Implementing the New GASB Rules – Eight Things Trustees should know about GASB's New Pension Accounting Standards

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Eight Things a Trustee Should Know About GASB's new Pension Standards

1. Funded status of the plan now will be recorded on the balance sheet of the participating employer using the fair value of investments and a prescribed actuarial method
2. GASB does not dictate contribution
3. Discount rate is based on funded status and history of contributions(likely lower on underfunded plans)
4. Investment policies should be reviewed and updated
5. Timing of actuarial valuations must be coordinated with financial reporting responsibilities
6. Pension expense in employer financial statements does not equal pension contribution
7. Employers must record pro-rata share of cost sharing plans net funded status
8. Special funding situations where one entity pays all or part of other entity contributions may affect amount recorded

Overview: GASB Statement No. 67 (For Plans)

- The Recognition, measurement and presentation of financial statement amounts is generally similar to current guidance
- Note disclosures and required supplementary information is:
  - Similar to nature of disclosures for employers with the addition of information on investment policies and actual rates of return on plan assets
  - Certain information is only required for single-employer and cost-sharing plans
- Requirements regarding the measurement of net pension liability are similar to the requirements for employers
  - Net pension liability not recognized by pension plans
- Effective for periods beginning for fiscal years beginning after June 15, 2013.
  - No impact on pension funding methodology used to establish annual employer contribution rates

Overview: GASB Statement No. 68 (For Employers)

- Key conceptual shift in reporting pension liabilities and expense from a "funding" approach to an "earnings" approach:
  - Currently, no liability is reported if government pays its contractually required contribution
  - Under new approach:
    - Pension liability is reported as employees earn their pension benefits by providing services
    - Changes in pension liability recognized immediately as pension expense or reported as deferred outflows/inflows of resources depending on nature of change
- Substantive changes to methods and assumptions used to determine actuarial information for GAAP reporting purposes are required by GASB 68
  - The actuarial methods and assumptions allowable under current standards may continue to be used to determine funding amounts

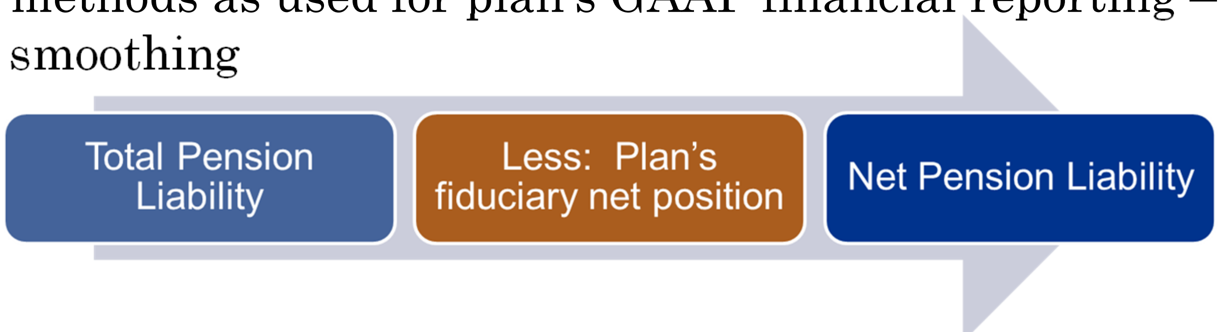
Overview: GASB Statement No. 68 (Continued)

- The following amounts for a defined benefit pension plan are required to be determined as of *a date no earlier than the end of the employer's prior fiscal year*:
  - Net pension liability
  - Pension expense
  - Pension deferred outflows of resources and deferred inflows of resources
- Employers participating in cost-sharing, multiple-employer plans recognize their proportionate share of the collective amounts for the plan as a whole
- Effective for periods beginning for fiscal years beginning after June 15, 2014.

1. *Funded Status of the Plan Now Will Be Recorded on the Balance Sheet of the Participating Employer Using the Fair Value of Investments and a Prescribed Actuarial Method*

NET PENSION LIABILITY
(SIMILAR TO UNFUNDED LIABILITY)

- Employers should report in their financial statements a net pension liability determined as of **a date no earlier than the end of the employer's prior fiscal year (measurement date)** for each defined-benefit pension plan in which they participate
- Net pension liability equals the total pension liability for the pension plan, net of the plan's fiduciary net position (value of plan assets):
  - Total pension liability is the actuarial present value of projected benefit payments attributed to past employee service
  - Plan's fiduciary net position is determined using same valuation methods as used for plan's GAAP financial reporting – No asset smoothing



Attributing the Present Value of Projected Future Benefit Payments to Past and Future Periods

- Attribution of the present value of projected future benefit payments to specific periods is based on the actuarial cost method applied
- Under new standards, Entry Age Normal method is the only allowable actuarial cost method:
  - Attribution made on individual employee-by-employee basis
  - Service costs based on level percentage of that employee's projected pay
  - Service costs attributed through assumed exit ages through retirement

Entry Age Normal method is most common actuarial cost method currently used. However, many variations of this method are used in practice. The new pension standards will eliminate potential variations.

2. GASB Does Not Dictate Contribution - Accounting and Funding will be separate

Separate Accounting from funding

- No impact on pension funding methodology used to establish annual employer contribution rates (Funding)
- Two sets of figures – one based on <u>accounting</u> standards and one based on <u>funding</u> policies
- Description of contribution requirements in the financial statement footnotes include:
  - Basis for determination of employer's contribution to the plan
  - Identification of the authority under which employer and employee contribution requirements are established or may be amended
  - Contribution rates (in dollars or as % of payroll)
  - Amount of employer's contributions to the plan during the period, if not otherwise disclosed
- ARC (Annual Required Contribution) goes away
- Last ARC –FYE June 30, 2013 to June 15, 2014
- Funding Policies should be developed
- Actuarial community is working on potential ARC replacement

3. *Discount Rate is Based on Funded Status and History of Contributions (Likely Lower on Underfunded Plans)*

Discounting Future Benefit Payments to Present Value

- A single blended rate should be used to discount projected future benefit payments based on:
  - The long-term expected rate of return on plan investments (net of investment expenses) that are expected to be used to finance the payment of pension benefits to the extent that the plan's fiduciary net position is projected to be sufficient to make projected benefit payments and is expected to be invested using a strategy to achieve that return; <u>*and*</u>
  - A yield or index rate for ***20-year***, tax-exempt general obligation (municipal) bonds with average rating of AA or higher, to the extent that the conditions above are not met

The new standards will likely result in a lower discount rate for plans that are significantly underfunded and/or have open amortization periods, thus increasing total pension liability

Discounting Future Benefit Payments to Present Value (continued)

- *To project future employer contributions when they are (a) established by statute or contract, or (b) determined under a formal written policy:*
  - *Apply professional judgment, considering:*
    - *Employer's most recent five-year contribution history as a key indicator of future contributions*
    - *All other known events and conditions potentially impacting contribution amounts*
- *To project future employer contributions in other circumstances:*
  - *Contribution amounts should be limited to an average of employer contributions over most recent five-year period, potentially modified based on consideration of subsequent events*
  - *Basis for average should be matter of professional judgment*
    - *Percentage of covered payroll contributed*
    - *Percentage of actuarially determined contributions made*

Comparison will generally require separate projections of cash flows into and out of the plan for each future period, however, alternative methods may be used if calculation can be made with sufficient reliability

4. *Investment policies should be reviewed and updated*

Investment policies should be reviewed and updated

- Investment Disclosures include:
  - Investment policies of the plan
  - Description of how fair value is determined
  - Identification of investments in any one organization that represent 5 percent or more of plan net position
  - Annual ***money-weighted rate of return*** on plan investments calculated as the internal rate of return on plan investments, net of investment expense, by asset class and an explanation of the concept of a money-weighted return

Investment allocations should be evaluated and determined to be sufficient to realize a rate of return that can meet or exceed the investment return assumption

5. Timing of Actuarial Valuations Must be Coordinated with Financial Reporting Responsibilities

Timing and Frequency of Measurement of Total Pension Liability

- Measurement of the net pension liability determined as of *a date no earlier than the end of the employer's prior fiscal year (measurement date)*
- *The measurement date used should be consistently applied from period to period*
- Measurement of the total pension liability determined through:
  - An actuarial valuation performed as of the *measurement date*; or
  - The use of update procedures to roll forward amounts from an actuarial valuation as of a date no more than *30 months and 1 day* earlier than the employer's year-end
  - Use professional judgment in determining extent of update procedures when changes in plan occur between last valuation date and the *measurement date*
    - Consider whether new actuarial valuation is needed
- Actuarial valuation of total pension liability should be performed at least biennially

Measurement date will most likely be year-end of plan. Employer's with same year-end as plan must choose measurement date as of their prior or current year-end.

6. Pension Expense in Employer Financial Statements Does Not Equal Pension Contributions

Potential Components of Annual Pension Expense

Service cost	$ 285,172
Interest on pension liability	32,878
Effect of changes in benefit terms	43,098
Member contributions	(110,111)
Plan administrative costs	4,309
Projected earnings on plan investments	(178,268)
Expensed portion of current-period excess of actual earnings over projected earnings on plan investments	(4,201)
Amortization of beginning deferred inflows related to accumulated net excess of actual earnings over projected earnings on plan investments	(9,012)
Expensed portion of current-period difference between expected and actual experience in the total pension liability	17,579
Amortization of beginning deferred outflows related to differences between expected and actual experience in the total pension liability	29,991
Expensed portion of current-period effect of changes in assumptions	9,022
Amortization of beginning deferred outflows related to effect of changes in assumptions	7,468
Pension expense	$ 127,925

Amortization of certain deferred inflows/outflows unique to employers participating in cost-sharing multiple-employer plans may be included as a component of pension expense for such employers

7. Employers Must Record Pro-rata Share of Cost Sharing Plans Net Funded Status

Participation in Cost-Sharing Multiple-Employer Plans

- An employer should recognize its proportionate share of the collective net pension liability, pension expense, and deferred inflows/outflows of a cost-sharing plan as of the employer's measurement date (no earlier than employer's prior year-end)
- Basis for proportion should be consistent with method in which contributions are determined
  - It should Account for different contribution rates that are based on classes of employees
  - The Employer's proportion share is established as of measurement date

Balance Sheet for ABC S.D.

	Governmental Activities	Governmental Activities
Liabilities		
Current Liabilities	3,079,628	3,079,628
Total current liabilities	3,079,628	3,079,628
Noncurrent Liabilities		
Net Pension Liability		23,536,000
Long-term debt - net of current portion	22,144,771	22,144,771
Compensated absences - net of current portion	313,427	313,427
Other post-employment benefit obligations	101,417	101,417
Total noncurrent liabilities	22,559,615	46,095,615
Total liabilities	25,639,243	49,175,243
Net Assets		
Invested in capital assets - net of related debt	11,350,893	11,350,893
Unrestricted	5,478,566	(18,057,434)
Total net assets	16,829,459	(6,706,541)
Total liabilities and net assets	42,468,702	42,468,702

8. Special Funding Situations Where One Entity Pays All or Part of Other Entity Contributions May Affect Amount Recorded

Special Funding Situation Overview

- Special funding situations are circumstances in which a nonemployer entity is legally responsible for making contributions directly to a pension plan to provide benefits of employees of another entity(ies) and at least one of the following conditions exists:
  - The nonemployer entity is the only entity with a legal obligation to make contributions directly to the plan
  - The amount of contributions for which the nonemployer entity is legally responsible is not dependent upon one or more events or circumstances unrelated to the pension benefits

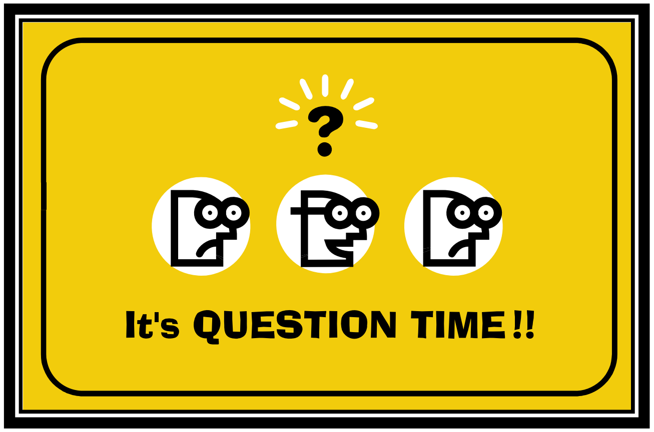
Potential Special Funding Situations - Pennsylvania

- School Districts
  - 24 Pa. C.S. ¶ 8535 "Payments to School Entities by Commonwealth"
    - Requires payment of not less than 50% of contribution
    - Paid by Commonwealth to school entity
    - School entity has 5 days to remit to PSERS
  - Not a special funding situation– not paid directly to PSERS
  - 100% of liability will be recorded by school entity
- Municipal Pension Aid
  - Chapter 205 ¶ 205.8 "Supplemental State Assistance"
    - Compliance requirement to be met by Municipality
    - Appropriation calculated annually based on plan actuary analysis
    - Paid to Municipality, 30 days to remit to plan
  - Not a special funding situation– not paid directly to plan

WHAT DO I DO NOW?

- Coordinate with Actuary, Investment Advisor, Auditor
  - Timing of Measurement Date
  - Key Assumptions / Support
- Review Investment Policy to insure it supports assumed rate of return
- Review / Adopt contribution policy to support projected future cash flow
- Educate Elected Officials on Impact to the Financial Statements

Q & A AND RESOURCES



http://www.gasb.org/home

- Pronouncements tab
- The GASB Implementation guide which will include Plan guidance is due out the second Qtr. Of 2013 and for employer guidance the first Qtr. Of 2014.

http://www.gabrielroeder.com/

- GRS Insight – October 2012 issue

http://www.kpmginstitutes.com/government-institute/

- KPMG Webcasts On Demand
  - GASB Pension Accounting and Financial Reporting Standards Part I
  - GASB Pension Accounting and Financial Reporting Standards Part II

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