



# Accounting and Financial Reporting for Pensions – A summary of changes and recommended steps

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# Today's presenters



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# Agenda

- GASB 67 Financial Reporting for Pension Plans
- GASB 68 Accounting and Financial Reporting for Pensions
- Recommended next steps

# GASB 67 and 68 – Accounting and Financial Reporting for Pensions and Plans

- Statements issued in June 2012
- GASB 67 – Reporting of plans
  - Effective for fiscal years beginning after June 15, 2013
- GASB 68 – Employer/sponsor accounting/reporting
  - Effective for fiscal years beginning after June 15, 2014
- Standards address
  - Changes in governmental accounting and financial reporting, principally the introduction of accrual-based government-wide financial statements
  - A perceived need among the users of governmental financial reports for comparable information about pensions
  - The continuing development of GASB concepts regarding what constitutes a liability and an outflow of resources

# GASB 67 – Financial Reporting for Pension Plans

## An Amendment of GASB Statement No. 25

- Establishes financial reporting standards for pension plans of SLGs
  - Defined benefit and defined contribution plans
    - Administered through trusts or equivalent arrangements, in which
      - Contributions are irrevocable
      - Assets are dedicated to providing pension benefits
      - Plan assets are legally protected from the creditors of
        - Employers
        - Nonemployer contributing entities
        - Plan administrators

# Defined benefit plans (DBPs)

- DBPs should present the following financial statements prepared on accrual basis
  - **Statement of fiduciary net position**
    - Assets
    - Deferred outflows
    - Liabilities
    - Deferred inflows
    - Fiduciary net position
  - **Statement of changes in fiduciary net position**
    - Addition to plan
    - Deductions from plan
    - Net increase (decrease) in fiduciary net position

# DBPs – additional reporting considerations

- Notes to financial statements
  - Plan description
  - Plan investments
  - Receivables
  - Allocated insurance contracts excluded from plan assets
  - Reserves
  - Deferred retirement option (DROP) balances
  - Disclosures specific to
    - Single-employer plans
    - Cost-sharing plans

# DBPs – additional reporting considerations

- Required supplementary information (RSI) for single employer and cost sharing plans
  - 10 year schedule of changes in the net pension liability
  - 10 year schedule of the following for each year
    - Total pension liability
    - Plan's fiduciary net position
    - Net pension liability
    - Plan's fiduciary net position as a percent of total pension liability
    - Covered employee payroll
    - Net pension liability as a percent of covered employee payroll
  - 10 year schedule of actuarial determined information
  - 10 year schedule of annual money-weighted return on pension investments



# GASB 67 also addresses

- Measurement of the DBP's net pension liability
  - Detailed considerations relative to the pension liability
- Defined contribution pension plan reporting
  - Required disclosures

# GASB 68 – Accounting and Financial Reporting for Pensions, An amendment of GASB Statement No. 27

- Establishes standards of accounting and financial reporting for defined benefit pensions and defined contribution pensions provided to the employees of state and local governmental employers through pension plans (as defined earlier)
- **Focus is on accounting and reporting by employers for pension plans addressed in GASB 67**

# GASB 68 – basic considerations

- Defined benefit pensions originate from exchanges between the employer and employees resulting from employee services and are part of the total compensation for employee services
- Obligations for pensions meet the definition of a liability in Concepts Statement 4
- Compensation expense should be recognized in the period employee services are provided

# GASB 68 – GASB’s fundamental approach

- View the cost of pensions within the context of an ongoing, career-long employment relationship
- Use an accounting-based versus funding-based approach to measurement
- Produce measures of the employer’s obligation to employees and the current period cost to taxpayers of providing governmental services

# GASB 68 – key GASB conclusions

- An employer is primarily responsible for the unfunded pension obligation resulting from an employment exchange
- The difference between the total pension liability and the plan net position would be reported as a net pension liability in the financial statements of the government

# GASB 68 – major accounting change

- A government employer will report in its financial statements a net pension liability for DBPs equal to the difference between the total pension liability and the value of assets set aside in a pension plan to pay benefits to current employees, retirees and their beneficiaries

# GASB 68 – another major accounting change

- A government participating in a cost-sharing DBP will report a liability in its own financial statements that is equivalent to its long-term proportionate share of the collective net pension liability
  - Approach uses a basis for allocation of proportionate share based on the employer's expected contribution effort relative to that of all contributors

# GASB 68 – yet another major accounting change

- Special funding situations for DBPs
  - Under certain conditions both governmental nonemployer contributing entities and governmental employers will recognize a proportionate share of the collective net pension liability



# GASB 68 – three step approach for measurement DBPs

1. Determine projected benefit payments
2. Discount future payments to determine present value of payments
3. Attribute PV of payment to employee periods of service

*Selection of all actuarial assumptions should be made in accordance with Actuarial Standards of Practice (with consideration of specific guidance provided by the GASB).*

# GASB 68 – actuarial considerations DBPs

- Benefit projections

- The projection of pension benefit payments should include the effects of projected future salary increases and future service credits, if part of the benefits formula, as well as automatic cost of living adjustments (COLAs)
- Ad hoc COLAs would be incorporated into projections of pension benefit payments only if an employer's practice indicates that the COLAs are substantively automatic

# GASB 68 – actuarial considerations DBPs, continued

- Discount rate
  - Should be a single rate that reflects
    - The long-term expected rate of return on plan investments to the extent that
      - Plan net position is projected to be sufficient to make benefit payments that are projected to occur in the period, and
      - Assets are projected to be invested using a long-term investment strategy
    - A high-quality tax exempt municipal bond index rate to the extent that plan net position is projected to no longer be available for long-term investment

# GASB 68 – actuarial considerations DBPs, continued

- Timing and frequency of measurement
  - Recognize a net pension liability that is measured as of a date (the measurement date) no earlier than the *end of its prior fiscal year, consistently applied from period to period*
  - Total pension liability component of the net pension liability at the measurement date is determined either by
    - An actuarial valuation as of that date or
    - The use of update procedures to roll forward amounts to the measurement date from an actuarial valuation as of a date no more than 30 months (plus 1 day) prior to the fiscal year-end
  - A single or agent employer should perform, for financial reporting purposes, actuarial valuations at least biennially
    - More frequent valuations are encouraged

# GASB 68 – measurement DBPs

- Plan net assets
  - In calculating the employer's net pension liability, plan net position should be measured in the same way as measured in the plan's statement of plan net position, including measurement of investments at fair value.
- Pension expense
  - Immediate
  - Deferred

# GASB 68 – expense recognition DBPs

- Immediate
  - Pension benefits earned during the reporting period (service cost or normal cost)
  - Interest cost on the total pension liability
  - Changes in benefit terms that affect the total pension liability
- Deferred
  - Expense would be deferred and recognized over a period equal to the average remaining service periods of active and inactive (including retirees) employees for
    - Differences between expected and actual changes in economic and demographic factors
    - Changes in assumptions about economic and demographic factors
  - Differences between actual and projected earnings on plan investments would be deferred and recognized as pension expense over a five-year, closed period

# GASB 68 – disclosures

- General information
  - Name of the plan through which benefits are provided
  - Identification of the public employee retirement system or other entity that administers the plan
  - Identification of the plan type
  - A brief description of the benefit provisions
  - A brief description of contribution requirements
  - The number of employees covered by the plan
  - Whether the pension plan issues a stand-alone financial report and how to obtain the report

# GASB 68 – disclosures DBPs

- Actuarial information
  - Assumptions used in measurement of pension benefit liability (PBL)
  - Discount rate
    - Assumptions
    - Expected long term rate of return
    - Municipal bond rate
    - Sensitivity analysis
- Also
  - Changes in net pension liability
  - Deferred inflows and outflows



# GASB 68 – required supplementary information (RSI) DBPs

- 10-year schedules for all governments, regardless of type of plan (plus notes)
  - Changes in the net pension liability by source
    - Collective level for cost-sharing employers
  - Components of the net pension liability and ratios:
    - *Plan net position ÷ total pension liability*
    - *Net pension liability ÷ covered-employee payroll*
    - Collective and individual level for cost-sharing
  - Contribution information, if a government has an actuarially determined contribution:
    - *Actuarially calculated contribution – actual contributions*
    - *Contributions ÷ payroll*

# GASB 68 – RSI for cost-sharing employer's DBPs

- 10-year schedules
  - Changes in the net pension liability (cost-sharing at collective level only)
  - Cost-sharing at both collective level and employer level with employer proportionate share percentage
    - Total pension liability, plan net position, net pension liability, and
      - Plan net position as a percentage of the total pension liability
      - Net pension liability as a percentage of covered-employee payroll
    - Statutory/contractual employer contributions, actual contributions made, the difference between them, and contributions made as a percentage of covered-employee payroll

# GASB 68 – audit considerations

- Coordination of efforts and clear division of responsibility between auditor, auditee and actuary
  - Consider nonaudit services and the impact of GAS
- Coordination and communication when participating in cost sharing plans and special funding situations
- Impact of new group audits clarity standard when other (component) auditors are responsible for plans

# Suggested action items

- Determine the type of plan you have (single, agent, cost sharing) and read the appropriate sections of GASB 68 that pertain to your situation.
  - Be sure to review the illustrations in Appendix C.
- Determine if there are any legal requirements to contribute certain actuarially determined amounts to your plan(s).
  - If there are, discuss with your actuary to determine if there are any efficiencies (cost reductions) by engaging a single actuary to prepare all the needed calculations.

# Suggested action items, continued

- Determine the measurement date you plan to use, and discuss it with your actuary. If the actuarial valuation can be performed as of the measurement date, a roll-forward of the actuary's calculation will not be necessary.
  - This should be a simple matter for most single employer plans, but is not as simple for multiple employer plans.

# Suggested action items, continued

- Plan net position is an important component of the net pension liability. Be sure to consider the expected issuance date of plan financial statements when selecting your measurement date.

# Suggested action items, continued

- If you are in a multiple employer plan, try to arrange a meeting of all the employers involved (and the plan's administrator).
  - Discuss the timing and frequency of the actuarial valuation and how (and when) information will be disseminated to each employer.
  - For cost sharing plans, determine the method to be used for calculating proportionate shares. If the actuarial valuation date is before the measurement date, discuss how an individual employer can obtain sufficient detail to enable an independent roll-forward of the calculation (unless this will be provided by the administrator).

# Suggested action items, continued

- If the measurement date and actuarial valuation date will not coincide, determine who will perform the necessary roll-forward. This calculation is a significant estimate, and major changes since the original valuation date could have a material impact on the calculation.
  - Your auditor may be unable (or unwilling) to perform this work. Consider if you will need to engage another actuary to update the original valuation.



# Suggested action items, continued

- Meet with officials of the plan. Assumptions used for plan reporting and employer reporting have to be the same. Agreeing to the assumptions in advance will help eliminate inconsistencies and should reduce the need for your actuaries to re-calculate data.
- Cost sharing plan participants – make sure you understand the contribution requirements as they will significantly impact the “proportionate share” of the liability you will record.
  - Determine how frequently the cost sharing allocations will be reviewed and the manner in which this will take place. Identify and communicate any concerns early in the process.

# Suggested action items, continued

- Meet with your governing body. Discuss the requirements of the new standard, the expected impact on net position, the significant assumptions selected by management, and discuss the level of involvement of other entities (other governments, plan administrators, etc.).
  - In situations in which there may not be a corroborative spirit between management of your entity and management of the plan or other entities, it may be necessary to get members of your governing body to intervene.

# Suggested action items, continued

- Be informed about the impacts of underfunding. A significantly underfunded plan will not go un-noticed by the rating agencies and certain other users of your financial statements.
  - Be prepared to discuss the impact this may have with your governing body. A rating decrease will likely increase your borrowing rate and could make debt issuances less affordable.

# Suggested action items, continued

- If you are responsible for engaging the actuary, meet with them early and make sure they are aware of the requirements of the new standards (both 67 and 68).
  - Determine what they will need from you in order to perform a timely and accurate actuarial valuation.
  - Discuss deadlines, both on your end and theirs.

# Suggested action items, continued

- Meet with your auditors. Discuss your plan for implementing this standard and ask for feedback.
  - Find out what the auditor will require in terms of documentation and support.
  - Provide information about the actuary to be engaged and what you know of their qualifications and professional reputation. Involving the actuary in this meeting would be beneficial.
  - Consider allowing your auditor to evaluate the significant assumptions you plan to use, particularly the long-term rate of return on investments, before the actuary finalizes the calculation.

# Suggested action items, continued

- In addition to the requirements of this standard, there are also new audit standards pertaining to group audits.
  - If your auditor will not be auditing the Plan, determine with your auditor, in advance, what communication and interaction they need to have with the plan auditors (and plan management).
- Draft the new footnotes and RSI. This will likely take a sizeable investment of your time.
  - If you will be asking your auditors (or independent consultants) to prepare this information, discuss what information they will need, the timing of the work, the assistance they can seek from the actuary, and any other concerns pertaining to these non-audit services.

# Next steps

- Read and become familiar with the text of both GASB Standards
- Be on-the-lookout for GASB implementation guidance
- Read McGladrey's whitepaper [GASB Statement No. 68, Accounting and Financial Reporting for Pensions](#)

# Questions



# Thank you for your participation



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