



The New GASB Pension Standards: What Does It All Mean?

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Learning Objectives

At the end of this session, participants should be able to -

- Recall the two new GASB pension standards
- Discuss differences in accounting between the old pension standards and the new
- Recognize new terminology related to the new pronouncements

Summary of Key Changes

- Significant changes for employers who recognize:
 - an unfunded pension obligation as a balance sheet **liability**
 - Pension **expense** that may have little relation to the actuarially determined contribution
- However, the GASB standards do not change the methods and assumptions used to determine the contributions needed to fund the plan.

Introduction

- The GASB's new pension standards will fundamentally change how state and local government employers account for the cost of pension benefits in their financial statements.
- However, the changes are complicated and could lead to serious misunderstandings.
- This session will provide a simple and straightforward explanation of the GASB's key changes and their implications for decision makers.

Overview

- Background
- GASB Statement No. 68 for Employers and Certain Nonemployers
 - Single and Agent Employers
 - Cost-Sharing Employers
 - Special Funding Situations
 - Disclosures – Notes and RSI
- GASB Statement No. 67 for Pension Plans
 - Basic Financial Statements
 - Disclosures – Notes and RSI
- Implications
 - Differences between funding and accounting measures
 - Practical implications for multiple-employer plans

Effective Date

- **Plans –**

- GASB Statement No. **67**, *Financial Reporting for Pension Plans*
- Effective for plan fiscal years beginning **after** June 15, 2013 (i.e., FYE's ending June 30, 2014 and after).

- **Employers –**

- GASB Statement No. **68**, *Accounting and Reporting for Pensions*
- Effective for employer (and contributing nonemployer) fiscal years beginning **after** June 15, 2014 (i.e., FYE's ending June 30, 2015 and after).

The Standards Apply to Defined Benefit (DB) Pensions

- DB pensions include:
 - Pension income received that does not depend on actual investment earnings; and
 - Certain other postemployment benefits (e.g., death benefits, life insurance, and disability benefits) provided through DB pension plans
- DB pensions do **not** apply to:
 - Postemployment healthcare benefits; and
 - Other postemployment benefits provided outside of DB pension plans
- Other postemployment benefits (OPEB) should be accounted for under GASB's current OPEB standards
- The current standards for defined contribution (DC) plans have not changed

The Standards Apply to Trusts

- The GASB's new standards apply to pensions provided through trusts (or equivalent arrangements) in which:
 - Employer (and nonemployer) contributions and investment earnings are **irrevocable**
 - Plan assets are dedicated to providing **benefits exclusively** for plan members
 - Plan assets are **legally protected** from creditors of the contributing employers (and nonemployers) and the plan administrator. Plan assets must also be legally protected from the creditors of plan members
- If pension benefits are not provided through trusts that meet these criteria, GASB Statements 25 and 27 apply.

Types of DB Plans and Employers

- For GASB's purposes, DB plans and employers are classified as:

Single-Employer Plans	Provide DB benefits to a single employer
Agent Multiple-Employer Plans	Provide DB benefits to multiple employers by pooling assets for investment purposes but <u>legally segregating each employer's assets to pay benefits only to that employer's plan members.</u>
Cost-Sharing Multiple-Employer Plans	Provide DB benefits to multiple employers by <u>pooling both plan assets and benefit obligations such that the assets can be used to pay the member benefits of any participating employer</u>

Summary of Key Changes

- Under the prior GASB standards, there is a close link between the accounting and funding measures. Under the new statements, the two are disconnected:

	Funding Purposes	Accounting Purposes
Actuarial Cost Method	Six allowable actuarial cost methods	Traditional entry age normal
Discount Rate	Long-term investment return rate	Long-term investment return rate and potentially a municipal bond rate
Asset Valuation	May be smoothed	Fair (market) value
Amortization of UAL	Over a period no longer than 30 years	Strict requirements and likely shorter periods

- Overall, the changes will likely make the accounting measures more **volatile** than the funding measures, but they may be more **comparable** from plan to plan.

GASB Statement 68

Accounting and Financial Reporting for Pensions

For Single & Agent Employers

Standards for Employers

Key Pension Accounting Measures

- For state and local employers that sponsor pension plans, two key accounting measures are provided in their government-wide financial statements
 - Pension Liability: measures the employer's financial responsibility for pensions as of a given measurement date (e.g., the fiscal year)
 - Pension Expense: measures the employer's cost of pension benefits over a given period (e.g., the fiscal year)
- Note that the GASB's changes apply to the **government-wide** financial statements, but **not** to **governmental funds**.

Standards for Single & Agent Employers - Prior Standards

- The GASB's prior standards (Statements 25 and 27) focus on the **cost** of pensions:
 - Pension Expense is the “Annual Pension Cost” (APC), consisting largely of the “Annual Required Contribution” (ARC).
 - The ARC consists of the normal cost plus amortization of any unfunded (or overfunded) liability over a period of no more than 30 years.
 - Pension Liability is the difference between the ARC and the actual pension contributions, accumulated since 1997
- In addition, the annual financial report presents the actuarial accrued liability, actuarial value of assets, and unfunded actuarial accrued liability as required supplementary information (RSI).

Standards for Single & Agent Employers

New Standards

- In developing its new standards, the GASB changed its focus to the pension **liability**, deciding:
 - The employer incurs a pension obligation as a result of the exchange of the employee services for compensation
 - The pension plan is primarily responsible for paying benefits, to the extent it has sufficient assets
 - The employer is primarily responsible for paying benefits to the extent the plan does not have assets
 - The unfunded pension obligation meets the definition of a liability and is sufficiently reliable to be recognized in the basic financial statements
- As a result, the GASB decided the employer's basic financial statement liability for pensions should represent the unfunded pension obligation.

Standards for Single & Agent Employees Net Pension Liability

- Under the new standards:
- Pension Liability for single and agent employers is the “Net Pension Liability” (NPL) which is the difference between the:
 - “Total Pension Liability” (TPL) – similar to the actuarial accrued liability
 - “Fiduciary Net Position” (FNP) – essentially the fair value of plan assets
- The NPL is reported as a balance sheet item in the employer’s government-wide financial statements for the reporting year.
- The “measurement date” should be no earlier than the end of the employer’s prior fiscal year. This is discussed in more detail later in the presentation.

Total Pension Liability

- Total Pension Liability (TPL) is:
 - The liability for projected benefits attributable to past service, including benefits related to:
 - Projected service and salary;
 - Automatic COLAs; and
 - Ad hoc COLAs to the extent they are “substantively automatic.”
 - Determined using the traditional entry age normal actuarial cost method and discounted using the “single discount rate.”

Single Discount Rate

- The TPL is **similar** to the **actuarial accrued liability** (AAL) that many state and local governments use for funding purposes.
- However, a key **difference** between the TPL and AAL is the “**Single Discount Rate**” which is an entirely new rate:
 - Based on the long-term expected investment return to the extent projected plan fiduciary net position is sufficient to pay future benefits; and
 - Based on a tax-exempt municipal bond index rate to the extent projected plan fiduciary net position is not sufficient

Pension Expense

- Generally, pension expense represents the cost of pension benefits over a given period.
- Under the **prior** GASB standards, the pension expense is the annual pension cost (APC) needed to fund future benefits.
- Under the **new** GASB standards, it largely represents the change in the Net Pension Liability from one year to the next, with provisions for deferring the recognition of certain items.

Pension Expense

- Items of the pension expense (PE) that are immediately recognized include:
 - **Service cost** (i.e., total normal cost using the traditional entry age actuarial cost method) – increases PE
 - **Interest** on the TPL – increases PE
 - **Projected investment earnings** – decreases PE
 - **Actual member contributions** – decreases PE
 - **Actual administrative costs** – increases PE
 - Changes in TPL due to **changes in benefits** – can increase or decrease PE

Pension Expense

- Items with deferred recognition are treated as “deferred outflows of resources” and “deferred inflows of resources” including:
- Changes in the plan’s fiduciary net position due to **differences** between **projected investment earnings** and **actual** investment earnings
 - Recognized over a closed 5-year period
- Changes in total pension liability due to (1) changes in **assumptions** or (2) **differences** between **assumed** and **actual actuarial experience**
 - Recognized over a closed period reflecting the average expected **remaining service life** of all members (active, inactive, and retirees)

Note Disclosures

- New note disclosures:
 - Aggregate Information: presenting the total of the employer's pension liabilities, assets, deferred outflows, deferred inflows, pension expense, etc.
 - Primary and Component Units: separately identifying amounts associated with the primary government and those associated with the discretely presented component units
 - Plan Description: identifying the pension plan, number and types of covered employees, authority to make contributions, contribution rates; and actual contributions made
 - Assumptions and Other Inputs: including significant economic and demographic assumptions and assumptions related to the single discount rate, including:
 - Inflation rate and long-term expected return on investments and a description of how it was determined, including significant methods and assumptions;
 - Additional information related to the plan's single discount rate, including periods over which the long-term rate applies;
 - Asset allocation and expected real return for each major asset class; and
 - Sensitivity of the NPL to a plus/minus 1-percentage point change in the single discount rate

Note Disclosures

- New note disclosures (continued)
 - Fiduciary Net Position (FNP): including assets, liabilities and plan fiduciary net position
 - Changes in the NPL: showing beginning and the ending balances in the TPL, FNP, and NPL as well as the effects of the underlying components
 - Other Information: including the NPL measurement date and date of the actuarial valuation on which the TPL is based. In addition, this section should include:
 - The employers balances of the deferred outflows of resources and deferred inflows of resources, classified as follows:
 - Difference between expected and actual plan experience
 - Changes in assumptions and other inputs
 - Net difference between projected and actual investment earnings
 - Employer contributions subsequent to the measurement date
 - The amounts of deferred outflows and inflows that will be recognized in pension expense over each of the next 5 years and in aggregate thereafter

Required Supplementary Information

- 10-Year Schedule of Changes in NPL: including the TPL, FNP, NPL and the underlying components
- 10-Year Schedules of the NPL: including the TPL, FNP, NPL, covered payroll and NPL as a percent of covered payroll
- 10-Year Schedule of Actuarially Determined Contributions (if calculated): including the employer's actuarially determined contribution, actual contributions, covered payroll, and actual contributions as a percent of covered payroll
- 10-Year Schedule of Statutorily or Contractually Established Employer Contributions (if statutorily based): similar to schedule of actuarially determined contributions above.

GASB Statement 68

Accounting and Financial Reporting for Pensions

For Cost-Sharing Employers and Special Funding Situations

Standards for Cost-Sharing Employers

Prior Standards

- Under the prior GASB standards, a cost-sharing employer's:
- Pension Expense is its contractually required contribution to the plan.
- Pension Liability is the accumulated difference between contractually required contributions and actual contributions.
- Since cost-sharing employers often make their full contractually required contributions, **few have a pension liability under the prior** GASB standards.

Standards for Cost-Sharing Employers

New Pension Liability

- Pension Liability: cost-sharing employers are required to report their “**proportionate share**” of the cost-sharing plan’s collective net pension liability.
- Cost-sharing plan’s collective net pension liability, pension expense, and deferrals will be determined in the **same way** as for **single and agent** employers.
- An individual employer’s proportionate share is determined in a “manner consistent with the method used by the cost-sharing plan to allocate contractually required contributions.”
- GASB encourages that the proportionate share be based on the employer’s “**long-term contribution effort**” to the plan.

Standards for Cost-Sharing Employers

Pension Expense

- Pension expense for a cost-sharing employer is its **proportionate share** of the plan's collective pension expense.
- In addition, a cost-sharing employer's pension expense **includes** deferral and recognition of:
 - **Annual changes** in the employer's proportionate share; and
 - **Annual differences** between the employer's **actual contributions** and its **proportionate share** of contributions.
- These are deferred and recognized over the average expected **remaining service life** of the employer's current members (active, inactive, and retired).

Standards for Cost-Sharing Employers

Note Disclosures and RSI

- Some note disclosures are the same for cost-sharing employers as for single and agent employers:
 - Aggregate Information
 - Pension Plan Description
 - Assumptions and Other Inputs
 - Pension Plan's Fiduciary Net Position

Standards for Cost-Sharing Employers

Note Disclosures and RSI

- Other note disclosures are **different** for cost-sharing employers:
 - The **proportionate share** of the collective **NPL** for the employer. The proportionate share should be expressed in dollars and as a percentage of the collective NPL
 - The **basis** on which the proportion was determined and the change in the proportion since the prior period
 - The cost-sharing plan's FNP as a **percent of payroll**
 - Other disclosures are also required

Standards for Cost-Sharing Employers

Required Supplementary Information

- 10-Year Schedule of Employer's Proportionate Share of the NPL
- 10-Year Schedule of Statutorily or Contractually Established Employer Contributions

Special Funding Situations

- In some cases, a governmental entity that does not employ plan participants has a legal responsibility to contribute to the pension plan.
- For example – a state may make contributions to a teachers' plan even though the teachers are employed by the school districts
- GASB refers to this as a “nonemployer contributing entity” (**NCE**).

Special Funding Situations

- A special funding situation occurs if:
- The NCE is required to make contributions directly to the plan **and** the contributions are “not dependent on events unrelated to pensions.” For example:
 - **No** special funding situation if NCE contributions are based on a revenue source not related to pensions
 - Special funding situation if NCE contributions are based on a percentage of employer contributions
- In these cases, the NCE would be treated in much the same manner as a cost-sharing employer and would need to calculate its proportionate share of the collective NPL, PE and deferred outflows and inflows.
- If the NCE assumes a “substantial” portion of the collective NPL, it would also be required to provide financial note disclosures and supplementary information as if it were a participating employer .

Special Funding Situations

- A special funding situation would **not occur** if the NCE is required to make contributions directly to the employer **or** if the NCE's contributions were dependent on events unrelated to pensions.
- For example, if the NCE's contributions were based on a revenue source not related to pensions, then a special funding situation would not occur.

All Employers and NCEs

Measurement Timing and Frequency

- The employer's pension liability should be fully (actuarially) measured at least every two years.
- The employer should recognize the NPL as of the "measurement date" which should be no earlier than the end of its prior fiscal year.
- If the TPL is not actuarially measured as of the "measurement date," it can be "rolled forward" from an actuarial valuation performed not more than 30 months plus 1 day prior to the employer's fiscal year-end.

All Employers and NCEs Transition

- Statement 68 is effective for employers (and NCEs) for fiscal years beginning after June 15, 2014
- In transitioning:
 - The effects of the standards should be reported as adjustments to prior periods and the beginning balance sheet liability should be restated.
 - GASB encourages restatement of beginning deferred outflows and inflows, but only if this is practical.

GASB Statement 67

Financial Reporting for Pension Plans

Current Standards for Plans

- Statement of Plan Net Assets
 - Assets
 - Receivables
 - Investments
 - Assets used in plan operations
 - Liabilities
 - Net assets held in trust for pension benefits
- Statement of Changes in Plan Net Assets
 - Additions
 - Deductions
 - Net assets held in trust for pension benefits – Beginning/Ending

Current Note Disclosures

- Plan description
 - Identify as single, agent or cost-sharing multiple-employer plan
 - Number of participating employers
 - Number, classes and current membership of employees
 - Description of benefit provisions
- Summary of significant accounting policies
 - Basis of accounting
 - Determination of fair value of investments

Current Note Disclosures

- Contributions and reserves
 - Authority for establishing and amending contributions
 - Funding policy
 - Required contribution rates
 - Terms of long-term contribution contracts
 - Legally required reserve balances
- Concentrations of investments

Current Required Supplementary Information

- Schedule of Funding Progress – minimum 6-year schedule
 - Actuarial valuation date
 - Actuarial value of plan assets
 - Actuarial accrued liability
 - Total unfunded actuarial liability
 - Funded ratio
 - Covered payroll
 - Ratio of UAL to covered payroll
- Schedule of Employer Contributions – minimum of 6-year schedule
 - Amount of the annual required contributions
 - Percent of ARC recognized as contributions from employers

Note Disclosures for All Plans

- Plan Description
 - Plan administration
 - Plan membership
 - Benefits
 - Contributions
- Investments
 - Investment policy
 - Determination of fair value
 - Concentrations
 - Annual money-weighted rate of return
- Receivables

Note Disclosures for All Plans

- Allocated Insurance Contracts
 - Amount of benefit payments attributable to contract
 - Description of the pensions covered
 - The fact that obligation has been transferred to insurance company
- Reserves
 - Policy description
 - Governing authority
 - Purposes and conditions for reserves
 - Reserve balances
- Deferred retirement option program (DROP)
 - Description of terms
 - Balances held by the plan

Additional Note Disclosures for Single-Employer and Cost-Sharing Plans

- Components of net pension liability
 - Total pension liability
 - Plan's fiduciary net position
 - Net pension liability
 - Fiduciary net position as percentage of TPL
- Significant assumptions
- Actuarial valuation date

Required Supplementary Information

Single-Employer and Cost-Sharing Plans

Notes to the Required Schedules

- Calculation of the actuarially determined employer contribution
 - Significant methods and assumptions
- Factors that affect trends
 - Examples: benefit terms, population changes and assumptions
- No restatement for the effects of changes
 - Examples: benefit terms or changes of assumptions

Timing and Frequency of Measurements

- Reporting date – plan’s fiscal year end
- Measurement date – date as of which TPL, FNP and NPL are determined
- Actuarial valuation date – date as of which TPL is determined
- Actuarial valuations must be at least biennial
 - No earlier than 24 months from reporting date
- If valuation date is before reporting date then TPL is rolled forward to the reporting date
 - Professional judgment to determine extent of procedures
 - Consider changes in discount rate and municipal bond rate
 - Consider whether new actuarial valuation is needed

Plan Effective Date and Transition

- GASB Statement 67 for plans is effective for fiscal years beginning after June 15, 2013
- Changes treated as an adjustment of prior periods
 - Affected financial statements should be restated **or**
 - Report the **cumulative effect** as a restatement of beginning net position
 - Disclose the nature and effect of any restatement
 - Describe the reason for not restating prior periods, if applicable.

What Can Be Done to Prepare for Transition?

- Communication is essential to successful implementation.
- Challenges for employers and public pension plans are many, and time is short.
- State is looking at plans such as Clerk & Sheriff retirement
 - **Watch for developments**

Transition Planning for Cost Sharing Plans

- Collective amounts could be provided by the plan
 - Total pension liability
 - Fiduciary net position
 - Net pension liability
 - Pension expense
 - Deferred outflows/inflows of resources
- Employer's proportionate share
 - Basis for determination
- Method of communicating with employers

Transition Planning

- Two sets of valuations – funding and accounting
- Additional cost
- Audited data – what can be provided

Summary

General Implications

- The GASB's changes to pension accounting standards are extensive and will take time to implement.
- State and local governments should work to understand the standards and establish a process for implementing them.
- Efforts should also be made to understand the differences between the accounting and funding measures in order to avoid confusion about the long-term sustainability of the plans.

Implications for Single and Agent Employers

- The new Net Pension Liability and Pension Expense will likely be **larger** and more **volatile** than the current measures of the unfunded actuarial accrued liability and the actuarially determined contributions.
- The Net Pension Liability will be shown as a **balance sheet** item in the employer's government-wide basic financial statements.

Underlying Differences between the UAAL and NPL

- The sources of the differences between the UAAL and the NPL
 - use of a different discount rate for the NPL
 - difference due to the (fair market) FNP rather than smoothed values

Need to Understand the Measures

- The differences between the accounting and funding measures will likely result in more volatility in the accounting measures.
- This could lead to confusion regarding what the numbers mean and whether the plan is being properly funded.
- Understanding the underlying differences between the NPL and UAAL is essential.
- However, it's also important to consider developing a pension funding policy to ensure the actuarially determined contributions meet the plan's needs.



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