Implementing GASB 68 Changes

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Overview

GASB issued two new statements that will substantially change accounting and financial reporting of public employee pensions

Statement No. 67 *Financial Reporting for Pension Plans*	Statement No. 68 *Accounting and Financial Reporting for Pensions*
• Revises existing guidance for the financial reports of most pension plans	• Revises and establishes new financial reporting requirements for most governments that provide their employees with pension benefits

- The most notable change is the separation of accounting calculations from funding calculations
- The statement does not apply to post-employment health benefits (GASB 45)

Summary of the Change

	Pre-GASB 68 (Statements 27 & 50)	Post-GASB 68
Balance Sheet (Government Wide Financial Statement)	Long-term liability was recorded in the footnotes of the financial statements	A new calculation of long-term liability, called Net Pension Liability, will be on the balance sheet and the footnotes will be more extensive
Income Statement (Government Wide)	Pension expense equaled the annual required contribution	Pension expense will now be calculated based on accrual accounting, thus it will not equal the annual required contribution
Deferred Outflows and Inflows		New requirement
Required Contributions	The annual actuarial valuation process calculates the required contributions	Same process

Unfunded Accrued Liability (UAL)

- Before the GASB 68 statement, employers disclosed their long-term pension liability (UAL) in their footnotes
- This long-term pension liability was calculated the following way:

Actuarial Accrued Liability

- The total value of benefits earned by members under a plan to date
- This number uses the actuarial assumed rate of return, which is currently 8%

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Actuarial Value of Assets

- The value of pension plan investments
- This calculation uses a smoothed asset value, which causes the amount to be different than the amount actually held in the trust for the plan (market value of assets)

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UAL

A New Calculation

- After GASB 68 statement, employers will disclose a new calculation of their long-term pension liability on their balance sheet
- This new calculation, called Net Pension Liability (NPL) is calculated the following way:

Total Pension Liability

- This number is similar to the Actuarial Accrued Liability, however for some plans the number will be calculated using a different discount rate

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Fiduciary Net Position

- The actual amount of assets held in the pension trust for a plan at the measurement date (market value of assets)

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NPL

More on Total Pension Liability / Discount Rate

- A key difference in the calculation of Total Pension Liability is the standard for how the **discount rate** is to be calculated
- Under the previous Statement 27, the long-term actuarial rate of return of 8% was used to discount the projected benefits back to the present value

More on Total Pension Liability / Discount Rate

Under Statement 68, this actuarial rate of 8% will still be considered as long as certain conditions are present

- At the point in which the net position (market value of assets) becomes insufficient to provide **current/inactive employee benefits** (called the crossover point) a blend of the actuarial rate of 8% and the 20-year municipal bond rate will be used
- This estimation of net position **includes projections** of contributions (employee and employer), investment earnings, and projected benefits for a period that extends through the end the employees lifecycle
- Plans that have large unfunded gaps will more rapidly reach the crossover point, resulting in a discount rate closer to the municipal bond rate
- For the vast majority of MERS plans this point will not be reached unless they stop making their required contributions
- MERS is actively managing the process to mitigate likelihood of triggering the discount rate

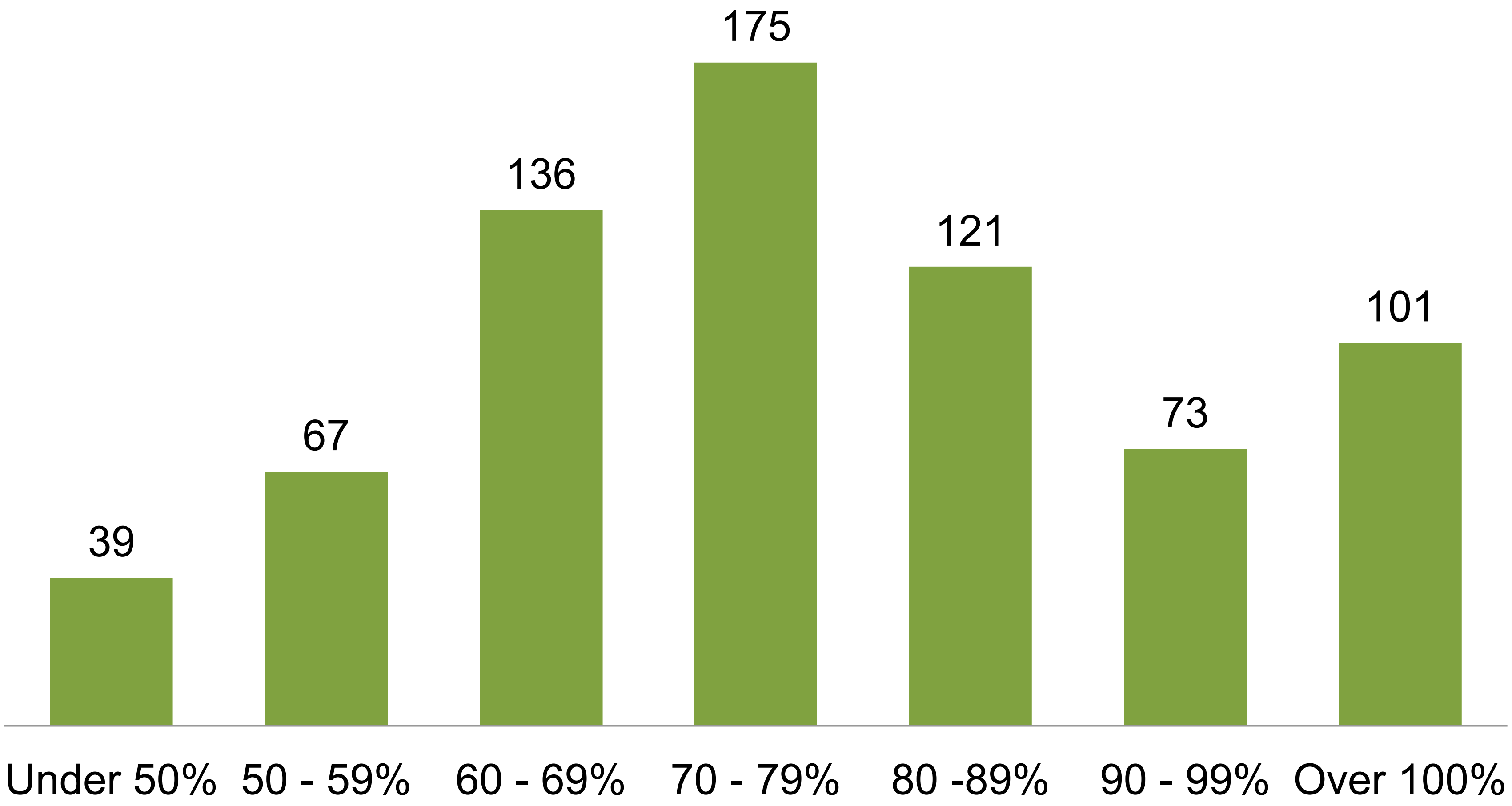
NPL Impact at 94% Funding

Assets	2012	2012 with GASB
Cash and Equivalents	$ 1,320,000	$ 1,320,000
Receivables, net	10,114,000	10,114,000
Capital Assets	27,442,000	27,442,000
Total Assets	**38,876,000**	**38,876,000**
Liabilities		
Accounts Payable/Accrued Liabilities	552,000	552,000
Long Term Debt	19,630,000	19,630,000
Net Pension Liability		1,178,000
Total Liabilities	**20,182,000**	**21,360,000**
Net Position		
Invested in Capital Assets, net of debt	10,003,000	10,003,000
Unrestricted	8,691,000	7,513,000
Total Net Position	**$ 18,694,000**	**$ 17,516,000**

NPL Impact at 63% Funding

Assets	**2012**	**2012 with GASB**
Cash and Equivalents	$ 9,900,200	$ 9,900,200
Receivables, net	24,300,000	24,300,000
Capital Assets, net	14,970,000	14,970,000
Total Assets	**49,170,200**	**49,170,200**
Liabilities		
Accounts Payable/Accrued Liabilities	5,590,000	5,590,000
Unearned Revenue	5,011,000	5,011,000
Long Term Debt	26,380,000	26,380,000
Net Pension Liability		35,444,000
Total Liabilities	**36,981,000**	**72,425,000**
Net Position		
Invested in Capital Assets, net of debt	5,690,000	5,690,000
Unrestricted	6,499,200	-28,944,800
Total Net Position	**$ 12,189,200**	**$ (23,254,800)**

Distribution of Funding Percentages for MERS Municipalities



The Bottom Line

- If pension is well-funded (95%), the liability is likely small
- If plan is less well-funded (60%), the new liability could be the largest number on the balance sheet
- The new standard will make local governments appear weaker

Pension Expense

- Before GASB 68, the pension expense that was recorded on the governmental wide income statement equaled the annual required contribution (ARC) that is reported in the annual actuarial valuation
- After GASB 68, the pension expense will be an accrual based calculation
  - Pension expense is the difference in Net Pension Liability from year to year, with some adjustments
  - It is projected that today's pension expense will likely be higher than ARC payments
  - This will affect any other income statements that the municipality may use accrual based accounting for

Sample Expense Calculation 12/31/15

Service Cost	2,075,134
Interest on Total Pension Liability Over measurement period	12,654,916
Expected Investment Return	(7,030,467)
Benefit Changes (COLA) Recognized immediately	19,869
Recognition of Experience Changes One year expense	104,804
Recognition of Assumption Changes One year expense	(135,344)
Recognition of Investment Gains/Losses (G/L) One year of five	(1,049,739)
Employee Contributions	(260,000)
Administrative Expense	340,000
Total Expense Recognized	6,719,173

Note: Employer contributions and benefit payments have **NO** direct impact on expense

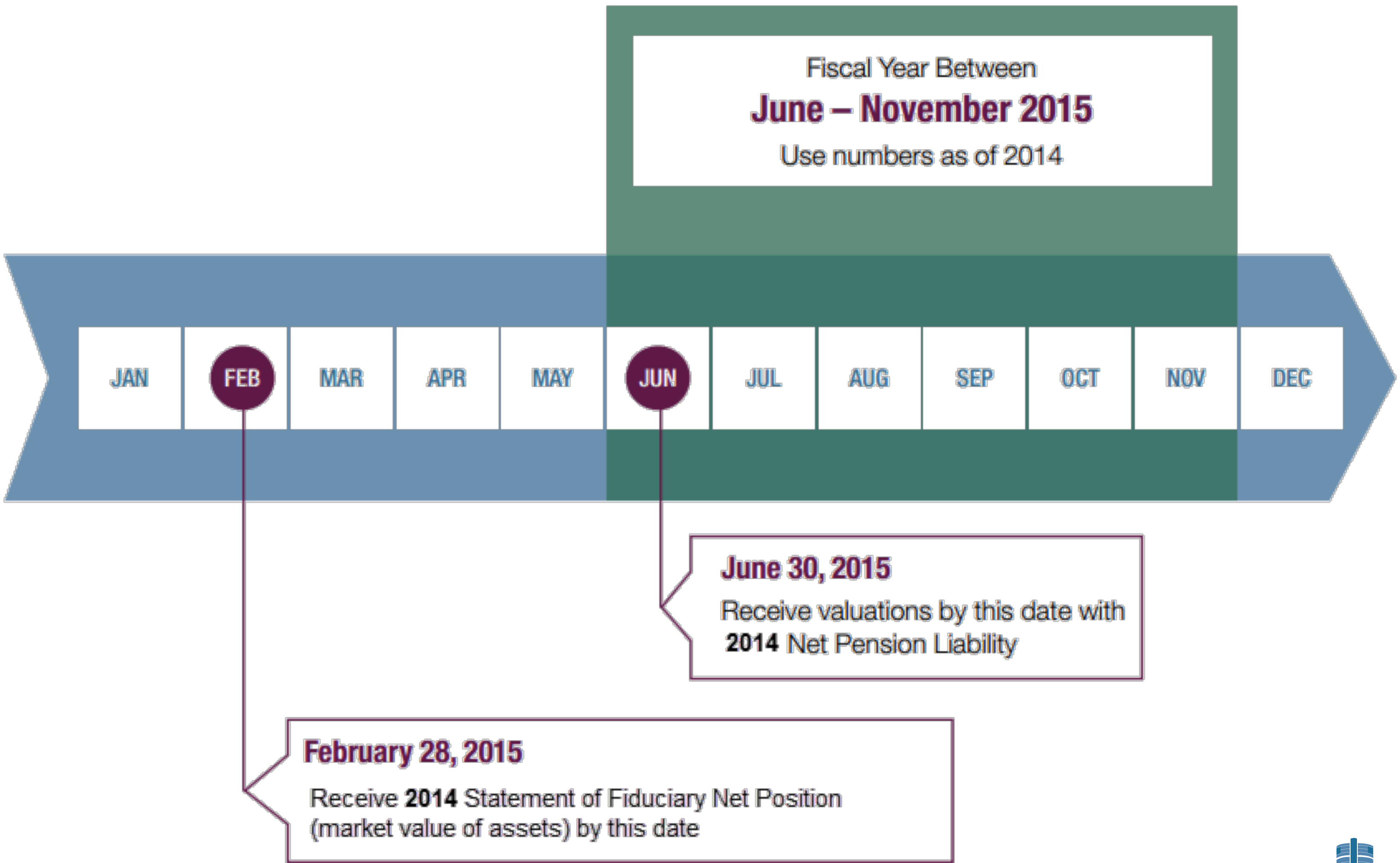
Deferred Outflows and Inflows

- New financial reporting concept, not an asset or liability
  - Similar to depreciation, spread out over future years
  - First time using this concept for some employers
- Requires several multi-year spreadsheets maintained from now on
  - Differences between projected and actual experience
  - Changes in assumptions
  - Difference between projected and actual earnings
- Detailed accounting task

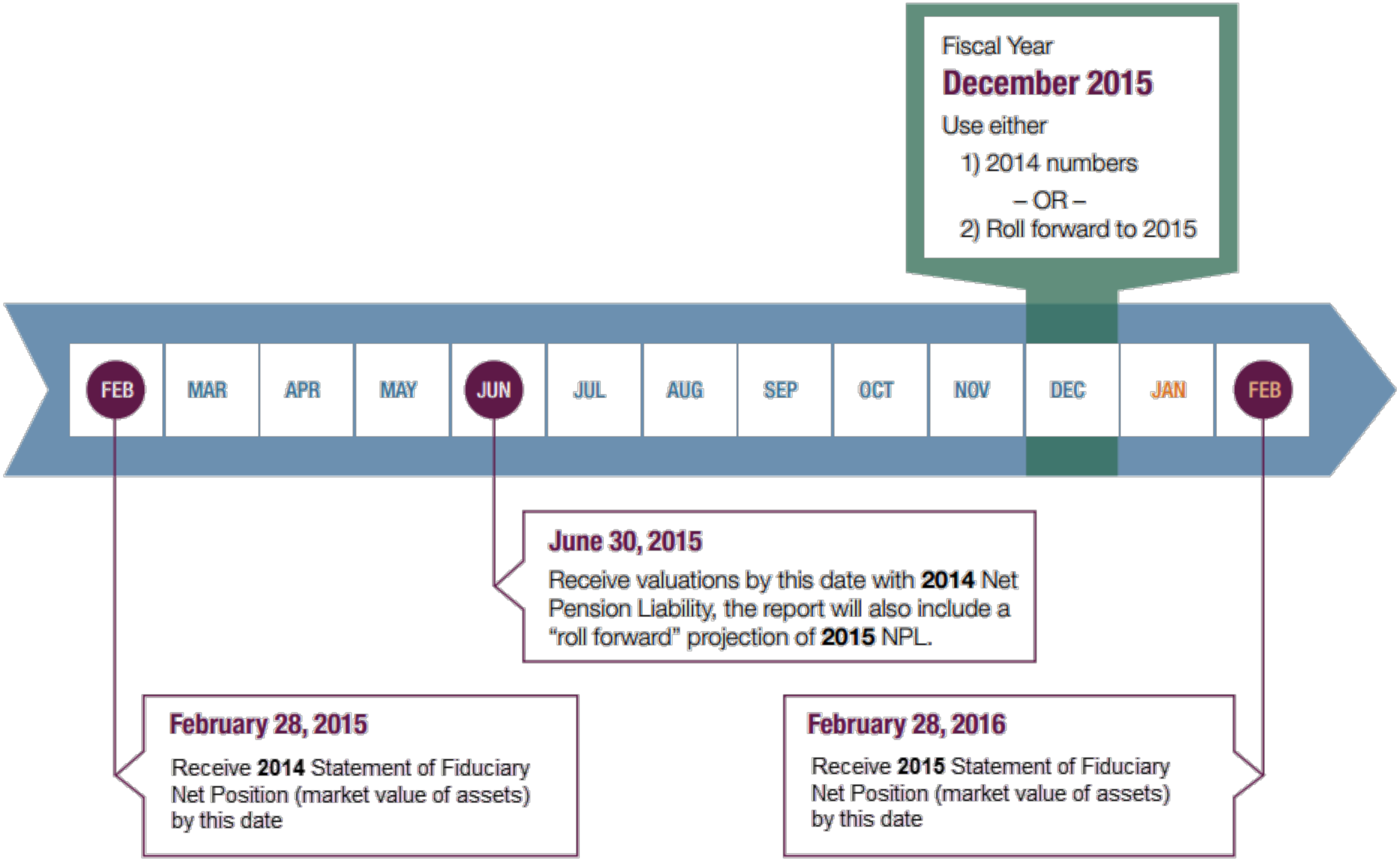
Implementation and Valuation Dates

- Will vary among 700+ employers based on their fiscal year end
- MERS will be flexible to offer best fit for each employer
- Some employers will need to choose which valuation date to use
  – Employers cannot change dates once date is selected (no switching back and forth)

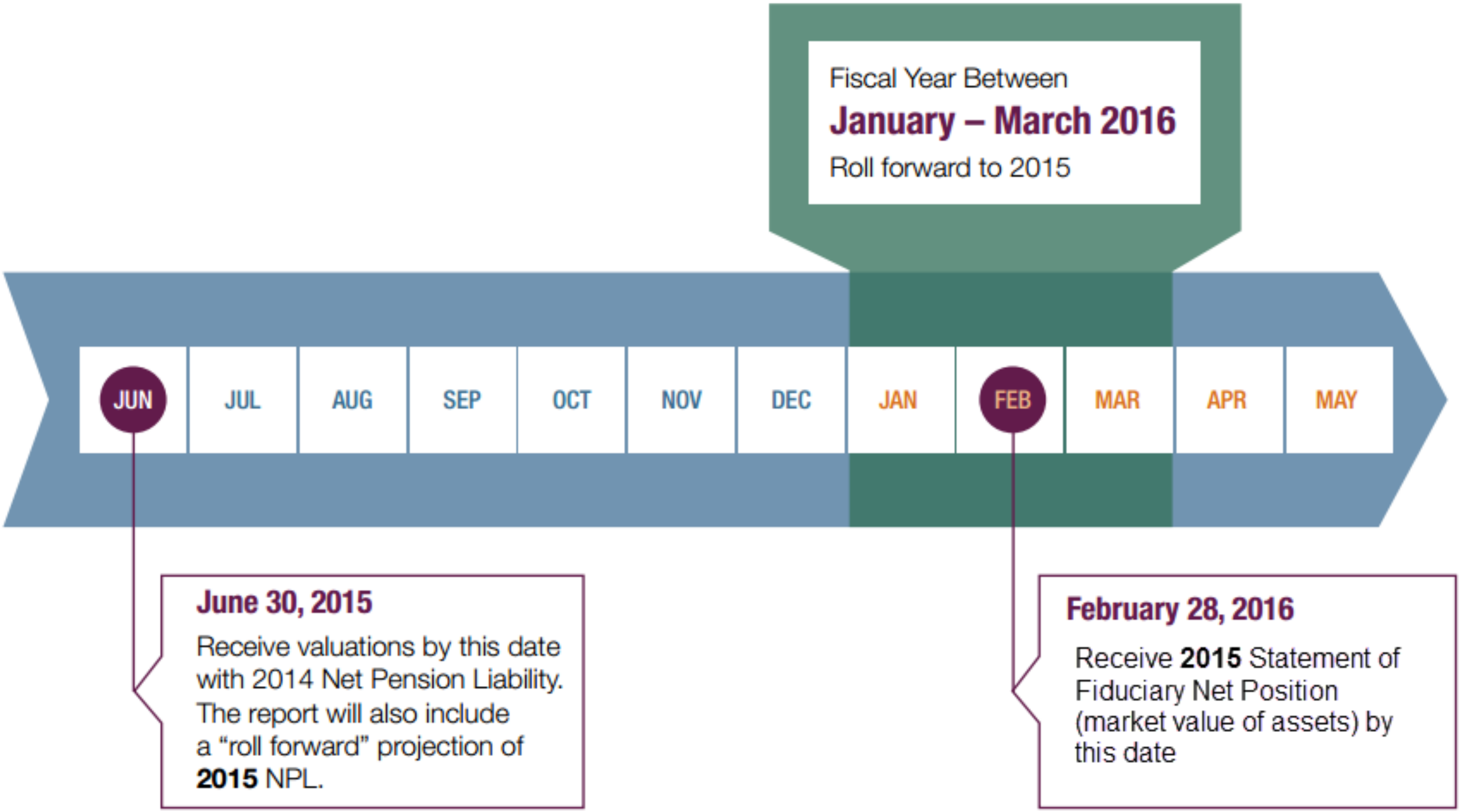
June – November Fiscal Years



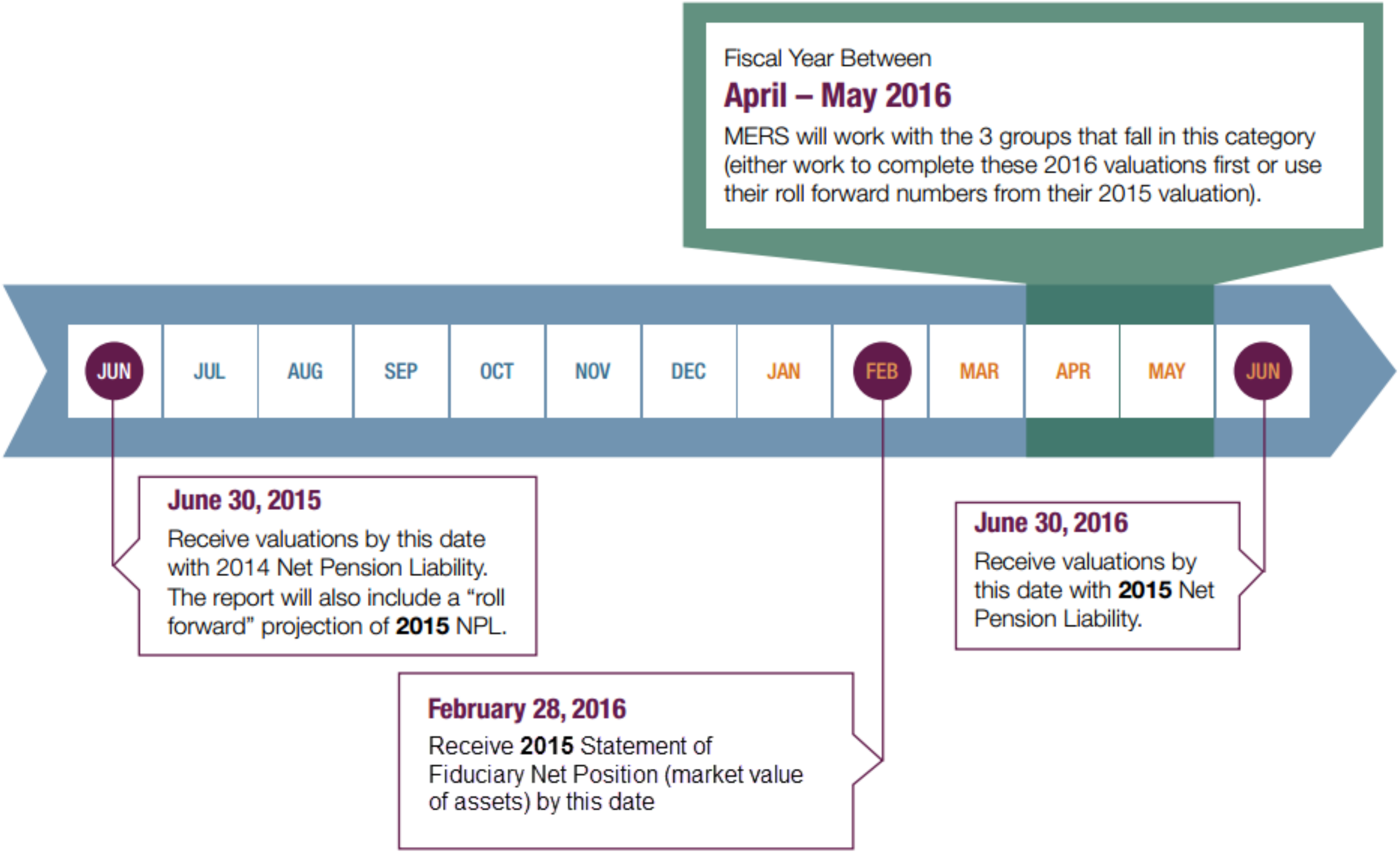
December Fiscal Years



January – March Fiscal Years



April – May Fiscal Years



Audit – potential issues

- Audited financial statements of the plan do not include actuarial information, nor do they include each employer’s “interest” in the fiduciary net position
- Allocation of fiduciary position reported by plan to employer is unaudited
- Employers need the following elements to record as of the measurement date:
  - Total pension liability less fiduciary position = net pension liability
  - Deferred outflows/inflows based on investment experience
  - Deferred outflows/inflows based on changes in assumptions
  - Deferred outflows/inflows based on actuarial gains and losses
  - Pension expense

AICPA Recommendations

- AICPA State and Local Government Expert Panel
- Pension Whitepaper Series
- Issued May 2014

AICPA® Governmental Audit Quality Center

SLGEP Pension Whitepaper Series

http://aicpa.org/gaqc ⋆ gaqc@aicpa.org May 2014

Governmental Employer Participation in Agent Multiple-Employer Plans: Issues Related to Information for Employer Reporting

MERS® Municipal Employees' Retirement System

AICPA recommendations

Plan Actuary:

- Separate actuarial valuation for each employer
  - TPL
  - Net pension liability
  - Deferred outflows/inflows by category and year
  - Pension expense
  - Discount rate calculation
- Actuarial certification letter addressed to employer management

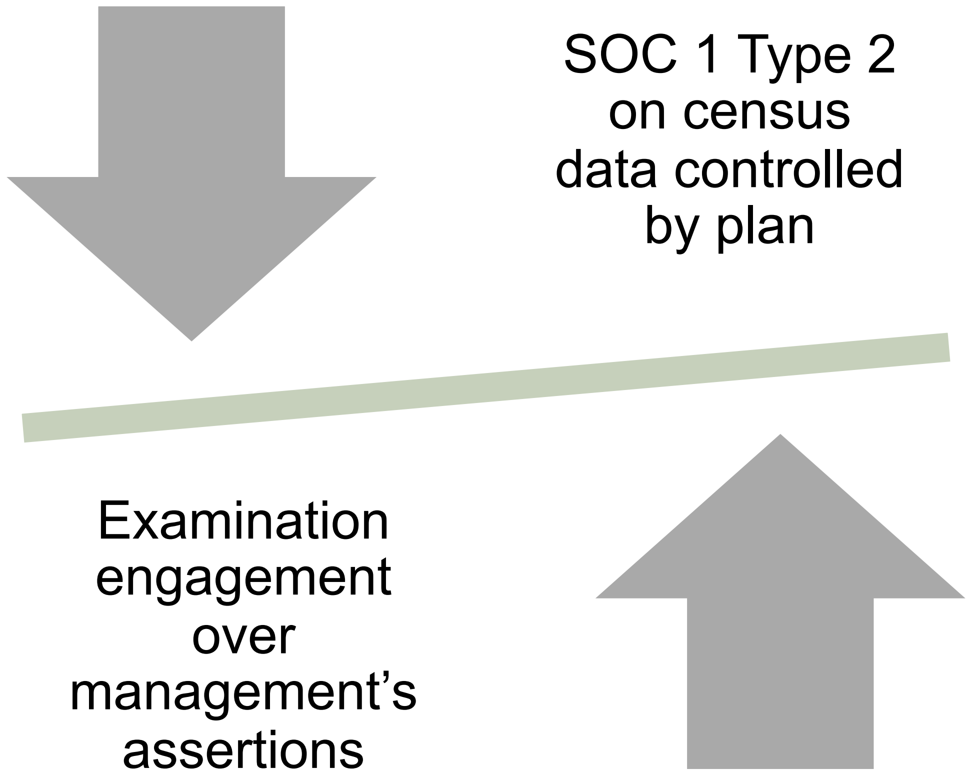
MERS Response to Recommendations

Annual Valuation Report completed each year to include GASB 68 section

- Employee Count
- Covered employee payroll
- TPL as of 12/31/13
- TPL as of 12/31/14
- Service cost
- Change in TPL due to benefit changes, differences between expected and actual experience, and changes in assumptions
- Average expected remaining service lives of all employees
- Current discount rate
- Sensitivity of TPL due to changes in discount rate (+1% and -1%)
- Data rolled forward to 12/31/15 applicable
- Actuarial certification letter

AICPA recommendations

Plan Auditor – to address liability side (TPL):



AICPA recommendations

Plan Auditor – to address Asset side:

- Include supplemental condensed schedule of “changes in fiduciary net position” by employer in plan financial statements for which plan auditor is engaged to provide opinion

  - Direct opinion on the schedule as a whole combined with a SOC 1 Type 2 on the calculation and allocation of additions and deductions to employer accounts

    OR

  - Opinion on each employer column
    - Separate materiality for each employer (yikes!)

Example Combining Schedule of Changes in Fiduciary Net Position *(by employer)*

Example Agent Multiple-Employer PERS
Combining Schedule of Changes in Fiduciary Net Position
Year ended June 30, 2015

	Employer 1	Employer 2	Employer 3	Total
Additions:				
Contributions:				
Employer	86,252,000	34,500,000	51,751,000	172,503,000
Member	32,662,000	13,065,000	19,597,000	65,324,000
Investment income:	80,965,000	20,347,000	37,112,000	138,424,000
Total additions	199,879,000	67,912,000	108,460,000	376,251,000
Deductions:				
Pension benefits, including refunds	384,635,000	184,352,000	228,356,000	797,343,000
Administrative expenses	4,716,000	1,886,000	2,829,000	9,431,000
Total deductions	389,351,000	186,238,000	231,185,000	806,774,000
Net increase (decrease)	(189,472,000)	(118,326,000)	(122,725,000)	(430,523,000)
Net position restricted for pension benefits:				
Beginning of year	5,843,645,000	1,468,538,000	2,678,595,000	9,990,778,000
End of year	$ 5,654,173,000	1,350,212,000	2,555,870,000	9,560,255,000

MERS Response to Recommendations

- We are proactively completing a SOC1 Type 2 audit for our customers so that their auditors can rely on the controls and information provided by MERS and its Actuaries
- The SOC1 report will identify and report on the existence and operating effectiveness of the processes and controls MERS has put in place related to census, contributions, net investment income, and pension payments
- This will be complete by year end

AICPA recommendations

Employer Auditor:

- Evaluate the SOC 1 Type 2 report on Census Data
  - Reporting period
  - Nature of the opinion
  - Scope of controls
  - Coverage and sufficiency of control activities
  - Nature and extent of exceptions
  - User control considerations

AICPA recommendations

Employer Auditor:

- Evaluate actuary's competence, capabilities, etc.
- Evaluate results of the actuarial valuation
- Evaluate completeness of census data used
- Further audit procedures on the Schedule of Changes in Net Position for the employer (unless an opinion is provided by employer column)

AICPA recommendations

Employer

- Support actuarial assumptions, including the discount rate
  - Projection of each employer’s net position and the amount of projected benefit payments
- Adequate controls over providing complete and accurate information to the plan and plan actuary
  - Obtain census file submitted by plan to actuary annually to determine whether census info is complete and accurate
- Verification of their specific numbers in information provided by plan (i.e. contributions)

Questions?

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