 3—Recalculation of Example 2 So That the Equivalent Single Amortization Period Is *within* the Maximum Acceptable Amortization Period

Lines 1 through 8 are repeated from Example 2 and the same assumptions apply. Given those assumptions, the minimum payment needed to pay off the total unfunded actuarial liability in thirty years (line 9) is $45,524, or 3.03 percent of payroll (lines 11 and 12).

One way to achieve the required minimum payment is to keep the amortization payments for the two loss bases the same (line 13) and recalculate the maximum credit that can be taken for the cumulative gain (line 14). To achieve that amount, the amortization factor for the cumulative gain should be 13.76 (line 15) instead of 8.51 (line 4). The number of years incorporated in that factor when the discount rate is 2.86 percent is eighteen years (line 16); base 3 should be amortized over eighteen years, not ten years. *Note that other solutions are possible, including various combinations of shortening the periods for base 1 or base 2 and lengthening the period for base 3.*

	Base 1 Initial UAL	Base 2 Plan Amendment	Base 3 Cumulative Loss (Gain)	Total
1. Covered payroll				$1,500,000
2. Amount of base	$1,000,000	$200,000	$(300,000)	$900,000
3. Remaining amortization years	30	15	10	
4. Amortization factor based on (3)	19.77	11.94	8.51	
5. Next year's payment (2)/(4)	$50,582	$16,750	$(35,253)	$32,079
6. Payment as a level percentage of payroll (5)/(1)	3.37%	1.12%	(2.35)%	2.14%
Equivalent single period				
7. Weighted average amortization factor (2)/(5)				28.06
8. Equivalent single amortization period (nearest whole year)				59
Minimum payment				
9. Maximum acceptable average period				30
10. Amortization factor for (9)				19.77
11. Minimum next year's payment (2)/(10)				$45,524
12. Minimum as a percentage of payroll				

(11)/(1)	3.03%
Adjusted amortization period for base 3	
13. Payment for base 1 plus base 2 (5)	$67,332
14. Maximum credit against cumulative gain (11) – (13)	$(21,808)
15. Base 3 amortization factor (2)/(14)	13.76
16. Base 3 amortization years	18

Appendix F

ILLUSTRATION OF CALCULATIONS USING THE ALTERNATIVE MEASUREMENT METHOD [paragraphs 33–35]

208. This appendix illustrates calculations that, if applicable, are required by this Statement for employers that apply the requirements of paragraphs 33 through 35. The facts assumed in the examples are illustrative only and are not intended to modify or limit the requirements of this Statement or to indicate the Board's endorsement of the policies or practices shown.

A sole or agent employer that meets any of the eligibility criteria in paragraph 11 is permitted to apply the *alternative measurement method* set forth in paragraphs 33 through 35, which allows for certain simplifying modifications to the selection of assumptions for purposes of measuring the ARC and the plan' s actuarial accrued liabilities and funded status. The alternative measurement method includes the same three broad measurement steps as an actuarial valuation:

1. *Project future cash outflows for benefits.* This step requires collecting and organizing in a spreadsheet format essential information about the *terms of the plan* and the *covered group.* It also involves making and applying *assumptions* about significant matters that will affect future cash flows. These include assumptions about future employment and retirement, life expectancy, and healthcare cost trends. The result of this step will be a spreadsheet of projected future cash outflows for benefits, by plan member (or by groups of plan members) and in total, for each of the future years in which benefit payments are expected.

2. *Discount projected benefits to their present value.* This step involves discounting the projected future cash outflows to present value, using as the discount rate the expected long-term rate of return on the assets expected to be used to pay the benefits. For example, for a plan that is financed on a pay-as-you-go basis, for which no plan assets have been set aside in a trust, or equivalent arrangement, the discount rate would be the expected long-term rate of return on the employer government's general investments.

3. *Allocate the present value of projected benefits to periods using an actuarial cost method.* This step involves the allocation of the present value of benefits to financial reporting periods using one of the six actuarial cost methods identified in paragraph 13d. Through the allocation process, the following elements are calculated:

   a. The *actuarial accrued liability,* representing the portions of the present value of benefits attributed by the actuarial cost method to prior periods

b. The *annual required contribution* of the employer (ARC), which is the basis for calculating the employer's *annual OPEB cost* (or expense) for the year.

This appendix includes an illustration of the projection of future benefit payments and the calculation of the present value of total future benefit payments (Illustration 1). Also illustrated are calculations of the ARC using two combinations of actuarial cost method and amortization method—entry age and level percentage of payroll (Illustration 2a) and projected unit credit and level dollar (Illustration 2b).

The formats and methods illustrated are intended as illustrations of how the alternative measurement method might be applied to particular facts and circumstances, including plan design, and might not be appropriate in other circumstances. Similarly, the assumptions illustrated below would not necessarily be appropriate in circumstances other than those assumed for purposes of illustration.

Facts and Assumptions

The following facts are assumed in the illustrations:

a. *Plan terms*— The plan is a single-employer defined benefit plan that pays 85 percent of the cost of healthcare insurance premiums for qualified retirees and their spouses for the remainder of their lives. To qualify for healthcare benefits under the plan, an employee is required to work for the town at least ten years and be at least fifty-five years old when service with the town terminates. Insurance for retired individuals is provided through the employer's group plan, which covers both active and retired members. The health insurance coverage for retired individuals has the same terms as the coverage for active employees, with the exception that the health insurance coverage for retired individuals is secondary to Medicare.

b. *Demographic information*— The plan has eighteen members. There are a total of twenty-six plan members and spouses, whose demographic information follows:

Member	Employment Status	Gender	Number of Years Employed	Age at Retirement	Current Age*	Spouse's Current Age
#1	Active	M	10		46	42
#2	Active	F	3		28	30
#3	Active	F	6		40	38
#4	Active	M	1		34	26
#5	Active	M	25		58	50
#6	Active	M	12		52	52
#7	Active	M	8		40	
#8	Active	M	2		33	
#9	Active	F	13		36	
#10	Active	F	4		30	
#11	Active	F	2		25	
#12	Active	M	1		22	
#13	Retired	F	20	56	60	
#14	Retired	M	35	66	68	62
#15	Retired	M	25	65	75	70
#16	Retired	F	30	62	71	
#17	Retired	M	18	60	64	
#18	Retired	M	32	63	deceased	81

*Current age is calculated as the difference between (1) the year as of the first day of the period for which the valuation is performed and (2) the individual's year of birth. For example, in this illustration the valuation is performed for the period beginning July 1, 2001, and Member #1 was born in 1955. Therefore, the age of Member #1 is calculated as 2001 – 1955 = 46. In the calculations that follow, this age is assumed for the period July 1, 2001, to June 30, 2002.

c. *Expected point in time at which benefits will begin to be provided* (paragraph 34b)—Active employees are assumed to retire at age 62, which is the historical average age of retirement for employees of this employer. If an employee would not yet qualify for benefits at age 62, the employee is assumed to work until the year in which he or she becomes eligible, at which time the employee is assumed to retire. Active employees age 62 or older who have qualified for postemployment benefits under the plan are assumed to retire in the first projected year.

d. *Marital status* (paragraph 34c)—Members who currently have spouses are assumed to be married to those spouses at retirement; those without spouses at the calculation date are assumed to be single at and throughout retirement.

e. *Mortality* (paragraph 34d)—Life expectancies are based on mortality tables at the National Center for Health Statistics website (www.cdc.gov). The 1999 United States Life Tables for Males and United States Life Tables for Females were used. Life expectancies that included partial years were rounded to the nearest whole year. For example, 54.4 years was rounded to 54 years. The calculation of postemployment health insurance coverage for each year is based on the assumption that all participants will live until their expected age as displayed in the mortality tables.

Remaining Life Expectancy at Current Age

	Member	Spouse		Member	Spouse
#1	31 years	39 years	#10	51 years	
#2	53	46	#11	55	
#3	41	38	#12	53	
#4	42	54	#13	23	
#5	21	32	#14	14	22 years
#6	26	30	#15	10	15
#7	37		#16	15	
#8	43		#17	17	
#9	45		#18	deceased	9

The average remaining life expectancy is calculated to be thirty-three years.

f. *Turnover* (paragraph 34e)—The probability that an employee will remain employed until the assumed retirement age was determined using non-group-specific age-based turnover data provided in Table 1 in paragraph 35b of this Statement.

Member	Current Age	Probability of Remaining Employed until Retirement
#1	46	0.943
#2	28	0.534
#3	40	0.841
#4	34	0.703
#5	58	1.000
#6	52	1.000
#7	40	0.841
#8	33	0.677
#9	36	0.753

#10	30	0.593
#11	25	0.440
#12	22	0.349
#13–#18	N/A	1.000

g. *Healthcare cost trend rate* (paragraph 34f)—The expected rate of increase in healthcare insurance premiums is based on projections of the Office of the Actuary at the Centers for Medicare & Medicaid Services, as published in *National Health Care Expenditures Projections: 2000–2010,* Table 3: National Health Expenditures, Aggregate & Per Capita Amounts, Percent Distribution, and Average Annual Percent Change by Source of Funds: Selected Calendar Years 1980–2010, published in March 2001 by the Health Care Financing Administration (www.cms.hhs.gov). Healthcare insurance premiums are expected to increase as follows:

For the Year Ended 6/30	Increase from Previous Year
2002	9.50%
2003	9.30
2004	8.30
2005	7.60
2006	6.70
2007	6.10
2008 & later	5.60

h. *Health insurance premiums* (paragraph 34g)—Because the terms of the plan cover a portion of the cost of healthcare insurance premiums for retired participants and premiums are assessed separately for the retiree group, the amount of current healthcare insurance premiums has been used as a basis for calculating the present value of benefits to be paid. For the year ended June 30, 2001, annual retiree health insurance premiums were:

Category	Total Premium	Employer Portion (85% of Total)
Pre–Age 65 (Not Medicare eligible)		
Single	$ 5,266	$4,476
Married (Employee *and* spouse under 65)	10,913	9,276
Ages 65 and Older (Medicare eligible)		
Single	2,118	1,800
Married (Employee *and* spouse 65 or older)	4,376	3,720
Married (Employee *or* spouse 65 or older)	7,384	6,276

The employer pays premiums monthly.

i. *Discount rate* (paragraph 13c)—Because the town finances OPEB using a pay-as-you-go approach, the discount rate is based on the historical (and expected future) returns of its short-term investment portfolio (the current and expected investments that are expected to be used in financing the payment of benefits). The town expects to earn an average of 5.5 percent on these investments in the future.

j. *Other economic assumptions* (paragraph 13c)—The expected long-term inflation assumption of 3.3 percent is based on projected changes in the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) in *The 2001 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds* for an intermediate growth scenario. The payroll growth rate is assumed to equal the long-term inflation assumption.

k. *Actuarial cost method* (paragraph 13d)—The ARC is determined using the entry age actuarial cost method.

l. *Actuarial value of plan assets* (paragraph 13e)—The town does not accumulate assets in a dedicated trust, or equivalent arrangement, for purposes of funding its retiree healthcare obligation. Therefore, the actuarial value of plan assets is zero.

m. *Annual required contributions of the employer (ARC)* (paragraph 13f)—The unfunded actuarial accrued liability is amortized as a level percentage of payroll on an open basis over the average remaining life expectancy of all participants or thirty years, whichever is shorter.

gasbs_st45_illustrations.xls

Appendix G

CODIFICATION INSTRUCTIONS

209. The sections that follow update the June 30, 2003, *Codification of Governmental Accounting and Financial Reporting Standards* for the effects of this Statement. Only the paragraph number of the Statement is listed if the paragraph will be cited in full in the Codification.

* * *

COMPREHENSIVE ANNUAL FINANCIAL REPORT **SECTION 2200**

Sources: [Add the following:] GASB Statement 45

.178 [In last parenthetical reference, add the following:] Section P50, "Postemployment Benefits Other Than Pension Benefits—Employer Reporting" [Add GASBS 45, ¶40, to sources.]

* * *

NOTES TO FINANCIAL STATEMENTS **SECTION 2300**

Sources: [Add the following:] GASB Statement 45

[Insert new subparagraph .106h; renumber subsequent subparagraphs.]

.106h Annual OPEB cost and net OPEB obligations. (See Section P50, "Postemployment Benefits Other Than Pension Benefits—Employer Reporting.") [Add GASBS 45, ¶24 and ¶25, to sources.]

[Delete current paragraph .107v; renumber subsequent subparagraphs.] [No change to sources.]

* * *

CLAIMS AND JUDGMENTS **SECTION C50**

.102 [Revise first two sentences as follows:] Paragraphs .109 through .148 of this section also apply to losses resulting when an entity agrees to provide accident and health, dental, and other medical benefits to its employees and their dependents and beneficiaries, based on covered events that have already occurred. The scope of this section *excludes* all postemployment benefits, which should be accounted for in accordance with the requirements of Section P20, "Pension Activities—Employer Reporting," or Section P50, "Postemployment Benefits Other Than Pension Benefits—Employer Reporting," as appropriate. [Delete third sentence.] [GASBS 10, ¶2, as amended by GASBS 45, ¶4–¶9]

* * *

COMPENSATED ABSENCES **SECTION C60**

Sources: [Add the following:] GASB Statement 45

.105 [Add the following at the end of footnote 4:] Similarly, when a terminating employee's unused sick leave credits are converted to provide or to enhance a defined benefit OPEB (for example, postemployment healthcare benefits), the resulting benefit or increase in benefit should be accounted for in accordance with the requirements of Section P50, "Postemployment Benefits Other Than Pension Benefits—Employer Reporting." [GASBS 16, fn6; GASBS 45, ¶9]

.108 [Revise footnote 6 as follows:] [Change *pension plan* to *pension or OPEB plan* in the first sentence.] [GASBS 16, fn7, as amended by GASBS 45, ¶9]

* * *

PENSION ACTIVITIES—EMPLOYER REPORTING **SECTION P20**

Sources: [Add the following:] GASB Statement 45

See also: [Revise as follows:]

Section P50, "Postemployment Benefits Other Than Pension Benefits—Employer Reporting"
Section T25, "Termination Benefits (Special)"
Section Pe5, "Pension Plans—Defined Benefit"
Section Pe6, "Pension Plans—Defined Contribution"
Section Po50, "Postemployment Healthcare Plans Administered by Defined Benefit Pension Plans"

.103 [Replace penultimate sentence and footnote 3 as follows:] Postemployment benefits provided through plans that do not provide retirement income are considered **other postemployment benefits** and should be reported in accordance with the requirements of Section P50.[3] [GASBS 27, ¶6, as amended by GASBS 45, ¶7]

3The term *other postemployment benefits* does not include termination offers and benefits such as special termination benefits, early-retirement incentive programs, and other termination-related benefits, regardless of who administers them. Special termination benefits are addressed in Section T25. [GASBS 27, fn3; GASBS 45, ¶8]

.104 [Replace the last sentence as follows:] Section P50 provides guidance for reporting of postemployment healthcare benefits by employers. [GASBS 27, ¶7, as amended by GASBS 45, ¶4]

DEFINITIONS

.501 [Revise as follows:] The following paragraphs contain definitions of certain terms *as they are used in this section or in Section P50;* the terms may have different meanings in other contexts. Terms defined in paragraph .585, "Actuarial Terminology," are cross-referenced to that paragraph and are not redefined here. [GASBS 27, ¶39, as amended by GASBS 34, ¶6, ¶70, and ¶82; GASBS 34, ¶69; GASBS 45, ¶40]

.502–.509 [Update cross-references; add GASBS 45, ¶40, to sources.]

.511–.512 [Update cross-references; add GASBS 45, ¶40, to sources.]

.513 [Revise current paragraph .513 as follows:] **Allocated insurance contract.** A contract with an insurance company under which related payments to the insurance company are currently used to purchase immediate or deferred annuities (for pensions) or an immediate or deferred benefit (for OPEB) for individual members. [GASBS 27, ¶39; GASBS 45, ¶40]

.514 [Update cross-references; add GASBS 45, ¶40, to sources.]

[Insert new paragraph .515 as follows:]

.515 **Annual OPEB cost.** An accrual-basis measure of the periodic cost of an employer's participation in a defined benefit OPEB plan. [GASBS 45, ¶40]

.516 [Insert current paragraph .515.]

.517 [Insert current paragraph .516, changing *pension* to *pension or OPEB;* add GASBS 45, ¶40, to sources.]

.518–.522 [Insert current paragraphs .517–.521; update cross-references; add GASBS 45, ¶40, to sources.]

.523 [Revise current paragraph .522 as follows:] **Covered payroll.** *For pensions,* all elements included in compensation paid to active employees on which contributions to a pension plan are based. *For OPEB,* annual compensation paid to active employees covered by an OPEB plan. If employees also are covered by a pension plan, the covered payroll should include all elements included in compensation on which contributions to the pension plan are based. For example, if pension contributions are calculated on base pay including overtime, covered payroll includes overtime compensation. [GASBS 27, ¶39; GASBS 45, ¶40]

[Insert new paragraph .524 as follows:]

.524 **Defined benefit OPEB plan.** An OPEB plan having terms that specify the *benefits* to be provided at or after separation from employment. The benefits may be specified in dollars (for example, a flat dollar payment or an amount based on one or more factors such as age, years of service, and compensation), or as a type or level of coverage (for example, prescription drugs or a percentage of healthcare insurance premiums). [GASBS 45, ¶40]

.525 [Insert current paragraph .523; add GASBS 45, ¶40, to sources.]

.526 [Revise current paragraph .524 as follows:] **Defined contribution plan.** A pension or OPEB plan having terms that (a) provide an individual account for each plan member and (b) specify *how contributions to an active plan member's account are to be determined,* rather than the income or other benefits the member or his or her beneficiaries are to receive at or after separation from employment. Those benefits will depend *only* on the amounts contributed to the member's account, earnings on investments of those contributions, and forfeitures of contributions made for other members that may be allocated to the member's account. For example, an employer may contribute a specified amount to each active member's postemployment healthcare account each month. At or after separation from employment, the balance of the account may be used by the member or on the member's behalf for the purchase of health insurance or other healthcare benefits. [Add GASBS 45, ¶40, to sources.]

.527 [Revise current paragraph .525 as follows:] **Employer's contributions.** Contributions made in relation to the annual required contributions of the employer (ARC). *For OPEB,* an employer has made a contribution in relation to the ARC if the employer has (a) made payments of benefits directly to or on behalf of a retiree or beneficiary, (b) made premium payments to an insurer, or (c) irrevocably transferred assets to a trust, or equivalent arrangement, in which plan assets are dedicated to providing benefits to retirees and their beneficiaries in accordance with the terms of the plan and are legally protected from creditors of the employer(s) or plan administrator. [GASBS 27, ¶39; GASBS 45, ¶40]

.528–.534 [Insert current paragraphs .526–.532; update cross-references; add GASBS 45, ¶40, to sources.]

.535 [Insert current paragraph .533, changing *pension plan* to *pension or OPEB plan;* add GASBS 45, ¶40, to sources.]

[Insert new paragraphs .536–.537 as follows:]

.536 **Healthcare cost trend rate.** The rate of change in per capita health claims costs over time as a result of factors such as medical inflation, utilization of healthcare services, plan design, and technological developments. [GASBS 45, ¶40]

.537 **Insured benefit.** An OPEB financing arrangement whereby an employer pays premiums to an insurance company, *while employees are in active service,* in return for which the insurance company unconditionally undertakes an obligation to pay the postemployment benefits of those employees or their beneficiaries, as defined in the employer's plan. [GASBS 45, ¶40]

.538 [Insert current paragraph .534.]

.539–.541 [Insert current paragraphs .535–.537; add GASBS 45, ¶40, to sources.]

.542 [Revise current paragraph .538 as follows:] **Market-related value of plan assets.** A term used with reference to the actuarial value of assets. A market-related value may be fair value, market value (or estimated market value), or a calculated value that recognizes changes in fair value or market value over a period of, for example, three to five years. [GASBS 27, ¶39; GASBS 45, ¶40]

[Insert new paragraph .543 as follows:]

.543 **Net OPEB obligation.** The cumulative difference since the effective date of Statement 45 between annual OPEB cost and the employer's contributions to the plan, including the OPEB liability (asset) at transition, if any, and excluding (a) short-term differences and (b) unpaid contributions that have been converted to OPEB-related debt. [GASBS 45, ¶40]

.544 [Insert current paragraph .539.]

.545 [Insert current paragraph .540; update cross-references; add GASBS 45, ¶40, to sources.]

[Insert new paragraphs .546–.550 as follows:]

.546 **OPEB assets.** The amount recognized by an employer for contributions to an OPEB plan greater than OPEB expense. [GASBS 45, ¶40]

.547 **OPEB expenditures.** The amount recognized by an employer in each accounting period for contributions to an OPEB plan on the modified accrual basis of accounting. [GASBS 45, ¶40]

.548 **OPEB expense.** The amount recognized by an employer in each accounting period for contributions to an OPEB plan on the accrual basis of accounting. [GASBS 45, ¶40]

.549 **OPEB liabilities.** The amount recognized by an employer for contributions to an OPEB plan less than OPEB expense/expenditures. [GASBS 45, ¶40]

.550 **OPEB-related debt.** All long-term liabilities of an employer *to an OPEB plan,* the payment of which is *not* included in the annual required contributions of a sole or agent employer (ARC) or the actuarially determined required contributions of a cost-sharing employer. Payments generally are made in accordance with installment contracts that usually include interest. Examples include contractually deferred contributions and amounts assessed to an employer upon joining a multiple-employer plan. [GASBS 45, ¶40]

.551 [Insert current paragraph .541; add GASBS 45, ¶40, to sources.]

.552 [Revise current paragraph .542 as follows:] **Other postemployment benefits.** Postemployment benefits other than pension benefits. Other postemployment benefits (OPEB) include postemployment healthcare benefits, regardless of the type of plan that provides them, and all postemployment benefits provided separately from a pension plan, excluding benefits defined as termination offers and benefits. [GASBS 27, ¶39; GASBS 45, ¶40]

.553 [Insert current paragraph .543, changing *pension* to *pension or OPEB;* add GASBS 45, ¶40, to sources.]

.554–.555 [Insert current paragraphs .544–.545; update cross-references; add GASBS 45, ¶40, to sources.]

.556 [Insert current paragraph .546.]

.557 [Insert current paragraph .547; add GASBS 45, ¶40, to sources.]

.558–.561 [Insert current paragraphs .548–.551.]

[Insert new paragraph .562 as follows:]

.562 **Plan assets.** Resources, usually in the form of stocks, bonds, and other classes of investments, that have been segregated and restricted in a trust, or equivalent arrangement, in which (a) employer contributions to the plan are irrevocable, (b) assets are dedicated to providing benefits to retirees and their beneficiaries, and (c) assets are legally protected from creditors of the employers or plan administrator, for the payment of benefits in accordance with the terms of the plan. [GASBS 45, ¶40]

.563 [Insert current paragraph .552, changing *pension* to *pension or OPEB;* add GASBS 45, ¶40, to sources.]

.564 [Insert current paragraph .553; add GASBS 45, ¶40, to sources.]

.565 [Revise current paragraph .554 as follows:] **Postemployment healthcare benefits.** Medical, dental, vision, and other health-related benefits provided to terminated or retired employees and their dependents and beneficiaries. [GASBS 27, ¶39; GASBS 45, ¶40]

.566 [Insert current paragraph .555, changing *pension benefits* to *benefits;* add GASBS 45, ¶40, to sources.]

.567 [Revise current paragraph .556 as follows:] **Projected salary increase assumption.** An actuarial assumption with respect to future increases in the individual salaries and wages of active plan members; used in determining the actuarial present value of total projected benefits when the benefit amounts are related to salaries and wages. The expected increases commonly include amounts for inflation, enhanced productivity, and employee merit and seniority. [GASBS 27, ¶39; GASBS 45, ¶40]

.568–.572 [Insert current paragraphs .557–.561; update cross-references and add GASBS 45, ¶40, to sources.]

[Insert new paragraphs .573–.575 as follows:]

.573 **Special termination benefits.** Benefits offered by an employer for a short period of time as an inducement to employees to hasten the termination of services. For example, to reduce payroll and related costs, an employer might offer enhanced pension benefits or OPEB to employees as an inducement to take early termination, for employees who accept the offer within a sixty-day window of opportunity. [GASBS 45, ¶40]

.574 **Sponsor.** The entity that established the plan. The sponsor generally is the employer or one of the employers that participate in the plan to provide benefits for their employees. Sometimes, however, the sponsor establishes the plan for the employees of other entities but does not include its own employees and, therefore, is not a participating employer of that plan. An example is a state government that establishes a plan for the employees of local governments within the state, but the employees of the state government are covered by a different plan. [GASBS 45, ¶40]

.575 **Stand-alone plan financial report.** A report that contains the financial statements of a plan and is issued by the plan or by the public employee retirement system that administers the plan. The term *stand-alone* is used to distinguish such a financial report from plan financial statements that are included in the financial report of the plan sponsor or employer (pension or other employee benefit trust fund). [GASBS 45, ¶40]

.576 [Insert current paragraph .562.]

[Insert new paragraph .577 as follows:]

.577 **Substantive plan.** The terms of an OPEB plan as understood by the employer(s) and plan members. [GASBS 45, ¶40]

.578 [Insert current paragraph .563; update cross-references; add GASBS 45, ¶40, to sources.]

[Insert new paragraphs .579–.580 as follows:]

.579 **Termination offers and benefits.** Inducements offered by employers to employees to hasten the termination of services, or payments made in consequence of the early termination of services. Termination offers and benefits include special termination benefits, early-retirement incentive programs, and other termination-related benefits. [GASBS 45, ¶40]

.580 **Transition year.** The fiscal year in which Statement 45 is first implemented. [GASBS 45, ¶40]

.581–.584 [Insert current paragraphs .564–.567; update cross-references; add GASBS 45, ¶40, to sources.]

ACTUARIAL TERMINOLOGY

.585 [Insert current paragraph .568 in its entirety, changing *Section Pe5* to *Section Pe5, Section P50, or Section Po50* in the last two sentences.] [Insert the following new sentence after the reference to footnote 22:] Although specifically adopted in relation to pensions, these terms and definitions also are generally applicable to other postemployment benefits. [Add GASBS 45, ¶41, to sources.]

[Revise footnote 22 by adding GASBS 45, fn32, to sources.]

* * *

POSTEMPLOYMENT BENEFITS OTHER THAN PENSION BENEFITS—EMPLOYER REPORTING **SECTION P50**

[Revise entire section as follows:]

Sources: GASB Statement 14, GASB Statement 45

See also: Section P20, "Pension Activities—Employer Reporting"
Section T25, "Termination Benefits (Special)" Section Pe5, "Pension Plans—Defined Benefit"
Section Pe6, "Pension Plans—Defined Contribution"
Section Po50, "Postemployment Healthcare Plans Administered by Defined Benefit Pension Plans"

Scope of This Section

.101 This section establishes standards of accounting and financial reporting for **OPEB expense/expenditures**1 and related **OPEB liabilities** or **OPEB assets,** note disclosures, and **required supplementary information (RSI)** in the financial reports of state and local governmental employers. It does not address accounting and financial reporting for trust funds of the employer, for which guidance is provided in Section Po50. [GASBS 45, ¶4]

1[GASBS 45, fn1] [Update cross-references.]

.102–.106 [GASBS 45, ¶5–¶9] [Change *Statement* to *section* and update cross-references.]

.107–.127 [GASBS 45, ¶11–¶31, including headings and footnotes] [Change *Statement* to *section* and update cross-references.]

Component Unit's Other Postemployment Benefit Information in the Reporting Entity's Financial Reports

.128 The same factors considered when making all note disclosures should be considered when making disclosures on other postemployment benefit information. The disclosures required by this section should distinguish between the primary government and its discretely presented component units. [GASBS 14, ¶11 and ¶63]

Special Funding Situations

.129 [GASBS 45, ¶32, including footnote] [Change *Statement* to *section* and update cross-reference.]

Alternative Measurement Method for Employers Participating in Plans with Fewer Than One Hundred Members

.131–.133 [GASBS 45, ¶33–¶35, including footnotes] [Change *Statement* to *section* and update cross-references.]

* * *

TERMINATION BENEFITS (SPECIAL) **Section T25**

Sources: [Add the following:] GASB Statement 45

.101 [Revise second and third sentences as follows:] Changes in pension and other postemployment benefits as a result of special termination benefits should not be included in measuring termination expense/expenditures. Accounting for pension and other postemployment benefits is addressed in Sections P20 and P50, respectively. [Add GASBS 45, ¶8, to sources.]

[Insert the following at the end of footnote 1:] In addition, the effects of an employee's acceptance of a special termination offer on OPEB obligations are excluded from the scope of this section. [GASBS 27, ¶5; GASBS 45, ¶8]

Attached Document(s):

ATTACHMENT G

CALCULATION OF POSSIBLE INCREASE IN ONE COMPONENT OF THE GRID MANAGEMENT CHARGE DUE TO USE OF SGAS 45 TO ACCOUNT FOR PBOP COSTS FOR 2007

Budgeted GMC revenue requirement	$189.9M
Budgeted O&M	$143.8M
GMC rate per MWh	$0.76
Budgeted transmission volume	250.00 MWh
Calculated difference between SGAS 45 and SFAS 106	$88K
% effect on budgeted GMC revenue requirement	0.046%
% effect on budgeted O&M	0.061%
$ effect per MWh on GMC rate	**$0.00035/MWh**