Implementing GASB 67 & 68 for Pensions

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Course Objectives

- To provide a brief overview of GASB 67 & 68 (the "Pension Standards")
- To discuss implementation considerations
- To provide an accounting, auditing, and actuarial perspective of the new standards

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Why the change?

- Existing pension standards had been around more than a decade and GASB research indicated opportunities for significant improvements
- Improve transparency, consistency and comparability of reported pension information

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Defining a "Pension Plan"

- The Pension Standards establish a definition of a pension plan that reflects the primary activities associated with the pension arrangement:
  - Determining pensions,
  - Accumulating and managing assets dedicated for pensions, and
  - Paying benefits to plan members as they become due

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GASB 67

- Financial Reporting for Pension Plans – an amendment of GASB Statement No. 25
- Effective for fiscal years beginning after June 15, 2013
- Restatement Required

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GASB 67 (continued)

- Addresses accounting and financial reporting for **the activities of pension plans** that are administered through trusts that have the following characteristics:
  - Irrevocable contributions
  - Pension plan assets dedicated for benefit payments
  - Pension plan assets legally protected from creditors

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GASB 67 (continued)

- Establishes standards of financial reporting in separately issued financial reports for:
  - Financial Statements
  - Notes to Financial Statements
  - Required Supplementary Information
- Specifies the required approach to measuring the pension liability

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GASB 68

- Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27
- Effective for fiscal years beginning after June 15, 2014
- Restatement Required

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GASB 68 (continued)

- Addresses accounting and financial reporting for **pensions provided by governmental employers through pension plans** that are administered through trusts that have the following characteristics:
  - Irrevocable contributions
  - Pension plan assets dedicated for benefit payments
  - Pension plan assets legally protected from creditors

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GASB 68 (continued)

- Establishes standards for measuring and recognizing
  - Liabilities
  - Deferred outflows/inflows of resources, and
  - Expenses/expenditures

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GASB 68 (continued)

- Identifies the methods and assumptions that should be used to:
  - Project benefit payments,
  - Discount projected benefit payments to their Actuarial Present Value (APV), and
  - Attribute that present value to periods of employee service
    - Entry age actuarial cost method with each period's service cost determined as a level percentage of pay
    - The APV must be attributed to each employee individually

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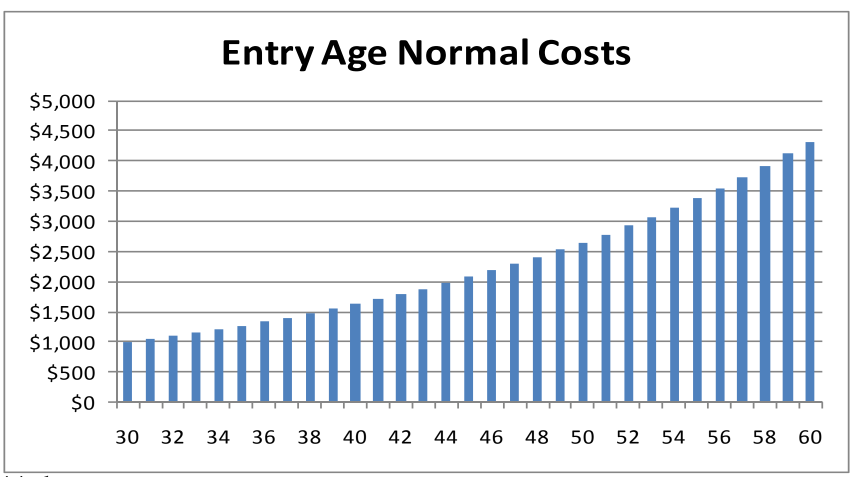
Entry Age Normal Costs



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Implementation Considerations

- New reporting requirements
- No more ARC
- Cost of Living Increases
- Discount Rates
- Expected Insolvency Date
- Deferred Recognition Periods
- Justification for Actuarial Assumptions
- Experience Studies
- Funding Policy

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No More ARC

- Current (GASB 25 & 27) Approach:
  - Unfunded liabilities are amortized as part of the ARC.
  - To the extent that the ARC is funded, these liabilities do not find their way to the balance sheet.
- New (GASB 67 & 68) Approach:
  - Unfunded Liabilities become a balance sheet item.
- Change in liability is immediately recognized or reported as deferred inflow or outflow of resources.

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Basic Components/Terminology

- Total Pension Liability (TPL) is the Actuarial Accrued Liability under the Entry Age Normal actuarial cost method
- Plan Net Position is the fair value of assets (no actuarial smoothing)
- Net Pension Liability is unfunded TPL
- Actuarially Determined Employer Contribution (no guidance on this)

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Cost-of-Living Increases

- Currently, only recognized when granted if ad hoc
- Under new standards, recognized if regularly granted, even if ad hoc, like automatic increases are now

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Discount Rate

- Currently, actuaries use expected rate of return on plan investments
- Under new standards, must use index rate for 20-year, high-quality, tax exempt municipal bonds for benefits payable after fund's expected insolvency date.
- Projected benefits for current plan members
- Projected assets include future employer contributions

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Discount Rate Disclosure

- Long-term expected rate of return and how it was determined:
  - How combined rate of return was developed (assumed asset allocation)
  - Best estimate of long-term expected rate for each major asset class
  - Whether expected rates of return are arithmetic or geometric means
  - Municipal bond rate index and period applied
  - Effect of 1% change (+ or -) in discount rate on current net pension liability

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Expected Insolvency Date

- Theoretically, if the plan makes actuarially required contributions, the plan should never become insolvent.
- We must do the calculations, in any event, to prove this.
- Reasoning behind muni bond rate: will have to borrow money to pay benefits if the fund runs dry.

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Deferred Recognition Periods

- Investment gain/loss: 5 years
- Actuarial gains or loss: expected remaining service period (retired members immediate)
- Changes in actuarial assumptions: expected remaining service period (including retired members)
- Plan benefits: immediate recognition

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Justification of Actuarial Assumptions

- Actuarial assumptions must be justified:
  - "Significant assumptions and other inputs used to measure the total pension liability, including assumptions about inflation, salary changes, and ad hoc postemployment benefit changes (including ad hoc COLAs) should be disclosed."
- How does one justify actuarial assumptions?

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Experience Studies

- Experience studies are required:
  - "The dates of experience studies on which significant assumptions are based also should be disclosed."
- Act 96 (County Pension Law) also requires periodic experience studies:
  - The actuary of the board shall periodically make an actuarial investigation into the mortality and service experience of the contributors to and beneficiaries of the fund

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Funding Policies After the ARC

- PA State Plans (legislative/budget)
- PA Municipal Plans (dictated by Act 205)
- PA County Plans
  - GASB no longer provides funding policy guidelines
  - Regulatory void

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GASB and Funding Policy

- Actuarially Determined Employer Contribution
  - Disclose method and amount, if determined
  - Compare to actual contributions
  - Only basis is actuarial standards of practice
  - "ADEC" is new ARC but not new expense

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Funding Policy vs. Assumptions

- "Right answer" vs. "pure policy"
- Future contributions plus current asset sufficient to fund benefits
- Policy Objectives
  - Reasonable allocation of funding to years of future service
  - Reasonable management and control of future contribution volatility
  - Support public policy goals of accountability and transparency

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Funding Policy Content

- Actuarial cost method
- Asset valuation method
- Amortization methods
  - Assumption changes
  - Benefit changes
- Actuarial assumptions (discount rate)
- Funding target
- Overfunding situations
- Responding to experience
- Risk management and risk sharing

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Objectives of Funding Policy

- Funding long-term costs of promised benefits
- Keeping employer contributions relatively stable
- Allocating pension costs to taxpayers on an equitable basis (intergenerational)
- Managing pension risks

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Reasons to Have a Funding Policy

- Help decision-makers understand tradeoffs related to reaching objectives
- Document underlying reasoning behind decisions
- Help decision-makers understand principles and practices that help sustain benefits over long-term

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Preparing an Implementation Plan

- Areas for consideration
  - Pension Funding Policy
  - Selection of Assumptions
  - Timing of Measurements
  - Timing of Actuarial Valuations
  - Development of Information for Employer Reporting

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QUESTIONS??

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Resources

- GASB.ORG
  - Full Text of Standards
  - Examples
  - Implementation Guide
  - Pension Toolkit

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Acknowledgement

- Certain information contained in this presentation was used with permission from the Conference of Consulting Actuaries.

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