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{Topics4theTimes}

20/20 Vision: A Clear View of Pension Obligations:

Perspective on GASB 67/68

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Presenters

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Eric is the leader of the firm's K-12 education professional standards team and is responsible for the industry's technical quality control and training of our K-12 education industry staff. Eric has presented on GASB's new pension standards to clients, K-12 education industry associations, and other practitioners in the last year.

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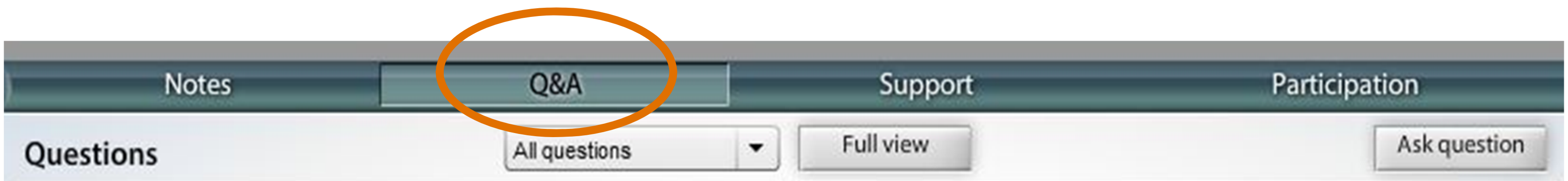
- Slides are available for download from your webcast console. A recording of today's webinar will be added to our website in a few days.

- We will allow time at the end of the presentation to respond to your questions, but please feel free to submit questions at any time.



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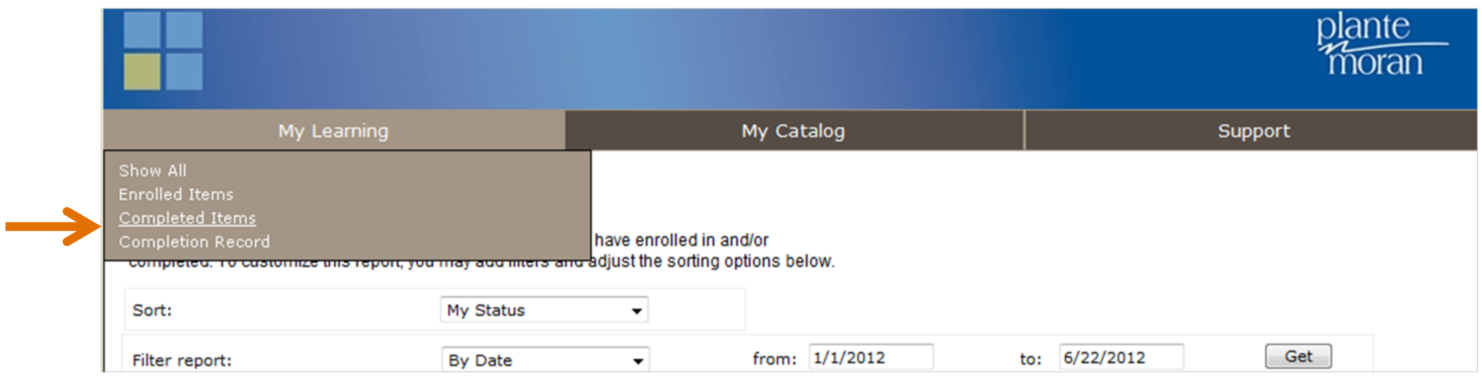

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Agenda

- **Background and scope**
- **Overview of the requirements**
- **Impact on various types of pension systems**
- **How to prepare**
- **Final thoughts**
- **Q&A**

History of “New” Pension Standards

Early 2009
GASB Issues Invitation to Comment

June 2010
Preliminary views document issued

June 2011
Exposure drafts Issued

June 2012
Final standards issued

2013
Time to prepare

2014
GASB 67 required to be implemented

2015
GASB 68 Required to be implemented

Effective Dates

GASB 67, FINANCIAL REPORTING FOR PENSION PLANS

- Years beginning after June 15, 2013
- Pension plans have much to do to prepare
- Implementation plans are important

GASB 68, ACCOUNTING & FINANCIAL REPORTING FOR PENSIONS

- Years beginning after June 15, 2014
- Understanding your type of plan
- Understanding the implications are not the same; depends on plan type
- Understanding the implications of your plan on your financial statements

June year end	December year end
Pension – 2014 Employer – 2015	Pension – 2014 Employer – 2015

This is a Big Deal!

Who Will Be Impacted?

GASB 67

- Defined benefit pension
  - Single employer
  - Agent multiple-employer
  - Cost-sharing plans
- Defined contribution plans

GASB 68

- Employers participating in any of the above plans

Polling Question #1

How much have you done to prepare for GASB 67/68 to date?

1. **Not much, that is why I am here!**
2. **Attended a few webinars, but feel there is much more to learn**
3. **Started talking to my actuaries and auditors**
4. **Spent a lot of time researching and discussing; I/we feel well prepared**

Key Steps in Implementation

	EMPLOYERS	PLANS
1. Scope - Understand type of pension plan(s) in which you participate (*single employer, agent, cost sharing*)	X	
2. Impact - Understand how the new standards impact your specific plan(s)	X	X
3. Information - Determine what information will need to be gathered and shared	X Where will required info come from?	X What needs to be provided to employer group?
4. Implementation - Develop implementation timeline and action list	X	X
5. Coordination - Ensure coordination with key parties	X Actuaries, Auditors, Plan	X Actuaries, Auditors, Employer Group

Current Approach vs. GASB 67/68

CURRENT:

Pension costs are recognized as the pensions are funded (or how they should be funded, based on the actuarially required contribution (ARC))

GASB 67/68:

Key conceptual shift in reporting pension liabilities and expense under the economic resources measurement focus from a "funding" approach to an approach more focused on interperiod equity.

Approach Under GASB 67/68

THEORY:

- Pension costs are part of the employment exchange, and should be recognized as the employment services are rendered (not as they are funded)
- The pension plan is the primary obligor for the funded portion – but the employer is the primary obligor for the unfunded portion; this does meet the definition of a liability and should be recorded as a liability (in the full accrual statements)

Approach Under GASB 67/68

ACCOUNTING IMPLICATIONS:

- Pension expense will be reported as employees earn their pension benefits by providing services
- If the amount funded is less than this, the governmentwide statements and proprietary funds will report a **net pension liability**
- Changes in pension liability will be immediately recognized as pension expense or reported as deferred outflows/inflows of resources depending on nature of change

No significant changes to accounting for pensions in modified accrual funds!

Formula for Net Pension Liability

Employers will now record the NET pension liability on the full accrual statements.

TOTAL pension liability − Plan Net Position = **NET** pension liability

*These amounts will be measured as of the "**measurement date**"*

Total Pension Liability

TOTAL pension liability

- Calculated by the actuary
- Similar to today's actuarial accrued liability (BUT definitely NOT the same)
- GASB significantly limits HOW the total pension liability will be calculated
  - Actuarial cost method
  - Discount rate
  - Measurement date

Plan Net Position

Plan Net Position

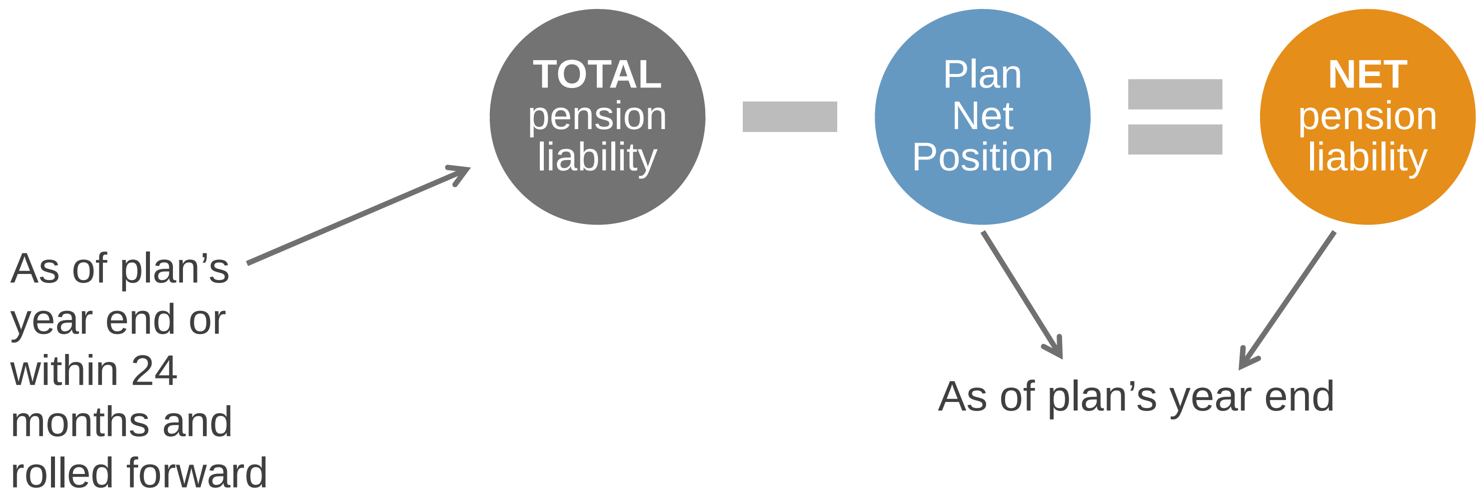
PLAN NET POSITION = PLAN ASSETS – PLAN LIABILITIES

- Assets are valued at FMV (not smoothed value!)
- All other amounts determined on same accounting basis used by pension plan

Measurement Date (of Net Pension Liability)

PLAN:

- Measured as of the plan’s year end
- To accomplish this, the actuarial valuation may be performed earlier (within 24 months and ROLLED FORWARD to plan’s balance sheet date)



Measurement Date (of Net Pension Liability)

EMPLOYER:

- Preference as of a government’s balance sheet date
- If NOT as of the unit’s balance sheet date; no earlier than the end of the employer’s prior fiscal year
- Actuarial valuation
  - Encourage valuation at measurement date
  - If not, allow valuations up to 30 months and 1 day prior to the employer’s most recent year end
  - Must update procedures to roll forward amounts to the measurement date

However, if there are new benefit changes or other significant changes, a new actuarial valuation may be required

Employer Example

1. ACTUARIAL VALUATION DATE (OF TPL):

*If not as of measurement date, as of date no more than 30 months (+1day) prior to FYE

*Roll forward to measurement date

2. MEASUREMENT DATE:

*No earlier than end of prior fiscal year

*Applies to BOTH TPL and plan net position

3. EMPLOYER'S FISCAL YEAR END (FYE)

Potentially 3 different dates to consider

Total Pension Liability

THREE BROAD STEPS

1. Project benefit payments
2. Discount projected benefit payments to actuarial present value
3. Attribute actuarial present value to periods employed

METHODS AND ASSUMPTIONS

- Generally, conform with Actuarial Standards of Practice
- Fewer alternatives than in the past for GAAP reporting purposes
- For funding purposes, you may continue to use existing actuarial methods and assumptions

Actuarial Methodology

Everyone will use the same actuarial methodology:

- The “**entry age**” actuarial cost method, and
- The “**level % of payroll**” basis for liability measurement.

This means no more choice to use projected unit credit, aggregate, etc; and no more level dollar contribution!

Discount Rate

Discount rate (to be applied to “present-value” of the projected benefit payment)

- Single blended rate
  - Long-term expected rate of return, to the extent that plan net position:
    - Projected to be sufficient to pay benefits
    - Plan assets expected to be invested using a strategy to achieve that return
  - Index rate for high-quality 20-year tax exempt bond (AA/Aa or higher)

Income Statement Impact

- **Impact on pension expense:** The change in the net pension liability **<u>does NOT</u>** all get recognized as pension expense immediately
- Certain changes can be deferred (shown as deferred inflow or outflow related to pensions)
    - See table on next slide
- Everything else (including benefit changes) will impact pension expense immediately

Income Statement Impact

CHANGE IN NET PENSION LIABILITY DUE TO:	EXPENSE	DEFD I/O
1. Employees work and earn more benefits	X	
2. Interest on the total pension liability	X	
3. Changes in total pension liability due to: a) Actual economic & demographic changes differing from assumed		Amortized Over Service Period
b) Changing assumptions about economic & demographic factors		Amortized Over Service Period
c) Changes in the terms of pension benefits	X	
4. Changes in amount of pension plan net assets due to: a) Projected investment earnings	X	
b) Actual investment earnings experience different than assumed		Amortized Over 5 Years
c) All other (receiving contributions, paying benefits, etc.)	X	

Other Implications

- ARC is no longer relevant for financial reporting
  - But still need to comply with state law!
- **If** ARC is calculated under the new standards, it will likely be higher than under current GAAP
  - However, you can continue to calculate ARC under prior parameters.
- Coordination with actuary – plan and employer!
  - Timing of roll forward procedures, if required

Types of Defined Benefit Plans

SINGLE-EMPLOYER PLANS/SINGLE EMPLOYER

- Provide benefits to the employees of only one employer.
  - *Example: City of Anytown creates a pension system just for its employees*

AGENT MULTIPLE-EMPLOYER PLANS/AGENT EMPLOYER

- Provide benefits to more than one employer by pooling assets for investment purposes, but legally segregating the assets to pay benefits promised by individual employers. Essentially an agent plan is a collection of single-employer plans.
  - *Example: MERS, in Michigan*

COST-SHARING MULTIPLE-EMPLOYER PLANS/COST-SHARING EMPLOYER

- Provide benefits to more than one employer by pooling the assets and obligations across all participating employers. As a result, plan assets may be used to pay the benefits of any participating employer.
  - *Examples: MPSERS, in Michigan*

Polling Question #2

What type of defined benefit plan are you associated with?

1. Single employer
2. Agent multiple employer
3. Cost sharing

Employers with Single Employer Defined Benefit Plans

- Current standards require liability for difference between the ARC and the employer’s actual contributions
  - In states where governments are legally required to contribute to the ARC, it is rare to see a liability for a net pension obligation today
- Process already in place for annual valuations
- Consider year end differences between the PLAN and the employer

Employers with Single Employer Defined Benefit Plans

- Ensure actuarial valuation complies with GASB 68 – work with actuary up-front on timing
- Net pension liability will be similar to today's UAAL
  - 100% of NPL will be recognized by single employers
  - Liability to be recorded on government-wide statements
  - Allocation between governmental activities and business-type activities

Employers Participating in Agent Multiple Employer Plans

- **Total pension liability** – most likely, already a process in place to calculate the AAL, calculating the TPL will be similar
- **Plan net position** – your piece
  - Verifiable information
  - Timing
- **Who calculates the deferrals?**
- **Actuary report**
  - Timing
  - Roll-forward
  - Setting discount rate – could be different for each different employer

Employers Participating in Cost-Sharing Plans

CURRENTLY

- As long as you pay the contractually required contribution, no liability will be reported
- No separate actuarial calculation
- Minimal footnote disclosure

Employers Participating in Cost-Sharing Plans

GOING FORWARD

- Report their proportionate share of the collective net pension liability
- Substantial footnote disclosures

Cost-Sharing Employers

Begin by calculating the net pension liability at the plan level

- Proportionate share - GASB encourages the estimation of expected future contributions as the basis to allocate; but it allows any method that is determined on a basis that is consistent with the manner in which required contributions are determined.

Cost-Sharing Employers

Cost sharing employers expense will include:

- Proportionate share of the plan's pension expense
- Amortization of deferrals including:
  - Net effect of annual changes in the employer's proportionate share
  - Annual differences between the employer's actual contribution and its proportionate share

Cost-Sharing Pension Plans

Cost Sharing Plan Pension Benefits - Estimated GASB 68 Liability *(*see caveats on next slide)*		
Total Pension Liability (TPL) as of 9/30/x1	$	60,927,000,000
Actuarial Value of Total Plan Net Position as of 9/30/x1	$	43,294,000,000
Net Pension Liability (NPL) as of 9/30/x1 – plan level	$	17,633,000,000
Total Covered Payroll for Year Ended 9/30/x1	$	8,845,000,000
Estimated XYZ Entity Covered Payroll for Year Ended 6/30/x2	**$**	**20,000,000**
Covered Payroll as a Percentage of Total Covered Payroll – PROPORTIONATE SHARE		0.23%
Estimated prorata share of unfunded liability as of 6/30/x2 (NPL x proportionate share of covered payroll)	**$**	**39,871,114**

Cost-Sharing Pension Plans: Allocation Method

The allocation method chosen for this calculation was the proportion of covered payroll.

This may be acceptable, but the GASB allows any method that measures the proportionate relationship of the individual employer to the aggregate of all employers.

They encourage the use of projected long-term contribution efforts of each employer as the basis.

Cost-Sharing Employers: Additional Considerations

Deferred inflow, outflows and expense calculation is not required at the plan level:

- Who will calculate this amount for each employer?

Coordination with plan:

- Timing
- Information to be provided

Pension Plans

DEFINED BENEFIT PLANS THEMSELVES

- Earlier implementation
- Same provisions related to assumptions, methodology, etc. as it relates to actuarial projections
- Financial statement reporting similar to GASB 25
- DROP balances – not a liability, but require disclosure
- Much more significant note and RSI disclosures
- Agent/cost sharing plans – Need to consider employers' needs (timing, verifiable data, etc.)

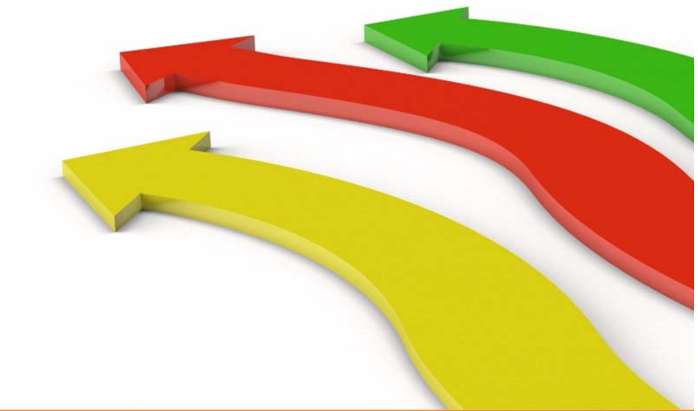
Pension Plans

DEFINED CONTRIBUTION PLANS

- Accounting hasn't changed – liability for the difference between required contribution and amounts actually contributed
- Similar disclosures as under GASB 25

Transition

- Report as adjustments to prior periods
- Restate all prior periods reported
- Deferred inflows/outflows – restate if practical; otherwise, assume zero beginning balance
- When single statements are issued, the prior year MD&A comparative information will still need to be updated
- RSI schedules prospective if information not initially available



Footnote Disclosure Changes

VERY SIGNIFICANT FOOTNOTE DISCLOSURE CHANGES (THE ILLUSTRATIVE MODEL TAKES 5 PAGES!):

- Benefit terms
- # of participants
- Contribution requirements
- Assumptions
- Support for the discount rate
- Details of the changes in the net pension liability

Likely these will be very time-intensive to compile! Plan accordingly!

Expanded Required Supplementary Information

- 10 years of changes in net pension liability
- 10-year comparison of funding status
- 10 years of ARC v. actual contributions

Impact of These Changes:

- Better measure of interperiod equity (the cost of providing services will be matched better with the periods in which the employment services were rendered)
- Higher volatility – possibly very significant
- These rules will not be required to be used for funding – just for financial statement measurements

✓ ***ARC is no longer relevant for accounting purposes***

✓***Expect similar changes to OPEB (eventually!)***

Polling Question #3

My next steps for implementation are:

A. **Read the standards more closely**

B. **Call my auditor**

C. **Call my actuary**

D. **All of the above**

Key Steps in Implementation

EMPLOYERS:

- Understand the type of pension plan(s) in which you participate (single employer, agent, cost sharing)
- Understand how the new standards impact your specific plan(s)
- Determine where all the information required by the standards will come from
- Develop an implementation timeline and action list
- Ensure coordination with all key parties – plan, actuaries, auditors, etc.

Key Steps in Implementation

PLANS:

- Understand how the new standards impact your specific plan type
- Determine what information will need to be provided to the employer group and address timing considerations
- Develop an implementation timeline and action list
- Ensure coordination with all key parties – actuaries, auditors, employer group

In Conclusion

- Governments, actuaries, and auditors will incur additional time and cost to comply with these new standards.
- Impact will be felt far more by cost-sharing plans and their employers, because of the consideration that will go into calculating and reporting each government’s share of the collective net pension liability.
- Changes are not suggestive of changes that governments will need to make in their pension contribution practices.

GASB IMPLEMENTATION GUIDE PENSION GUIDANCE

- 2Q13 - Plan
- 1Q14 - Employer

Q&A

Resources

GASB.org

- Fact sheets
- Statements
- Plain-language articles

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