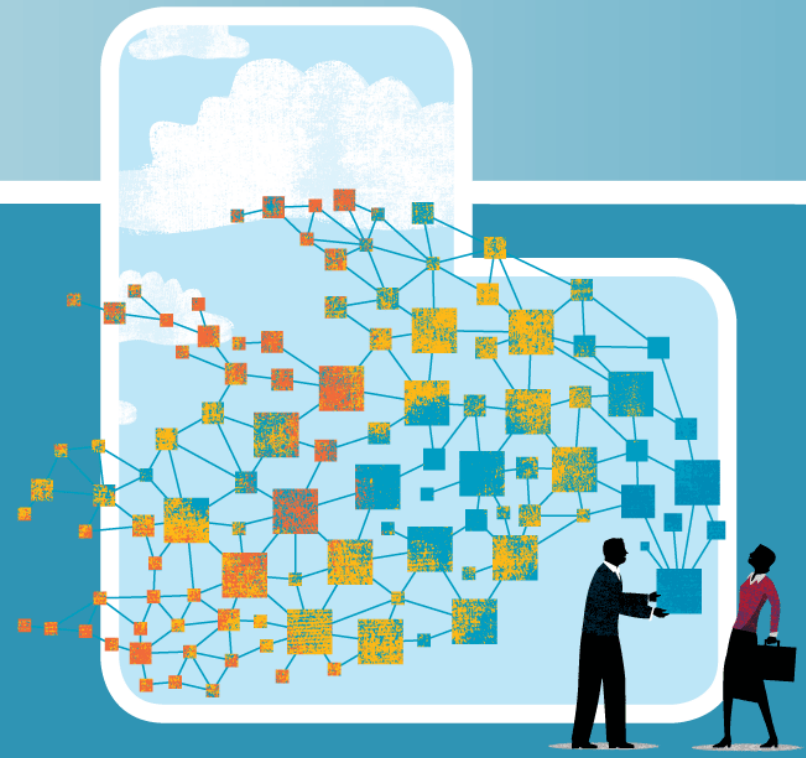
GASB PENSION STANDARDS



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Statement No. 68, *Accounting and Financial Reporting For Pensions*

WHAT WAS THE STARTING POINT?

- Current standards were issued in 1994
- Statement No. 25, Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans
- Statement No. 27, Accounting for Pensions by State and Local Governmental Employers
- GASB's strategic plan calls for the periodic reexamination of major standards

WHY DID THE GASB LOOK AT THIS TOPIC?

- What has changed since the issuance of current standards?
- Relevant conceptual points—not available when Statements 25 and 27 were developed
- Concepts Statement No. 4, Elements of Financial Statements—Issued in June, 2007
- Included the definition of a liability
- Concepts Statement No. 3, Communication Methods in General Purpose External Financial Statements That Contain Basic Financial Statements —Issued in April, 2005
- Provided definitions of communications methods—including recognition/display in basic financial statements, notes to basic financial statements, and required supplementary information

FUNDAMENTAL APPROACH

- Balance between a point-in-time measure of the employer's obligation to employees and the measures over time of the cost to taxpayers of providing governmental services
- Employment-exchange transactions create an obligation of employer to employees to provide pension benefits in retirement
  - Annual exchanges, viewed by Board within context of a career-long employment relationship
- Accounting-based versus funding-based proposals (currently we compare the ARC with the actual payment made)

TYPES OF PLANS

- Single-employer plans—involve only one government
- Multiple-employer plans—include more than one government
  - Agent multiple-employer plans—separate accounts are maintained to ensure that each employer's contributions are used to provide benefits only for the employees of that government
    - Individual employers are responsible for benefits associated with their own employees only, and separate actuarial calculations are made for each participating government in the plan.
    - Costs of administering the plan is shared by participating governments and the plan assets are pooled for investment purposes
  - Cost-sharing multiple-employer plans—governments pool (share) the costs of providing benefits and administering the plan and the assets accumulated to pay benefits
    - A single actuarial valuation is conducted for all of the employees of the participating governments combined

SCOPE AND APPLICABILITY

Defined benefit and defined contribution pensions provided through trusts that meet the following criteria:

- Employer/nonemployer contributions irrevocable
- Plan assets dedicated to providing pensions
- Plan assets legally protected from creditors

Excludes OPEB!

DEFINED BENEFIT PENSIONS

Liabilities to the pension plan (payables)

Liabilities to employees for pensions

- Net pension liability (NPL)
  - Total pension liability (TPL), net of plan's fiduciary net position
  - TPL = Actuarial present value of projected benefit payments attributed to past periods
  - Fiduciary net position as measured by pension plan

<u>Single/agent employers</u> recognize 100% of NPL

<u>Cost-sharing employers</u> recognize their proportionate share of the collective NPL

NPL: MEASUREMENT—TIMING

Potentially 3 different dates to consider!

- Employer's FYE
- Measurement date
- Actuarial valuation date

Measurement date (of NPL)

- As of a date no earlier than end of prior fiscal year
- Both components (TPL/plan net position) measured as of the same date
- Measurement is consistently applied from period to period

Actuarial valuation date (of TPL)

- If not measurement date, as of a date no more than 30 months prior to FYE
- Actuarial valuation at least every 2 years

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IMPACT OF MEASUREMENT DATE

- Employer Concerns
  - Which measurement date should we pick?
  - Should the date be influenced by timing of plan financial statements?
  - Reporting contributions after the measurement date
- Plan Concerns
  - When will the employer need information for their financial statements?
  - How will the selection of the actuarial valuation date impact the completion of audited financial statements
- Auditor Concerns
  - When will the necessary information be available to audit?

CONSIDERATIONS FOR MEASUREMENT DATE

- Potential for multiple measurement dates for entities with the same reporting period
- Timeliness of information available from pension plans
- Impact on precision and significance of changes since measurement date

NPL: MEASUREMENT(GENERAL APPROACH)

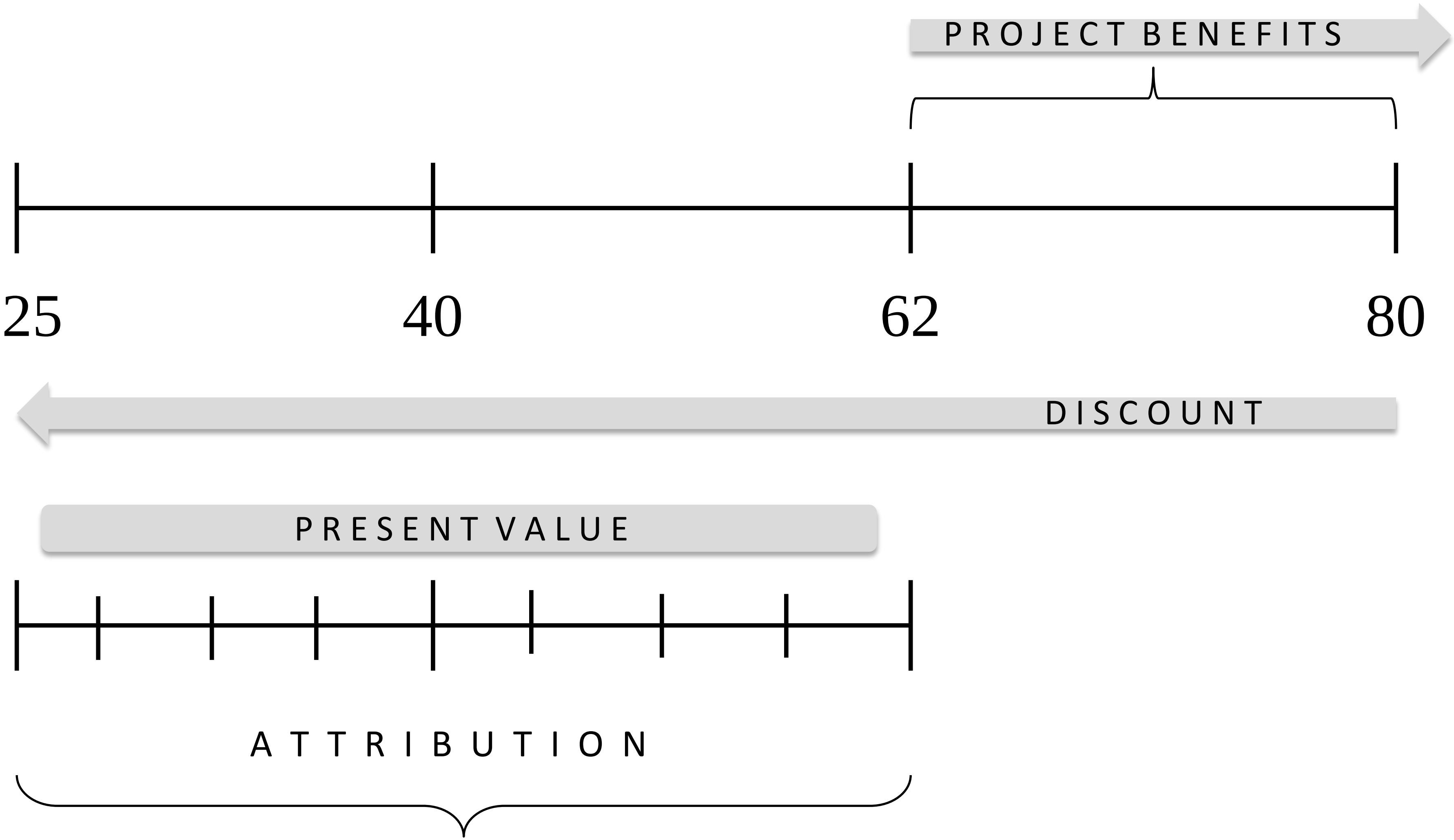
3 broad steps

- ❖ Project benefit payments
- ❖ Discount projected benefit payments to actuarial present value
- ❖ Attribute actuarial present value to periods

Methods and assumptions

- ❖ Assumptions in conformity with ASOPs
- ❖ Fewer options than in Statement 27 for methods and assumptions for GAAP reporting purposes
- ❖ No changes required to actuarial methods and assumptions used to determine funding amounts

TOTAL PENSION LIABILITY (TPL): ILLUSTRATION



NPL: MEASUREMENT—PROJECTION

Benefit terms/agreements at the measurement date

Current active and inactive employees

Includes expectations of the following:

- ❖Salary changes
- ❖Service credits
- ❖Automatic postemployment benefit changes (COLAs)
- ❖Ad hoc postemployment benefit changes

NPL MEASUREMENT-PROJECTION

- Census Data
  - Date of birth
  - Gender
  - Date of hire
  - Marital status
- Actuarial Assumptions
  - Investment Return Rate
  - Wage inflation
  - Assumed retirement
  - Rates of mortality
  - Rates of disability

IMPACT OF ACTUARIAL INFORMATION

- Plan Concerns
  - What level of involvement should the employer have in establishing actuarial assumptions?
  - Does the auditor of the plan possess the skills, knowledge, and experience related to the actuarial information
  - Does the auditor of the plan include a specialist?
- Employer Concerns
  - What level of involvement should we have in establishing actuarial assumptions?
  - Can we rely on plan actuary as a management specialist?

IMPACT OF ACTUARIAL INFORMATION

- Auditor Concerns
  - What role should we have in evaluating the actuarial assumptions used?
  - As auditor of plan, do I have to engage specialists for actuarial information
  - As auditor of employer, did the auditor of plan engage an auditor specialist to review actuarial information?
  - Responsibility for census data
    - Active employees
    - Inactive/retired

IMPACT OF ACTUARIAL INFORMATION- USE OF SPECIALISTS

Auditor's Specialist: Individual or organization possessing expertise in a field other than accounting or auditing, whose work in that field is used by the ***auditor*** to assist the auditor in obtaining sufficient audit evidence. An auditor may be either an auditor's internal or external specialist

Management's Specialist: Individual or organization possessing expertise in a field other than accounting or auditing, whose work in that field is used by the ***entity*** to assist the entity in preparing the financial statements.

MANAGEMENT AND AUDITOR SPECIALISTS-RECOMMENDATIONS

- Employers participating in single and agent multiple-employer plans should directly receive actuarial valuation reports from plan actuary to rely on as management specialist
- Both employers and plans are responsible for evaluating appropriateness of actuarial valuations
- Involve auditors in discussion of actuarial assumptions prior to completing actuarial valuations
- Plans should engage their auditors in dialogue on the use of auditor specialists
- Auditors should carefully evaluate engagement team skills and expertise as it relates to actuarial information

NPL: DISCOUNT RATE

- Projected benefit payments must be discounted to their present value, which requires the selection of a discount rate. (for payments received in the future, a lower discount rate (rate of return) would require you to invest a larger amount today)
- Currently, the discount rate used for this purpose is the long term expected rate of return on pension plan investments, since it is those investment that ultimately will be used to make projected benefit payments
- In some cases…the assets held by a pension plan over time may be projected to not fully cover projected benefit payments.

NPL: DISCOUNT RATE

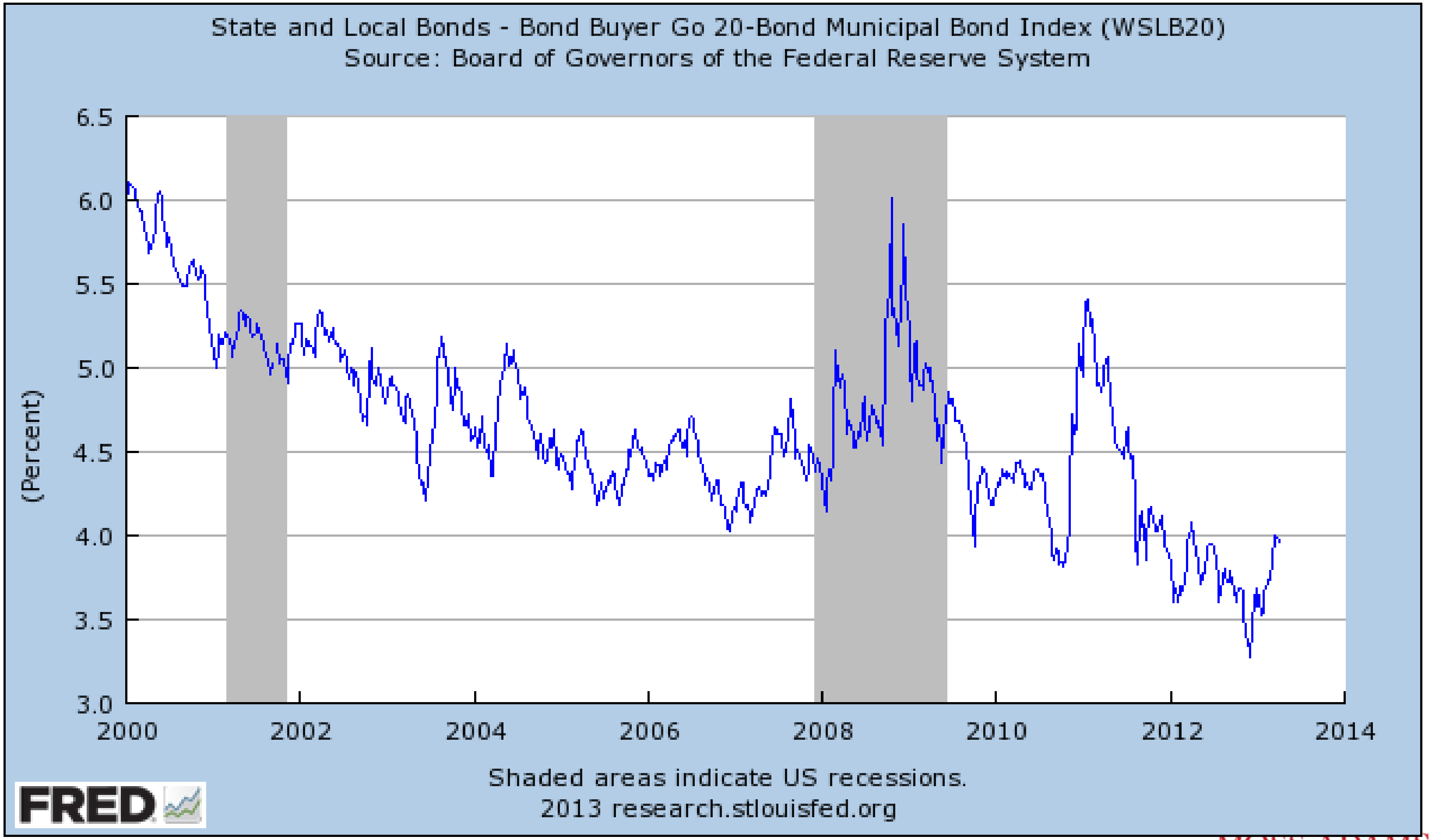
Under the new Standards, the discount rate should be a single rate that reflects:

- The long term expected rate of return on plan investments to the extent that current expected future plan net position available for pension benefits are projected to be sufficient to make benefit payments

- A high-quality 20-year municipal bond index rate or yield on tax-exempt general obligation bonds (AA rated or higher or an equivalent rating) beyond the point at which plan net assets available for pension benefits are projected to no longer be available for long-term investment

NPL: DISCOUNT RATE

20 Bond Index (Source: St. Louis Fed)



NPL: FINDING THE DISCOUNT RATE

1. Compare projected benefit payments to the pension plan's projected fiduciary net position in each period
2. Apply relevant discount rate to each period's projected benefit payments
3. Total the present values of all projected benefit payments
4. Determine the single rate that results in the same present value (if applied to all projected benefit payments) as using the two rates

IMPACT OF DISCOUNT RATES

- Small increases or decreases in the discount rate may result in significant changes in the reported total pension liability

- How do significant changes to investment rates or return after the measurement date affect the reported total pension liability?

NPL: ATTRIBUTION METHOD

Attribution of the present value of projected benefit payments to periods (for accounting purposes and not for funding purposes):

- Single attribution method: Based on entry age normal (used to be 6 methods available for use)
- Attribution method: Level percentage of payroll – calculates payments so that they equal a constant percentage of projected payroll over time
- Attribution period: over periods beginning in the first period in which the employee's services lead to benefits under the plan and ending in the last period of the employee's service

NPL: MEASURING PENSION EXPENSE

Pension expense in the financial statements is a product of the following:

- Employees work and earn benefits (***service cost***)
- The outstanding liability accrues interest
- Changes in the measurement of the TPL due to:
  - Actual economic and demographic changes differing from what was assumed
  - Changing the assumptions about economic or demographic factors
  - Changes in the terms of pension benefits
- Changes in the measurement of plan net position due to:
  - Expected investment earnings
  - Effects other than investment earnings, such as receipt of contributions from the employer and employee and payment of benefits
  - Difference between actual investment earning and what was expected

NPL: DEFERRED EXPENSE RECOGNITION

The effects of the following items are reported as a deferred outflow of resources or a deferred inflow of resources and recognized as part of pension expense future reporting periods:

- Differences between expected and actual changes in economic and demographic factors (remaining service periods of plan members)
- Changes in the assumptions about economic and demographic factors (remaining service periods of plan members)
- Differences between actual and projected earnings on plan investments (recognized over a five-year, closed period)

PUTTING IT ALL TOGETHER

	Total Pension Liability (TPL) (a)	Plan Net Position (b)	Net Pension Liability (NPL) (a) - (b)	Deferred Outflows of Resources	Deferred Inflows of Resources	Pension Expense
Balances—at 6/30/X8	$ 3,045,893	$2,283,333	$ 762,560	$ 310,538	$ 50,766	$ -
Changes for the year:						
Service cost	101,695		101,695			101,695
Interest	231,141		231,141			231,141
Benefit changes	-					-
Experience loss (gains)	(69,638)		(69,638)	-	56,690	(9,948)
Changes of assumptions	-		-	-	-	-
Contributions - Employer		109,544	(109,544)			
Contributions - Employees		51,119	(51,119)			(51,119)
Net investment income		199,273	(199,273)			-
Expected return on plan						(178,268)
Expected portion of differences between expected return on plan						(4,201)
Non-expensed portion of plan investments above				-	16,804	
Refunds of contributions	(2,780)	(2,780)	-			-
benefits paid	(124,083)	(124,083)	-			-
Plan administrative costs		(3,427)	3,427			3,427
Other changes		8	(8)			(8)
Amortization				(80,979)	(24,250)	56,729
Net changes	136,335	229,654	(93,319)	(80,979)	49,244	149,448
Balance—at 6/30/X9	$ 3,182,228	$2,512,987	$ 669,241	$ 229,559	$ 100,010	$149,448

COST SHARE PLANS AND EMPLOYERS

NPL: COST-SHARING EMPLOYERS

- Recognize proportionate shares of collective NPL, pension expense, deferred outflows of resources/ deferred inflows of resources
- Proportion (%)
- Basis required to be consistent with contributions
- Consider separate rates related to separate portions of collective NPL
- Use of relative long-term projected contribution effort encouraged
- Collective measure x proportion = proportionate share of collective measure

NPL: COST-SHARING EMPLOYERS—ADDITIONAL CONSIDERATIONS

- **Potentially three items**
  1. Change in proportion
  2. Difference between:
     - The employer's proportionate share of all employer contributions included in collective plan net position
     - Contributions recognized by the employer in the measurement period
  3. Employer's contributions subsequent to measurement date
- **Items 1 & 2—expense in current and future periods (systematic/rational method, closed period equal to average of expected remaining service lives)**
- **Item 3—deferred outflow of resources, expense in next period**

COST SHARING EMPLOYER PLANS-CONCERNS

- Employer Concerns
  - Where will the amounts and disclosures come from to record in the financial statements?
  - Who is responsible for the accuracy and verifiability of information?
  - Do my auditors have perform any audit testwork at the plan?
- Plan Concerns
  - Who should calculate the allocation percentages?
  - Will employers and auditors want to visit the plan to obtain audit information?
  - How do we fund the additional cost of providing information to employers?

COST SHARING EMPLOYER PLANS- CONCERNS

- Auditor Concerns
  - Is the employer or plan auditor responsible for auditing the collective pension amounts and their allocation to the participating employers?
  - What is the plan auditor's responsibility to test census data at participating employers?
  - Audited financial statements of the plan only include total net pension liability for plan. They do NOT include:
    - Deferred outflows/inflows of resources by category
    - Pension expense
    - Each participating employer's share of the collective pension amounts

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COST SHARING EMPLOYER PLANS: AICPA PROPOSED RECOMMENDATIONS

- Include supplemental “schedule of employer allocations” in plan financial statements for which plan auditor is engaged to provide an opinion
  - Use allocation method based on covered payroll or actual contributions depending on whether there are different classes of benefits and whether allocations are expected to be representative of future contributions
  - Standard does not preclude employers from calculating their own allocation percentage

COST SHARING EMPLOYER PLANS: AICPA PROPOSED RECOMMENDATIONS

- Include supplemental "schedule of plan pension amounts" in which plan auditor is engaged to provide opinion
  - Supplemental schedule of plan pension amounts include net pension liability, deferred outflows/inflows of resources, and pension expense for plan as a whole
  - Alternative could be to include a "schedule of employer pension amounts"

SPECIAL FUNDING: INVOLVEMENT OF NONEMPLOYER CONTRIBUTING ENTITIES

- Statement addresses those with legal requirement to contribute *directly to* the pension plan
  - Special funding situations
    - Contribution amount not dependent upon events unrelated to pensions OR nonemployer is only entity with legal obligation to contribute
    - Employer(s) and nonemployer contributing entity apply cost-sharing measurement to collective NPL, expense, and deferred outflows/deferred inflows of resources
      - Nonemployer expense classified in same manner as similar grants to other entities
    - Employer recognizes additional expense and revenue equal to nonemployer contributing entity's proportionate share of collective expense (portion related to the employer)

SPECIAL FUNDING: INVOLVEMENT OF NONEMPLOYER CONTRIBUTING ENTITIES

- **Not special funding**
  - Employer recognizes revenue for change in NPL from contributions from nonemployer contributing entities (rather than expense)
  - Nonemployer entity classifies expense for contributions in same manner as similar grants to other entities

SPECIAL FUNDING: INVOLVEMENT OF NONEMPLOYER CONTRIBUTING ENTITIES - CONCERNS

- Employer, Plan and Auditor Concerns:
  - Do we have a special funding situation?
  - Who should determine?
  - What do we do if there is a difference of opinion between the non-employer and employer governments? Who arbitrates?

SPECIAL FUNDING: INVOLVEMENT OF NONEMPLOYER CONTRIBUTING ENTITIES - RECOMMENDATIONS

- Coordinate meeting between plan, non-employer government, key employers, and their auditors
- Carefully review plan documents and state statutes to determine if special funding situation exists
- Document any analysis that is distributed to participating employers
- Initiate inquiry with GASB if differences of opinion exist

EFFECTIVE DATE AND TRANSITION

- Fiscal years beginning after June 15, 2014
- Pension plan Standard for fiscal years beginning after June 15, 2013
- Changes made to comply with the standards should be treated as an adjustment of prior periods, resulting in restatement of those periods
  - Employers should not report beginning balances of deferred outflows/inflows of resources if not practical to determine, *except for effects of contributions made after the measurement date related to a prior year*.
- RSI schedules prospective if information not initially available
- Ten-year RSI schedule related to contributions should be presented in full upon implementation, if applicable

EFFECTIVE DATE CONCERNS

- Employer Concerns:
  - Will the plans and employers be able to implement the standards within the required timeframes with GASB delay of implementation?
  - What is the impact to the audits opinion if plan is not able to implement AICPA proposed recommendations?
- Plan Concerns:
  - Will plan be able to implement the standards within the required timeframes?
  - Do we need to engage a consultant to assist us with implementation?
  - Do we need to engage auditors to provide assurance about information provided to participating employers?

EFFECTIVE DATE CONCERNS

- Auditor Concerns:
  - Will plans be able to implement standard, including AICPA proposed recommendations, within the required time frame?
  - Will there be sufficient appropriate audit evidence for unmodified opinion?

CLOSING THOUGHTS

THE TIME IS NOW!

EFFECTIVE COMMUNICATION BETWEEN PLAN, EMPLOYER, AND AUDITOR IS ESSENTIAL

CONSIDER THE TIMELINESS OF INFORMATION IN SELECTING MEASUREMENT DATE

CONSIDER WHETHER ADDITIONAL ASSISTANCE IS NEEDED WITH IMPLEMENTATION

EVALUATE AUDITOR RELATIONSHIP AND SCOPE OF WORK

QUESTIONS?

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CELEBRATING A CENTURY OF SERVICE

In 1913 an accountant opened a small practice in Seattle to serve the Pacific Northwest's booming timber industry. Today, that practice is one of the largest accounting and consulting firms in the nation, serving businesses and organizations around the globe.

Yet while we're pleased to celebrate our centennial, we remain focused on what's truly mattered all along: you. Because anniversaries are nice. But providing you with vital insights to help your organization succeed? That counts.