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Postemployment Benefits

Dear Reader:

The following document was created from the MTAS website (mtas.tennessee.edu). This website is maintained daily by MTAS staff and seeks to represent the most current information regarding issues relative to Tennessee municipal government.

We hope this information will be useful to you; reference to it will assist you with many of the questions that will arise in your tenure with municipal government. However, the *Tennessee Code Annotated* and other relevant laws or regulations should always be consulted before any action is taken based upon the contents of this document.

Please feel free to contact us if you have questions or comments regarding this information or any other MTAS website material.

Sincerely,

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NOTE:

GASB Statement No. 74, "Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans " was issued in June of 2015. GASB's stated objective is to "improve the usefulness of information about postemployment benefits other than pensions (other postemployment benefits or OPEB) included in the general purpose external financial reports of state and local governmental OPEB plans for making decisions and assessing accountability." It is effective for fiscal years beginning after June 15, 2016 but earlier implementation is encouraged. It amends and/or supecedes a number of previosly issued GASB Statements.

GASB Statement No. 75, "Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions" was issued in June of 2015. GASB's stated objective is to "improve the decision-usefulness of information in employer and governmental nonemployer contributing entity financial reports and will enhance its value for assessing accountability and interperiod equity by requiring recognition of the entire OPEB liability and a more comprehensive measure of OPEB expense. Decision-usefulness and accountability also will be enhanced through new note disclosures and required supplementary information." It is effective for fiscal years beginning after June 15, 2017 but earlier implementation is encouraged. It amends and/or supecedes a number of previosly issued GASB Statements.

Postemployment Benefits

An employer may offer postemployment benefits to its employees as part of their total compensation package as a reward for years of continuous service. These benefits are authorized in an agreement or policy that defines what the employer promises to provide a qualified retiring employee. Major categories of retirement benefits include retirement income – pensions and any other benefit as an integral part of a pension, such as healthcare or other group benefits.

Retirement Income

The most familiar type of retirement benefit is postemployment income derived from a pension. Pensions may be separated into three categories:

- Defined contribution plan;
- Defined benefit plan; and
- Hybrid.

Although each type of plan provides for postemployment income, the structures are quite different, and, depending on which plan is chosen, the risk of funding retirement income may be with the employee or with the employer.

Defined Contribution Plan

Defined contribution plans focus on the input or contributions made by the employee and, perhaps, on behalf of the employee by the employer. When plan contributions and applicable interest earnings have been distributed, the plan has no further obligation to the retiree. The only retirement promise made to the employee by the employer is that the contributions made toward the employee’s retirement, plus interest earned on the investment, will be returned to the employee upon retirement.

Under the defined contribution plan, the complete risk for postretirement income lies with the employee. Will the amount invested by the employee over time, plus the interest earned on the investment, provide enough money for retirement? Most employees do not have the expertise to plan for their income needs at retirement. They often employ the services of financial advisors who assist them in the process of investing for their retirement.

Defined Benefit Plan

A second type of employee retirement pension is the defined benefit plan. This type of pension plan is based on the employer's promise that future investment returns will be paid to the employee. Under this plan, the employer may or may not require the employee to make contributions. The focus of this plan is the guarantee that the employer will make payments to the employee from the time of retirement until the employee's death, regardless of the amount the employee has contributed to the plan. Some of these plans provide options to allow the surviving spouse of an employee to continue to receive payments throughout his or her life as well.

This pension type is a guarantee of retirement income to the employee that is usually based on a formula considering the employee's years of service and average annual compensation. In this case, the employer is assuming the full risk of the promise to provide the retiree's income. In order to determine the future financial exposure to the organization regarding this retirement income guarantee, an employer will hire an actuarial firm to calculate the cost of this retirement promise. Actuarial calculations estimate the cost of the retirement plan by factoring payroll projections, ages, and years of service for all employees of the organization as well as the rate of return on investment of present and future assets of the retirement fund.

Since the organization assumes the total risk for this type of employee pension, the employer typically makes annual deposits into a retirement trust fund in order to guarantee a source of funds for these future obligations. In the past several years there has been a trend by employers to move from a defined benefit plan to a defined contribution plan for the reasons noted above. When this is done, current employees are typically 'grandfathered' into the old plan,, while all new employees fall under the new plan. Over time, the number of employees will increase in the DC plan and decrease in their DB plan.

Hybrid

The hybrid may be any combination of the defined contribution and defined benefit pension plans. Contributions are typically made to the plan each month. Options may include a guarantee from the employer of the rate of interest the employee will earn on the contributions, but there is no full retirement income guarantee.

The Government Finance Officers Association (GFOA) committe on Pension and Benefit Administration has a number of best practices related to pensions and may be accessed at: http://www.gfoa.org/best-practices [1]

Links:
[1] http://www.gfoa.org/best-practices

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