GASB 67/68-Accounting and Financial Reporting for Pensions

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Learning objectives/Agenda

- Understand the implications and impacts of GASB Standards 67 & 68 related to the accounting and financial reporting of pensions
- Components of the pension liability and expense and how calculated
- Audit Issues to Consider
- Bond rating agency's perspective and impact

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

an amendment of GASB Statement No. 27

Highlights

- Scope limited to pensions provided through trusts that meet certain criteria
- Revises recognition, measurement, disclosure requirements for all employers
  - Liability
    - Measured net of pension plan's fiduciary net position
    - Fully recognized in accrual-basis financial statements
  - Changes in the liability
    - Some recognized as expense in the period of the change
    - Others recognized as deferred outflows/inflows of resources with expense recognized over defined future periods
- Effective for FYs beginning after June 15, 2014

Scope & 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 all OPEB
- Applies to employers and nonemployer contributing entities that have a legal obligation to make contributions directly to a pension plan
  - Special funding situations
  - Other circumstances

Defined benefit pensions

- Two potential liabilities

  1. **Liability to the pension plan (payables)**
     - Short-term amounts
       - Example—contributions payable at FYE
     - Long-term amounts
       - Example—installment contract for individual past service liability upon joining a cost-sharing plan
       - Formerly referred to as “pension-related debt”

Defined benefit pensions

- Two potential liabilities (cont.)

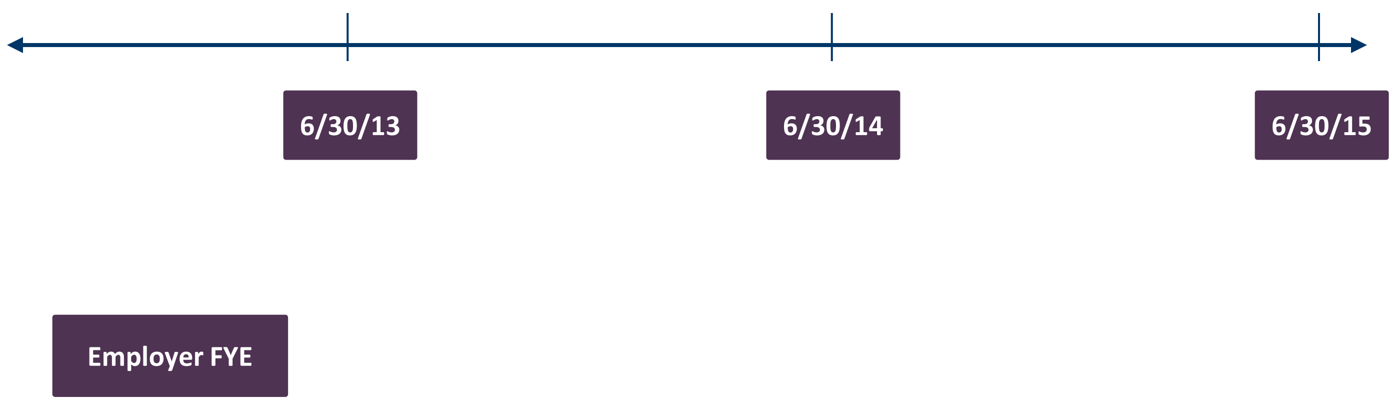
  2. Liability to employees for pensions

  - "Net pension liability" (NPL)
    - Total pension liability (TPL), net of pension 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
    - "Collective NPL" = NPL for all benefits provided through cost-sharing pension plan
  - Single/agent employers recognize 100 percent of NPL
  - Cost-sharing employers recognize proportionate shares of collective NPL

NPL: Measurement—timing

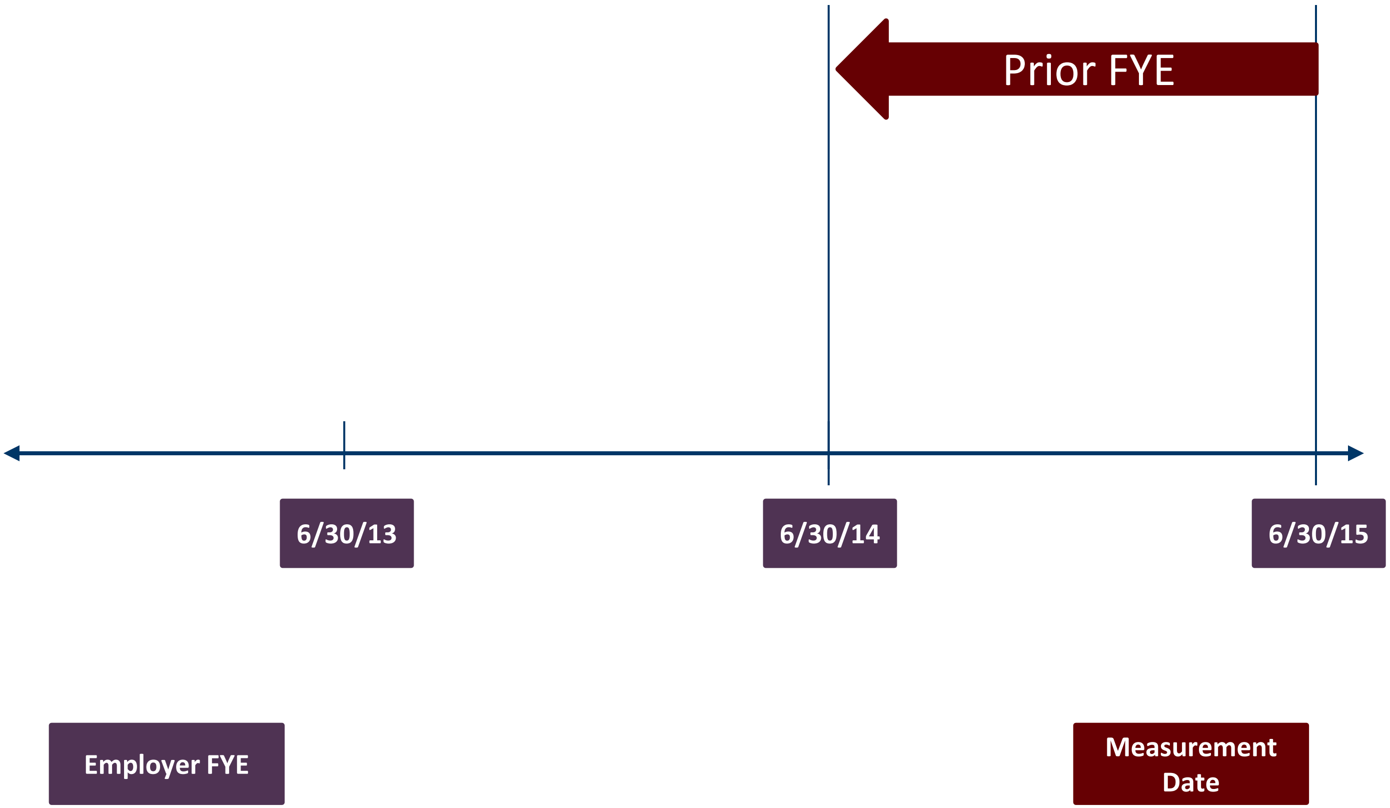
- Potentially 3 different dates
  - FYE
  - Measurement date (of NPL)
    - As of date no earlier than end of prior fiscal year
    - Both components (TPL/plan net position) as of the same date
  - Actuarial valuation date (of TPL)
    - If not measurement date, as of date no more than 30 months (+1 day) prior to FYE
    - Actuarial valuations at least every 2 years (more frequent valuations encouraged)
- Coordination with pension plan

Timing—Example



* obtained from AICPA Audit Quality Center website

Timing—Example



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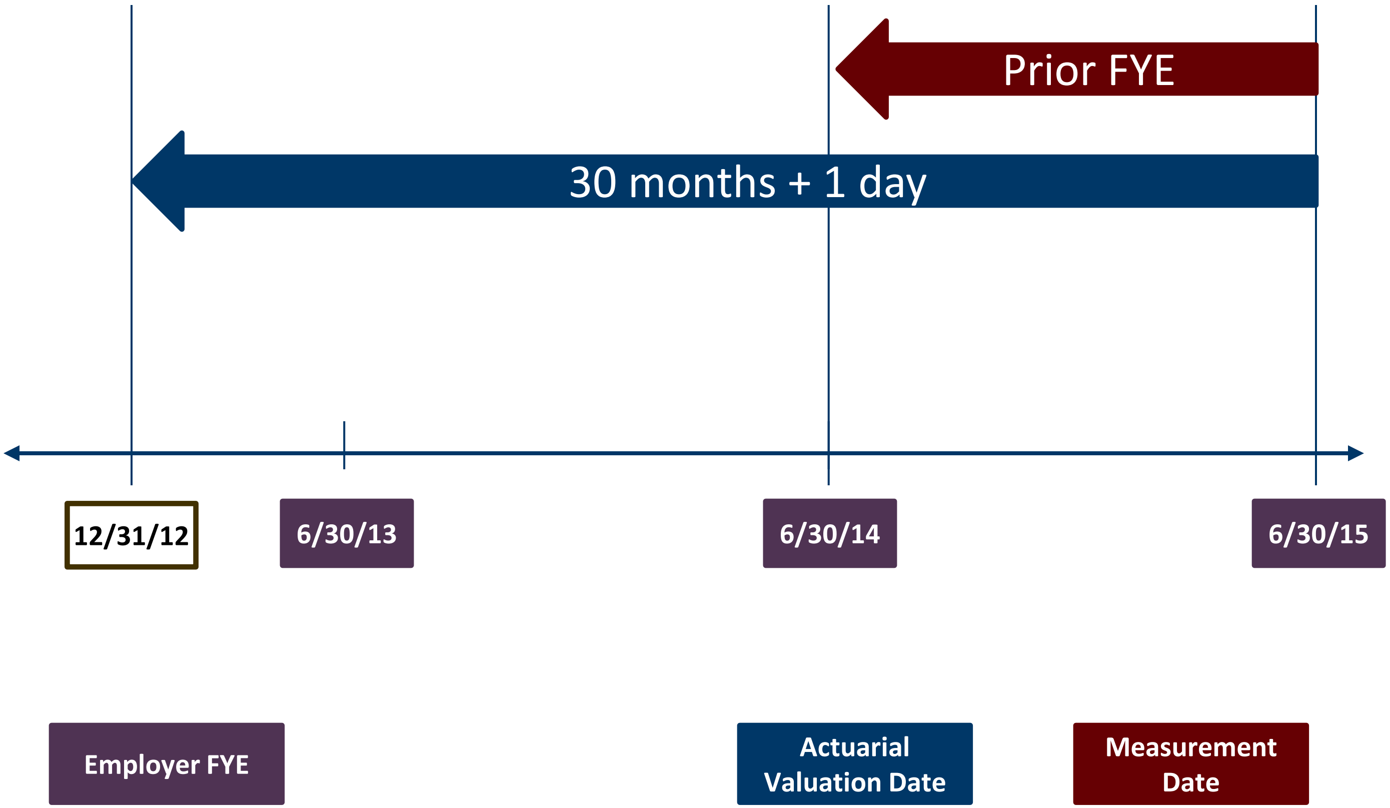
Timing—Example



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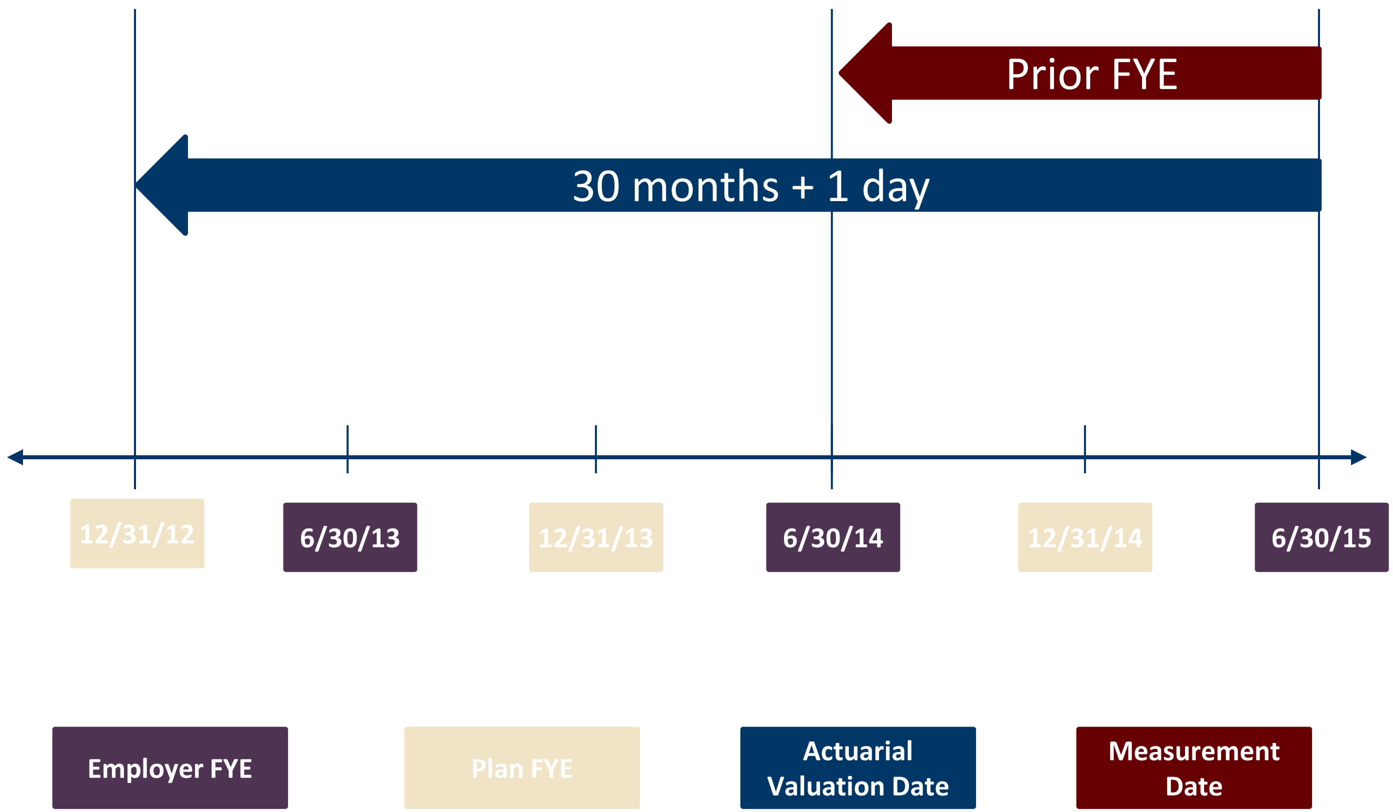
Timing—Example



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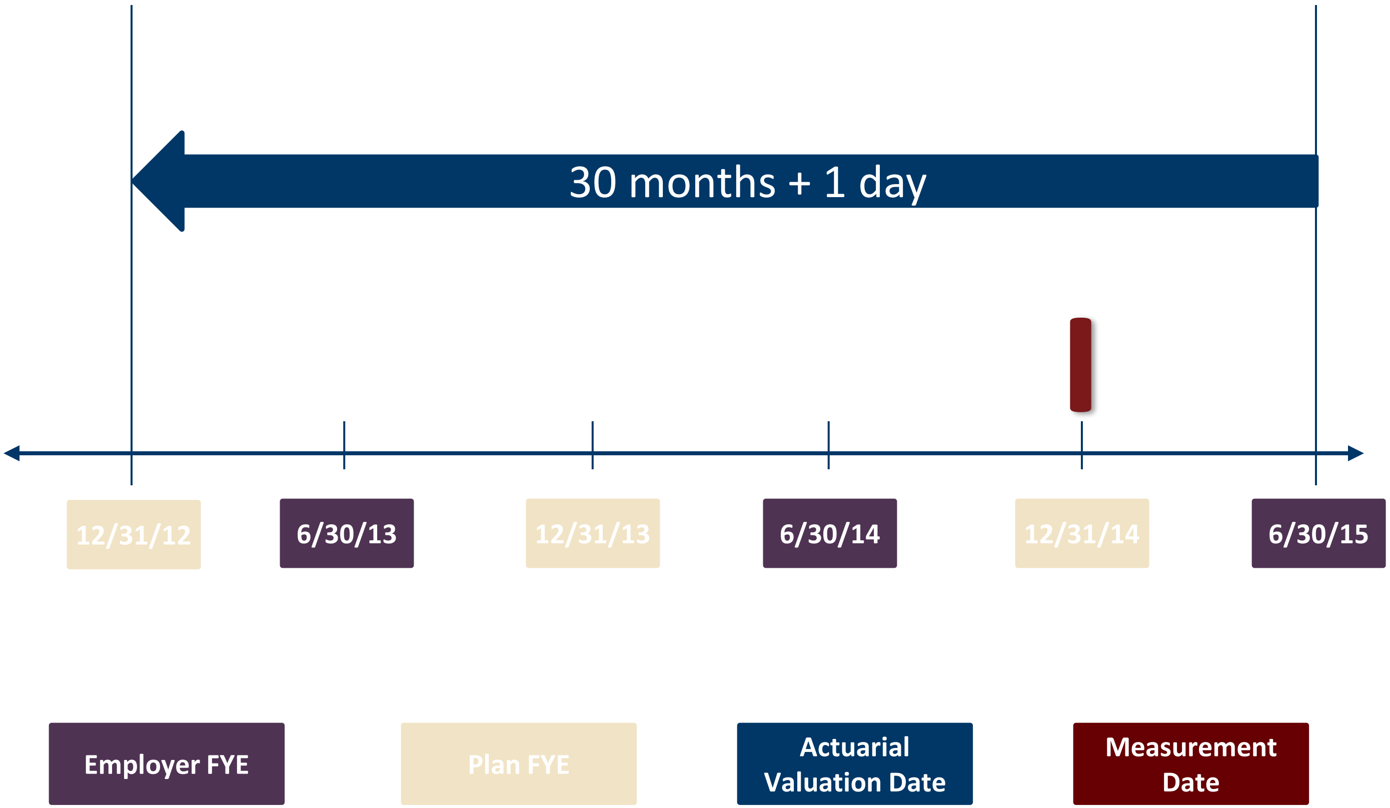
Timing—Example



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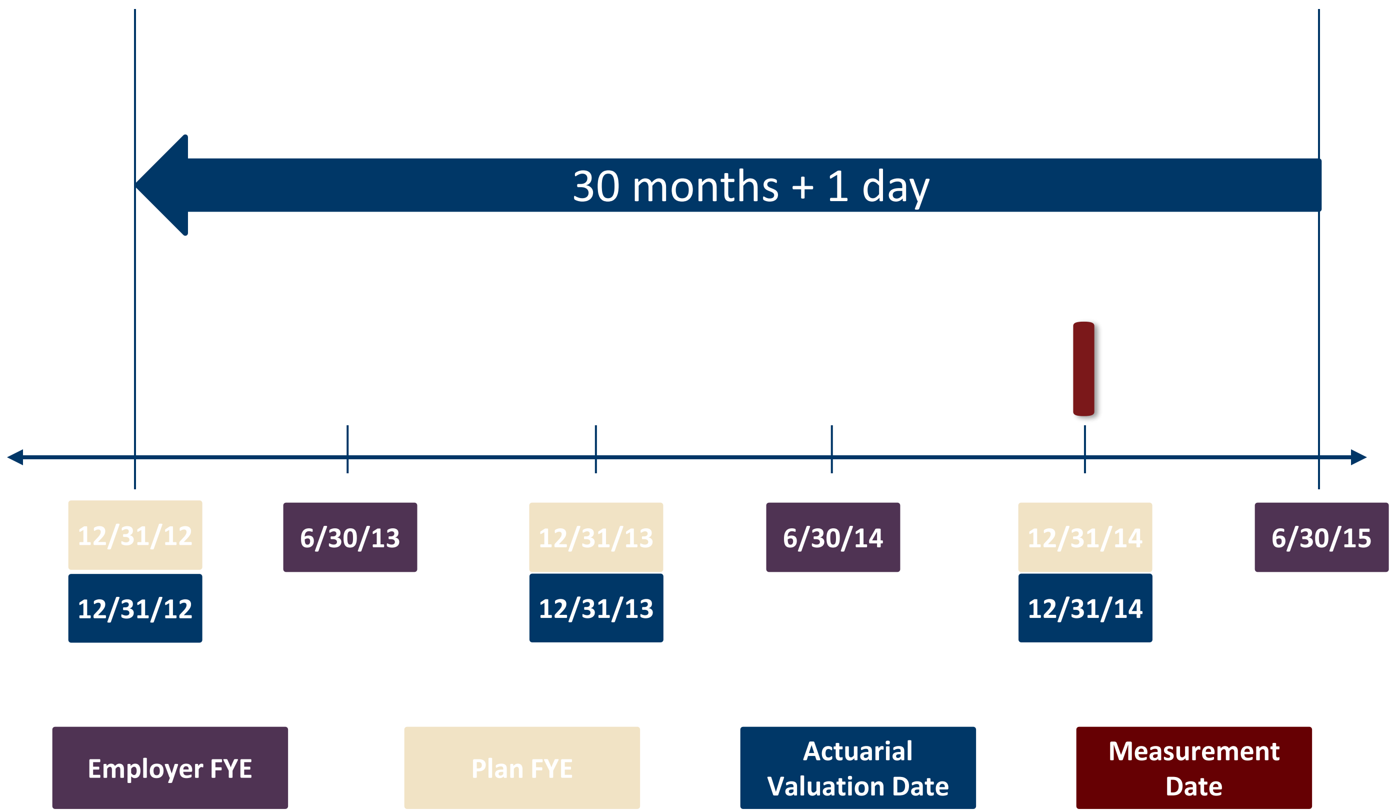
Timing—Example



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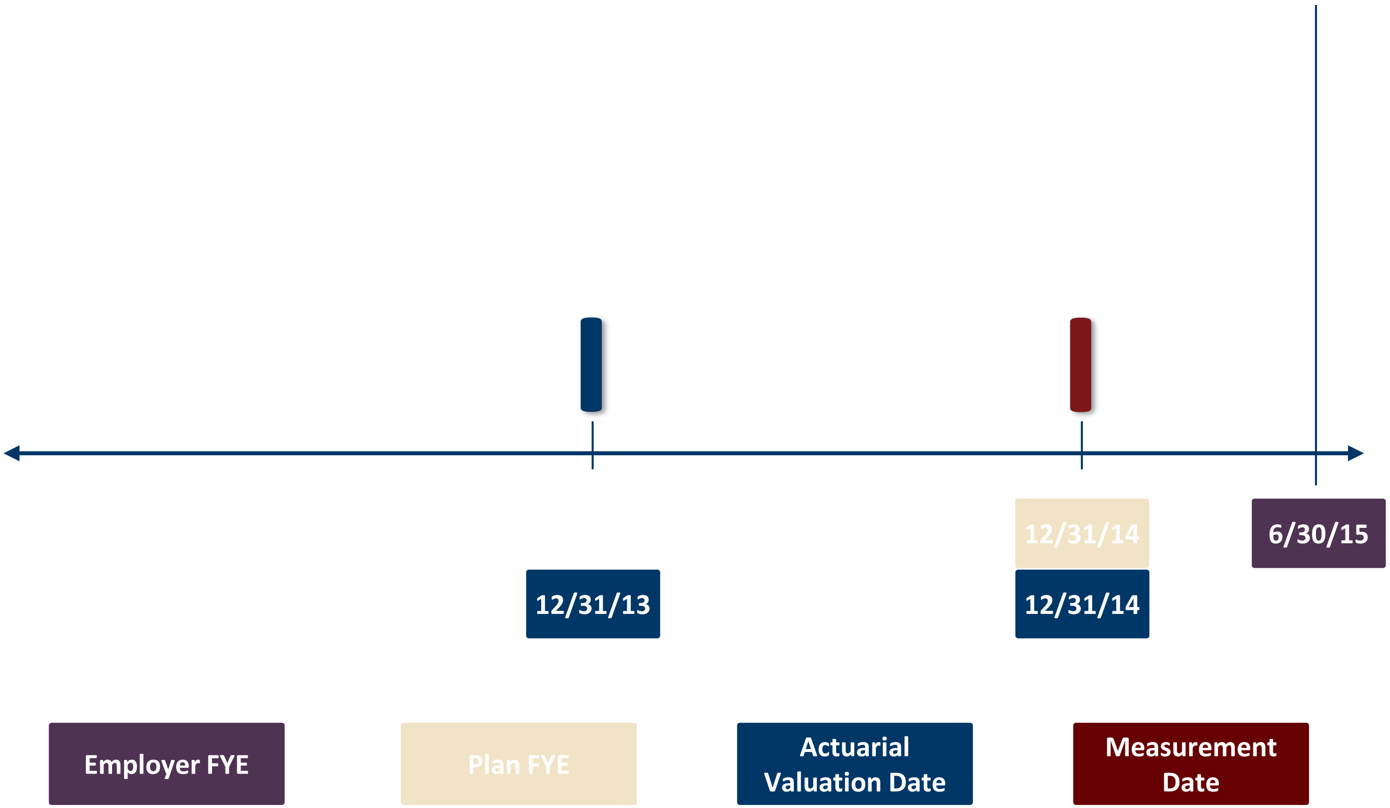
Timing—Example



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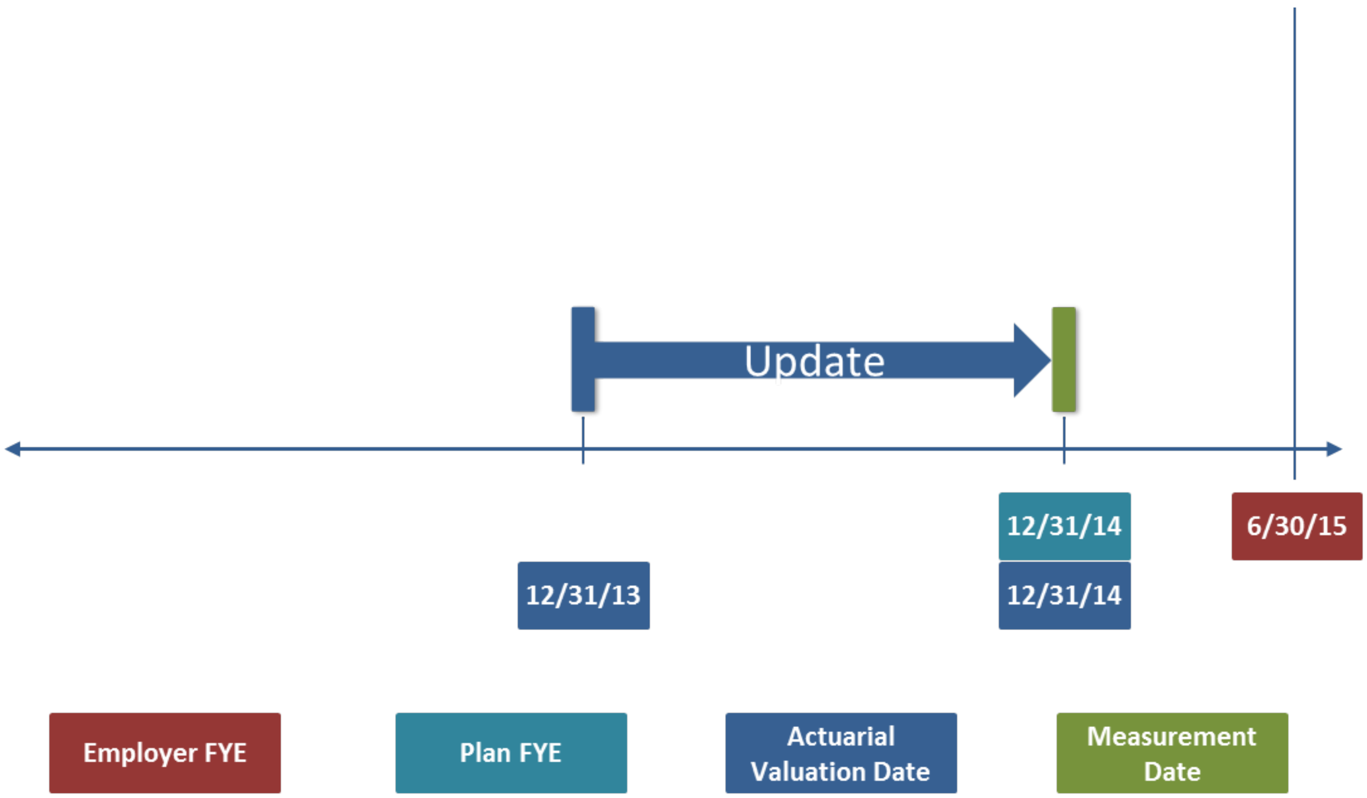
Timing—Example



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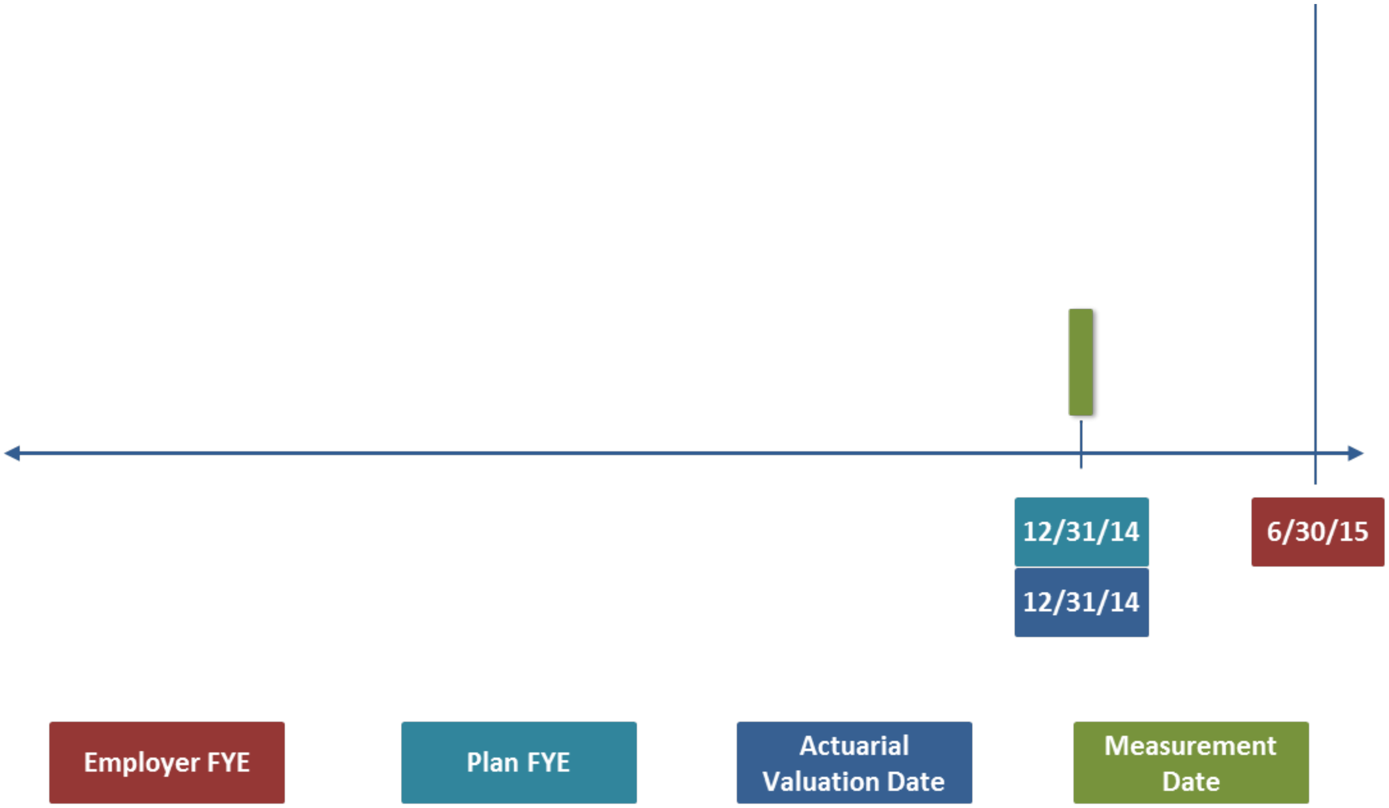
Timing—Example



* obtained from AICPA Audit Quality Center website

NPL: Measurement—general approach

- Three broad steps
  - Project benefit payments
  - Discount projected benefit payments to actuarial present value
  - Attribute actuarial present value to periods
- Methods and assumptions
  - Generally, assumptions in conformity with Actuarial Standards of Practice
  - Fewer alternatives 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

NPL: Measurement—projection

- Benefit terms/agreements at measurement date
- Current active and inactive employees
- Incorporate expectations of:
  - Salary changes
  - Service credits
  - Automatic postemployment benefit changes (including COLAs)
  - Ad hoc postemployment benefit changes *if substantively automatic*

NPL: Measurement—discounting

- Single discount rate
  - Reflects:
    - LTeRoR on pension plan investments, to 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
    - Rate for 20-year, tax-exempt general obligation municipal bonds to extent that conditions for LTeRoR not met

Discount rate—sufficiency of projected plan net position for use of LTeRoR

- Includes:
  - Employer contributions for current and former employees
  - Contributions from current employees
  - Projected investment earnings on projected plan net position
  - Projected benefit payments and administrative expenses
- Does not include:
  - Employer contributions for service costs of future employees
  - Contributions of future employees, unless expected to exceed their own service cost

Discount rate—sufficiency of projected plan net position for use of LTeRoR (cont.)

- Projections of employer contributions
  - Apply professional judgment if amounts established by statute, contract, or formal written policy
    - Consider most recent 5-year contribution history
    - Reflect all known events and conditions
  - In other circumstances, projected contributions limited to average over most recent 5 years
    - May be modified by consideration of subsequent events
    - Basis for average determined through professional judgment

Discount rate—determining the single rate

- Compare projected benefit payments to plan's projected fiduciary net position in each period
- Apply relevant rate to each period's projected benefit payments
- Total the present values of all projected benefit payments
- Calculate single discount rate that results in same present value (if applied to all projected benefit payments) as use of the two rates

Discount rate calculation: Steps

Step 1:

Project benefit payments.

Step 2:

Project plan fiduciary net position.

Discount rate calculation: Steps 1 and 2

Year (a)	Projected Beginning Fiduciary Net Position (b)	Projected Benefit Payments (c)	Projected Benefit Payments: "Funded" Portion of Benefit Payments (d)	Projected Benefit Payments: "Unfunded" Portion of Benefit Payments (e)	Actuarial Present Values of Projected Benefit Payments: Present Value of "Funded" Benefit Payments (f) = (d) ÷ (1 + 7.5%)[a]		Actuarial Present Values of Projected Benefit Payments: Present Value of "Unfunded" Benefit Payments (g) = (e) ÷ (1 + 4%)[a]		Actuarial Present Values of Projected Benefit Payments: Present Value of Benefit Payments Using the Single Discount Rate (h) = (c) ÷ (1 + 5.29%)[a]
1	$ 1,431,956	$ 109,951	$ 109,951	$ -	$ 102,280		$ -		$ 104,427
2	1,500,197	116,500	116,500	-	100,811		-		105,088
3	1,565,686	123,749	123,749	-	99,613		-		106,019
4	1,628,547	131,690	131,690						,154
5	1,687,890	140,229	140,229						,370
6	1,742,722	149,168	149,168						,487
7	1,792,194	158,466	158,466						,468
8	1,835,463	168,332	168,332						,450
9	1,871,402	178,591	178,591						,302
10	1,898,930	189,069	189,069	-	91,735		-		112,918
26	547,880	322,779	322,779	-	49,236		-		84,503
27	316,985	326,326	-	326,326	-		113,175		81,140
28	64,800	328,997	-	328,997	-		109,713		77,694
29	-	330,678	-	330,678	-		106,032		74,168
30	-	331,266	-	331,266	-		102,135		70,567
96	-	1	-	1	-		-		-
97	-	-	-	-	-		-		-
Total					$ 2,109,333	+	$ 1,724,534	=	$ 3,833,867

Future benefit payments (column c) and plan fiduciary net position (column b) are both projected.

* obtained from AICPA Audit Quality Center website

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Discount rate calculation: Step 2 (more detail)

Year	Projected Beginning Fiduciary Net Position (a)	Projected Total Contributions (b)	Projected Benefit Payments (c)	Projected Administrative Expense (d)	Projected Investment Earnings (e)	Projected Ending Fiduciary Net Position (f) = (a) + (b) – (c) – (d) + (e)
1	$ 1,431,956	$ 73,211	$ 109,951	$ 1,000	$ 105,981	$ 1,500,197
2	1,500,197	72,204	116,500	1,030	110,815	1,565,686
3	1,565,686	72,217	123,749	1,061	115,454	1,628,547
4	1,628,547	72,255	131,690	1,093	119,871	1,687,890
5	1,687,890	72,189	140,229	1,126	123,998	1,742,722
6	1,742,722	72,032	149,168	1,160	127,768	1,792,194
7	1,792,194	71,810	158,466	1,195	131,120	1,835,463
8	1,835,463	71,519	168,332	1,231	133,983	1,871,402
9	1,871,402	71,110	178,591	1,268	136,277	1,898,930
10	1,898,930	70,620	189,069	1,306	137,929	1,917,104

- Include only cash flows associated with current employees
- Cash flows from future employees should not be included, unless those employees contribute more than their own service cost.

* obtained from AICPA Audit Quality Center website

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Discount rate calculation: Steps (cont.)

Step 3:

In each period, determine whether plan fiduciary net position is projected to be sufficient to make the benefit payments.

Discount rate calculation: Step 3

Year (a)	Projected Beginning Fiduciary Net Position (b)	Projected Benefit Payments (c)	Projected Benefit Payments: "Funded" Portion of Benefit Payments (d)	Projected Benefit Payments: "Unfunded" Portion of Benefit Payments (e)
1	$ 1,431,956	$ 109,951	$ 109,951	$ -
2	1,500,197	116,500	116,500	-
3	1,565,686	123,749	123,749	-
4	1,628,547	131,690	131,690	-
5	1,687,890	140,229	140,229	-
6	1,742,722	149,168	149,168	-
7	1,792,194	158,466	158,466	-
8	1,835,463	168,332	168,332	-
9	1,871,402	178,591	178,591	-
10	1,898,930	189,069	189,069	-
26	547,880	322,779	322,779	-
27	316,985	326,326	-	326,326
28	64,800	328,997	-	328,997
29	-	330,678	-	330,678
30	-	331,266	-	331,266
96	-	1	-	1
97	-	-	-	-
Total				

Actuarial Present Values of Projected Benefit Payments

Year	Pr "F (f) =		Benefit g the Rate 29%)[a]
1	$		04,427
2			05,088
3			06,019
4			07,154
5			08,370
6			09,487
7			10,468
8			11,450
9			12,302
10			12,918
26			84,503
27			81,140
28			77,694
29			74,168
30			70,567
96	-	-	-
97	-	-	-
Total	$ 2,109,333 +	$ 1,724,534 =	$ 3,833,867

Each year's projected benefit payments (column c) are compared to projected beginning plan fiduciary net position (column b) and are assigned to one of two benefit payment streams (columns d and e) depending upon whether plan fiduciary net position is projected to be sufficient to make the benefit payments.

* obtained from AICPA Audit Quality Center website

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Discount rate calculation: Step 3 (cont.)

Year (a)	Projected Beginning Fiduciary Net Position (b)	Projected Benefit Payments (c)	Projected Benefit Payments: "Funded" Portion of Benefit Payments (d)	Projected Benefit Payments: "Unfunded" Portion of Benefit Payments (e)	Actuarial Present Values of Projected Benefit Payments: Pres… "Fu… (f) = (d…	Actuarial Present Values of Projected Benefit Payments	Actuarial Present Values of Projected Benefit Payments: Present Value of Benefit …nts Using the …iscount Rate …÷ (1 + 5.29%)^(a)
1	$ 1,431,956	$ 109,951	$ 109,951	$ -	$		104,427
2	1,500,197	116,500	116,500	-			105,088
3	1,565,686	123,749	123,749	-			106,019
4	1,628,547	131,690	131,690	-			107,154
5	1,687,890	140,229	140,229	-			108,370
6	1,742,722	149,168	149,168	-			109,487
7	1,792,194	158,466	158,466	-			110,468
8	1,835,463	168,332	168,332	-			111,450
9	1,871,402	178,591	178,591	-			112,302
10	1,898,930	189,069	189,069	-			112,918
26	547,880	322,779	322,779	-			84,503
27	316,985	326,326	-	326,326			81,140
28	64,800	328,997	-	328,997			77,694
29	-	330,678	-	330,678			74,168
30	-	331,266	-	331,266			70,567
96	-	1	-	1			-
97	-	-	-	-	-	-	-
Total					$ 2,109,333 +	$ 1,724,534 =	$ 3,833,867

In this example, projected beginning plan fiduciary net position is greater than projected benefit payments through year 26. Therefore, those projected benefit payments are assigned to the "funded" benefit payment stream in column d.

* obtained from AICPA Audit Quality Center website

Discount rate calculation: Step 3 (cont.)

			Projected Benefit Payments		Actuarial Present Values of Projected Benefit Payments		
Year (a)	Projected Beginning Fiduciary Net Position (b)	Projected Benefit Payments (c)	"Funded" Portion of Benefit Payments (d)	"Unfunded" Portion of Benefit Payments (e)	Present Value of (f)	Present Value of	Present Value of Benefit Payments Using the Single Discount Rate (c) ÷ (1 + 5.29%)[a]
1	$ 1,431,956	$ 109,951	$ 109,951	$ -	$		104,427
2	1,500,197	116,500	116,500	-			105,088
3	1,565,686	123,749	123,749	-			106,019
4	1,628,547	131,690	131,690	-			107,154
5	1,687,890	140,229	140,229	-			108,370
6	1,742,722	149,168	149,168	-			109,487
7	1,792,194	158,466	158,466	-			110,468
8	1,835,463	168,332	168,332	-			111,450
9	1,871,402	178,591	178,591	-			112,302
10	1,898,930	189,069	189,069	-			112,918
26	547,880	322,779	322,779	-			84,503
27	316,985	326,326	-	326,326			81,140
28	64,800	328,997	-	328,997			77,694
29	-	330,678	-	330,678			74,168
30	-	331,266	-	331,266			70,567
96	-	1	-	1	-	-	-
97	-	-	-	-	-	-	-
Total					$ 2,109,333 +	$ 1,724,534 =	$ 3,833,867

In year 27, the total of projected benefit payments exceeds projected beginning plan fiduciary net position. Beginning in that year, projected benefit payments are assigned to the "unfunded" benefit payment stream in column e.

* obtained from AICPA Audit Quality Center website

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Discount rate calculation: Steps (cont.)

Step 4:

Calculate the present value of each period's projected benefit payments using the relevant rate.

Discount rate calculation: Step 4

	Projected Benefit Payments		Actuarial Present Values of Projected Benefit Payments		
	"Funded" Portion of Benefit Payments (d)	"Unfunded" Portion of Benefit Payments (e)	Present Value of "Funded" Benefit Payments (f) = (d) ÷ (1 + 7.5%)[a]	Present Value of "Unfunded" Benefit Payments (g) = (e) ÷ (1 + 4%)[a]	Present Value of Benefit Payments Using the Single Discount Rate (h) = (c) ÷ (1 + 5.29%)[a]
	$ 109,951	$ -	$ 102,280	$ -	$ 104,427
	116,500	-	100,811	-	105,088
	123,749	-	99,613	-	106,019
	131,690	-	98,610	-	107,154
	140,229	-	97,678	-	108,370
	149,168	-	96,655	-	109,487
	158,466	-	95,516	-	110,468
	168,332	-	94,384	-	111,450
	178,591	-	93,150	-	112,302
	189,069	-	91,735	-	112,918
	322,779	-	49,236	-	84,503
	-	326,326	-	113,175	81,140
	-	328,997	-	109,713	77,694
	-	330,678	-	106,032	74,168
	-	331,266	-	102,135	70,567
	-	1	-	-	-
	-	-	-	-	-
Total			$ 2,109,333 +	$ 1,724,534 =	$ 3,833,867

The present values of projected benefit payments in the "funded" payment stream are calculated using the long-term eROR.

* obtained from AICPA Audit Quality Center website

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Discount rate calculation: Step 4 (cont.)

			Projected Benefit Payments		Actuarial Present Values of Projected Benefit Payments		
Year (a)	Projected Beginning Fiduciary Net Position	Projected Benefit Payments	"Funded" Portion of Benefit Payments	"Unfunded" Portion of Benefit Payments (e)	Present Value of "Funded" Benefit Payments (f) = (d) ÷ (1 + 7.5%)[a]	Present Value of "Unfunded" Benefit Payments (g) = (e) ÷ (1 + 4%)[a]	Present Value of Benefit Payments Using the Single Discount Rate (h) = (c) ÷ (1 + 5.29%)[a]
1	$		9,951	$ -	$ 102,280	$ -	$ 104,427
2			6,500	-	100,811	-	105,088
3			3,749	-	99,613	-	106,019
4			1,690	-	98,610	-	107,154
5			0,229	-	97,678	-	108,370
6			9,168	-	96,655	-	109,487
7			8,466	-	95,516	-	110,468
8			8,332	-	94,384	-	111,450
9			8,591	-	93,150	-	112,302
10			9,069	-	91,735	-	112,918
26			2,779	-	49,236	-	84,503
27			-	326,326	-	113,175	81,140
28			-	328,997	-	109,713	77,694
29			-	330,678	-	106,032	74,168
30			-	331,266	-	102,135	70,567
96	-	1	-	1	-	-	-
97	-	-	-	-	-	-	-
Total					$ 2,109,333 +	$ 1,724,534 =	$ 3,833,867

The present values of projected benefit payments in the "unfunded" payment stream are calculated using the bond index rate.

* obtained from AICPA Audit Quality Center website

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Discount rate calculation: Steps (cont.)

Step 5:

Calculate the sum of:

(a) the present values of projected benefit payments discounted using the LTeRoR

(b) the present values of projected benefit payments discounted using the bond index rate.

Discount rate calculation: Step 5

			Projected Benefit Payments		Actuarial Present Values of Projected Benefit Payments		
Year (a)	Projected Beginning Fiduciary Net Position (b)	Projected Benefit Payments (c)	"Funded" Portion of Benefit Payments (d)	"Unfunded" Portion of Benefit Payments (e)	Present Value of "Funded" Benefit Payments (f) = (d) ÷ (1 + 7.5%)[(a)]	Present Value of "Unfunded" Benefit Payments (g) = (e) ÷ (1 + 4%)[(a)]	Present Value of Benefit Payments Using the Single Discount Rate (h) = (c) ÷ (1 + 5.29%)[(a)]
1	$ 1,431,956	$ 109,951	$ 109,951	$ -	$ 102,280	$ -	$ 104,427
2	1,500,197	116,500	116,500	-	100,811	-	105,088
3	1,565,686	123,749	123,749	-	99,613	-	106,019
4	1,628,547	131,690	131,690	-	98,610	-	107,154
5	1,687,890	140,229	140,229	-	97,678	-	108,370
6	1,742,722	149,168	149,168	-	96,655	-	109,487
7	1,792,194	158,466	158,466	-	95,516	-	110,468
8	1,835,463	168,332	168,332	-	94,384	-	111,450
9	1,871,402	178,591	178,591	-	93,150	-	112,302
10	1,898,930	189,069	[illegible]	[illegible]	[illegible]	[illegible]	112,918
26	547,880	322,779	[illegible]	[illegible]	[illegible]	[illegible]	84,503
27	316,985	326,326	[illegible]	[illegible]	[illegible]	[illegible]	81,140
28	64,800	328,997	[illegible]	[illegible]	[illegible]	[illegible]	77,694
29	-	330,678	[illegible]	[illegible]	[illegible]	[illegible]	74,168
30	-	331,266	-	331,266	-	102,135	70,567
96	-	1	-	1	-	-	-
97	-	-	-	-			
Total					$ 2,109,333 +	$ 1,724,534 =	$ 3,833,867

The sum of the present values of the two benefit payment streams is calculated.

* obtained from AICPA Audit Quality Center website

Discount rate calculation: Steps (cont.)

Step 6:

Determine the single discount rate that, if applied to all projected benefit payments, will result in a present value equal to the result of step 5.

Discount rate calculation: Step 6

Year (a)	Projected Beginning Fiduciary Net Position (b)	Projected Benefit Payments (c)	"Funded" Portion of Benefit Payments (d)	"Unfunded" Portion of Benefit (e)	Present Value of "Funded" Benefit (f)	Present Value of "Unfunded" Benefit (g)	Present Value of Benefit Payments Using the Single Discount Rate (h) = (c) ÷ (1 + 5.29%)[a]
			Projected Benefit Payments		Actuarial Present Values of Projected Benefit Payments		
1	$ 1,431,956	$ 109,951	$ 109,9			-	$ 104,427
2	1,500,197	116,500	116,5			-	105,088
3	1,565,686	123,749	123,7			-	106,019
4	1,628,547	131,690	131,6			-	107,154
5	1,687,890	140,229	140,2			-	108,370
6	1,742,722	149,168	149,1			-	109,487
7	1,792,194	158,466	158,4			-	110,468
8	1,835,463	168,332	168,3			-	111,450
9	1,871,402	178,591	178,5			-	112,302
10	1,898,930	189,069	189,0			-	112,918
26	547,880	322,779	322,7			-	84,503
27	316,985	326,326	-	326,326	-	113,175	81,140
28	64,800	328,997					77,694
29	-	330,678	-	330,678		106,032	74,168
30	-	331,266	-			102,135	70,567
96	-	1	-			-	-
97	-	-	-			-	-
Total					$ 2,109,333 +	$ 1,724,534 =	$ 3,833,867

Through a process of interpolation, the single discount rate is determined such that, when applied to the projected benefit payments in column c, the result is the same present value as the sum of columns f and g.

In this example, that rate is 5.29%.

* obtained from AICPA Audit Quality Center website

NPL: Measurement—attribution

- Single method
  - Entry age actuarial cost method
  - Level percentage of pay
- Individually applied
- Beginning = 1st period of benefit accrual
- Ending = Expected retirement
  - DROPs—entry date into DROP = retirement date
- Same benefit terms to determine service cost as to determine actuarial present value of projected benefit payments

Changes in NPL

- Calculated from measurement date to measurement date ("measurement period")

NPL recognized in current reporting period

(NPL recognized in prior reporting period)

Change in NPL for current reporting period

Changes in NPL

- Recognize most changes as expense in full in reporting period of change
  - Examples: service cost, interest on TPL, effects of benefit changes, projected earnings on pension plan investments
- Exceptions:
  - Differences between expected and actual experience (TPL)
  - Changes of assumptions (TPL)
  - Difference between projected and actual earnings on pension plan investments
  - Employer contributions

Changes in NPL—TPL exceptions

- Expense recognized in current and future periods
  - Systematic and rational method
  - Closed period
  - Average of expected remaining service lives of all employees (active and inactive, including retirees)
- Portion not recognized in expense = deferred outflow of resources/deferred inflow of resources related to pensions

Changes in NPL—investment earnings exception

- Expense recognized in current and future periods
  - Systematic and rational method
  - Closed, 5-year period
- Portion not recognized in expense = deferred outflow of resources/deferred inflow of resources related to pensions
- Report net deferred outflow of resources/deferred inflow of resources from this source

NPL: Employer contributions

- During the measurement period
  - Directly reduce NPL (no expense impact)
- Subsequent to measurement date
  - Deferred outflow of resources related to pensions
  - Directly reduce NPL in next reporting period (no expense impact)

NPL: Cost-sharing employers

- Recognize proportionate shares of collective NPL, pension expense, deferred outflows of resources/ deferred inflows of resources
- Proportion (%)
  - Relationship of the employer to the total of all contributing entities
  - Basis required to be consistent with assessed contributions
  - Consider separate rates related to separate portions of collective NPL
  - Use of relative long-term projected contribution effort encouraged

NPL: Cost-sharing employers (cont.)

- Calculation of the employer's proportionate shares
  - Collective measure x proportion

	Collective Measure	Employer's Proportion	Employer's Proportionate Share
NPL	$7,455,024	2%	$149,100
Deferred Outflows of Resources	$2,185,968	2%	$43,719
Deferred Inflows of Resources	$1,229,826	2%	$24,597
Pension Expense	$1,162,654	2%	$23,253

* obtained from AICPA Audit Quality Center website

NPL: Cost-sharing employers—additional considerations

- Potentially three items
  1. Net effect of change in proportion
  2. Difference between:
     - 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

NPL: Cost-sharing employers—additional considerations (cont.)

- Calculation of the change in proportion

	NPL	Deferred Outflows of Resources	Deferred Inflows of Resources
Beginning balance collective measure	$7,455,024	$2,185,968	$1,229,826
Employer's proportionate share (current year) @ 2.5%	$186,376	$54,649	$30,746
Employer's proportionate share (prior year) @ 2%	$149,100	$43,719	$24,597
Increase in beginning balance	$37,276	$10,930	$6,149
Net effect (increase in deferred outflows of resources)		$32,495	

* obtained from AICPA Audit Quality Center website

NPL: Cost-sharing employers—additional considerations (cont.)

- Difference between proportionate share of collective contributions and employer's actual contributions

Total employer contributions (as recognized by plan)	$1,004,730

Employer's proportionate share of total employer contributions (@ 2.5%)	$25,118
Employer's actual contributions	22,018
Difference (increase in deferred inflows of resources)	$ 3,100

* obtained from AICPA Audit Quality Center website

NPL: Cost-sharing employers—additional considerations (cont.)

- Expense impact of changes in proportion and contribution-related differences
  - In current and future periods
  - Systematic/rational method
  - Closed period = average of expected remaining service lives (actives and retirees)
- Employer contributions subsequent to measurement date
  - Deferred outflow of resources in current period
  - Reduction of collective NPL in next period (part of comparison of actual contributions to share of collective contributions)

Example Implementation Year Journal Entry & FS Presentation for Employer – Cont'd

Changes in Net Pension Liability

	Increase (Decrease)		
	TPL (a)	**PNP (b)**	**NPL (a)-(b)**
Balances --at 12/31/2014	$ 2,853,455	$ 2,052,589	$ 800,866
Changes for the year:			
Service Cost	75,864		75,864
Interest	216,515		216,515
Difference between expected			-
and actual experience	(37,539)		(37,539)
Contributions- Employer		79,713	(79,713)
Contributions- Member		31,451	(31,451)
Net investment income		196,154	(196,154)
Benefits paid	(119,434)	(119,434)	-
Plan administrative expenese		(3,373)	3,373
Other		8	(8)
Net changes	135,406	184,519	(49,113)
Balances --at 12/31/2015	$ 2,988,861	2,237,108	751,753

* obtained from AICPA Audit Quality Center website

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Example Implementation Year Journal Entry & FS Presentation for Employer – Cont'd

JE 1

	DR	CR
Net position	800,866	
Pension expense	130,645	
Deferred inflow-expected v. actual		35,036
Deferred inflow-invest		36,923 **1**
Other admin	3,365	
Contributions		111,164
NPL		751,753
	934,876	934,876

Pension expense:	
Service cost	75,864
Interest on liability	216,515
Expected ret.	(150,000)
Experience change	(2,503)
Smoothing interest	(9,231)
	130,645

Projected earnings were:	150,000	
Differences between expected		
actual experience	(37,539)	Amortized over 15 years (expected remaining service lives of all employees, active and inactive)
Contributions after measurement date	45,645	

1 - Difference between projected earnings and net investment income amortized over 5 years.

* obtained from AICPA Audit Quality Center website

Example Implementation Year Journal Entry & FS Presentation for Employer – Cont'd

LOCAL AGENCY
STATEMENT OF NET POSITION
December 31, 2015

	BEFORE	AFTER
ASSETS		
Cash deposits	$ 87,749	$ 87,749
Investments	966,970	966,970
Receivables	1,053,321	1,053,321
Capital assets, being depreciated (net of accumulated depreciation)	1,016,526	1,016,526
Total assets	3,124,566	3,124,566
Deferred outflows of resources		
District contributions subsequent to measurement date	-	45,645
Total deferred outflows of resources	-	45,645
LIABILITIES		
Accounts payable and accrued expneses	19,909	19,909
Long-term liabilities:		
Due within more than one year	22,117	773,870
Total liabilities	42,026	793,779
Deferred inflows of resources		
Differences between expected and actual experience	-	35,036
Difference between projected and actual earnings on pension plan	-	36,923
Total deferred inflows of resources	-	71,959
NET POSITION		
Net investment in capital assets	1,016,526	1,016,526
Unrestricted	2,066,014	1,287,947
Total net position	$ 3,082,540	$ 2,304,473

* obtained from AICPA Audit Quality Center website

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Example Implementation Year Journal Entry & FS Presentation for Employer – Cont'd

Deferred inflows/outflows of resources

	Deferred Outflows of Resources	Deferred inflows of Resources
Differences between expected and actual experience in the measurement of the TPL	-	35,036.00
Changes in assumptions	-	-
Net difference between projected and actual earnings on pension plan invesments	-	36,923.00
Changes in employer's proportion	-	-
Contribution to pension plan after measurement date	45,645	-
Total	45,645	71,959

$45,645 reported as deferred outflows of resources related to pensions resulting from District contributions subsequent to the measurement date will be recognized as a reduction of the NPL in the year ended December 31, 2016. Other amounts reported as deferred inflows of resources related to pensions will be recognized in pension expense as follows.

Year ended December 31:

2016	(11,734)
2017	(11,734)
2018	(11,734)
2019	(11,734)
2020	(2,503)
Thereafter	(22,520)

* obtained from AICPA Audit Quality Center website

NPL: 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)

NPL: Involvement of nonemployer contributing entities (cont.)

- Statement addresses those with legal requirement to contribute *directly to* the pension plan (cont.)
  - Not special funding
    - Employer
      - Follows applicable requirements for single, agent, or cost-sharing employer
      - Recognizes revenue equal to change in NPL from contributions from nonemployer contributing entities
    - Nonemployer entity classifies expense for contributions in same manner as similar grants to other entities

NPL: Note disclosures—employers

- Descriptive information
  - Type of plan, identification of administrator
  - Benefit terms—types of benefits, key elements of benefit formula, classes of employees covered, legal authority
  - Contributions—basis, authority, rates ($ or % of pay), contributions in reporting period
  - Availability of plan report
- Significant assumptions/other inputs in TPL
  - Inflation, salary changes, postemployment benefit changes, mortality assumptions, dates of experience studies
  - Discount rate—rate, assumptions re: cash flows, how LTeRoR determined, municipal bond rate (if applicable), periods to which each rate applied, assumed asset allocation/expected real rates of return, NPL at discount rate +/- 1%

Discount rate disclosures—example

(without LTeRoR description & asset allocation information)

Discount rate. The discount rate used to measure the total pension liability was 7.75 percent. The projection of cash flows used to determine the discount rate assumed that employee contributions will be made at the current contribution rate and that contributions from school districts will be made at contractually required rates, actuarially determined. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

Sensitivity of the City's proportionate share of the net pension liability to changes in the discount rate. The following presents the City's proportionate share of the net pension liability calculated using the discount rate of 7.75 percent, as well as what the City's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (6.75 percent) or 1-percentage-point higher (8.75 percent) than the current rate:

	1% Decrease (6.75%)	Current Discount Rate (7.75%)	1% Increase (8.75%)
City's proportionate share of the net pension liability	$ 16,476	$ 14,910	$ 13,091

* obtained from AICPA Audit Quality Center website

NPL: Note disclosures—employers (cont.)

- Info re: pension plan’s fiduciary net position or reference to plan report
- Measurement date, actuarial valuation date
- Changes of assumptions/other inputs and changes of benefit terms
- Changes subsequent to measurement date

NPL: Note disclosures—employers (cont.)

- Pension expense in current reporting period
- Deferred outflows/deferred inflows of resources
  - Balances by source
  - Net impact on pension expense in each of the next 5 years and thereafter in the aggregate
  - Amount that will be reduction of NPL

Expense and deferred outflows/inflows of resources disclosures—example

For the year ended December 31, 20X9, the City recognized pension expense of $2,395. At December 31, 20X9, the City reported deferred outflows of resources and deferred inflows of resource related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	$ 2,657	$ 142
Changes of assumptions	1,714	130
Net difference between projected and actual earnings on pension plan investments	—	2,188
Changes in proportion and differences between City contributions and proportionate share of contributions	747	153
City contributions subsequent to the measurement date	1,065	—
Total	$ 6,183	$ 2,613

$1,065 reported as deferred outflows of resources related to pensions resulting from City contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended December 31, 20Y0. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as shown at right:

Year ended December 31:	
20Y0	$ (269)
20Y1	161
20Y2	217
20Y3	545
20Y4	551
Thereafter	1,300

* obtained from AICPA Audit Quality Center website

Note disclosures (NPL)—employers (cont.)

- Single/agent only
  - Number of employees covered—inactive receiving benefits, inactive not receiving benefits, active
  - Allocated insurance contracts
  - Schedule of changes in NPL by source for current period
    - Service cost, interest, benefit changes, contributions by source, plan investment income, etc.
    - If special funding situation:
      - Amounts in schedule for collective NPL
      - Nonemployer contributing entity's proportionate share (amount) of collective NPL
      - Employer's proportionate share of collective NPL

Changes in NPL by source—example

	Increase (Decrease)		
	Total Pension Liability (a)	**Plan Fiduciary Net Position (b)**	**Net Pension Liability (a) – (b)**
Balances at 6/30/X8	$ 2,853,455	$ 2,052,589	$ 800,866
Changes for the year:			
Service cost	75,864		75,864
Interest	216,515		216,515
Differences between expected and actual experience	(37,539)		(37,539)
Contributions—employer		79,713	(79,713)
Contributions—employee		31,451	(31,451)
Net investment income		196,154	(196,154)
Benefit payments, including refunds of employee contributions	(119,434)	(119,434)	-
Administrative expense		(3,373)	3,373
Other changes		8	(8)
Net changes	135,406	184,519	(49,113)
Balances at 6/30/X9	$ 2,988,861	$ 2,237,108	$ 751,753

* obtained from AICPA Audit Quality Center website

Note disclosures (NPL)—employers (cont.)

- Cost-sharing only
  - Employer's proportion, basis for proportion, change in proportion
  - Employer's proportionate share (amount) of collective NPL
    - If special funding situation:
      - Nonemployer contributing entity's proportionate share
      - Total of employer's and nonemployer entity's proportionate shares

NPL: RSI—single/agent employers

- 10-year schedules
  - Changes in NPL by source
  - TPL, pension plan fiduciary net position, NPL, plan net position as % of TPL, covered-employee payroll, NPL as % of covered-employee payroll
    - May be presented with changes in NPL by source
  - If actuarially determined employer contribution (ADEC)
    - ADEC, contributions in relation to the ADEC, difference, covered-employee payroll, contributions as % of covered-employee payroll
  - If no ADEC, but statutory or contractual contribution requirements, schedule similar to ADEC schedule
- Notes to RSI with methods and assumptions for ADEC and significant changes

NPL: RSI—cost-sharing employers

- 10-year schedules
  - Employer's proportion (%), proportionate share (amount) of collective NPL, covered-employee payroll, proportionate share as % of covered-employee payroll, pension plan's net position as % of TPL
    - If special funding situation, also (1) nonemployer contributing entity's proportionate share and (2) total of employer's and nonemployer entity's proportionate shares
  - If statutory or contractual contribution requirements
    - Required contribution, contributions in relation to required, difference, covered-employee payroll, contributions as % of covered-employee payroll
- Notes to RSI with significant changes

NPL: Note disclosures/RSI—nonemployer contributing entities in SFS

- Required information depends on how much of the NPL is recognized by the nonemployer entity
  - If substantial proportion, disclosures similar to cost-sharing employer
  - If less-than-substantial proportion, reduced information
    - Notes
      - Type of pension plan, identification of administrator
      - Contribution basis, authority, amount in reporting period
      - Proportionate share (amount) of collective NPL, proportion (%), basis for proportion, change in proportion, expense, and deferred outflows/deferred inflows of resources
    - RSI (10 years)—entity's proportionate share (amount) of collective NPL, amount of contributions

Defined contribution pensions

- Pension expense for amounts defined by benefit terms as attributable to the reporting period
  - Net of forfeited amounts removed from employee accounts
- Liability for difference between pension expense and contributions
- Note disclosures
  - Descriptive information about plan, benefit terms, contribution rates, amount of expense, amount of forfeitures, amount of liability
- Nonemployer contributing entities with legal requirements to contribute directly to pension plan also addressed

Effective date and transition

- Fiscal years beginning after June 15, 2014
- Beginning deferred outflows/deferred inflows of resources balances all or nothing at initial implementation
- RSI schedules prospective if information not initially available

Statement No. 67, *Financial Reporting for Pension Plans*

an amendment of GASB Statement No. 25

Highlights

- Scope limited to defined benefit and defined contribution pension plans administered through trusts that meet certain criteria (same as criteria in Statement 68)
- Few changes from Statement 25 for financial statement recognition
- Notes/RSI changes primarily to reflect changes in measurement of liabilities of employers

Highlights (cont.)

- Notable changes in note disclosures/RSI
  - Annual money-weighted rate of return (1 year in notes; 10 years in RSI)
  - Notes for single-employer and cost-sharing pension plans
    - Components of NPL & net position as % of TPL (1 year)
    - Assumptions used to measure TPL
  - RSI for single-employer and cost-sharing pension plans (10 years):
    - Schedule of changes in NPL by source
    - Components of NPL/related ratios
    - Schedule of actuarially determined contributions
  - Aggregated employer-related information not required for agent pension plans

Highlights (cont.)

- Effective for FYs beginning after June 15, 2013
- RSI prospective (except contribution schedule, if presented), if information not initially available

Accounting and Audit Issues Related to Cost-Sharing Multiple-Employer PERS

Cost-Sharing Multiple-Employer Plans – Issues

- Standard is silent on who (plan or each individual participating employer) should calculate allocation percentages
- Audited financial statements of the plan may not include necessary information to calculate allocation percentages
- Standard provides flexibility in approach to determining allocations
- Standard encourages an allocation method that will be extremely difficult to audit as it is based on projected future contributions

Who should calculate the allocation percentages?

Who should calculate the allocated pension amounts?

Cost-Sharing Multiple-Employer Plans – Potential Solutions

- **Include supplemental "schedule of employer allocations" in plan financial statements for which plan auditor is engaged to provide opinion.**
  - Use allocation method based on covered payroll or required (actual) contributions depending on whether there are different classes of benefits and whether allocations expected to be representative of future contributions
  - Projected future contributions could be used if necessary
  - Standard does not preclude employers from calculating their own allocation percentage; however, this could potentially result in different employers who participate in same plan allocating collective pension amounts on a different basis. Additionally, it could be difficult for employer auditor to get sufficient competent audit evidence on allocation. For example,
    - If employer allocates based on covered payroll, the denominator for the calculation (i.e. total covered payroll) is not audited by plan auditors.
    - If employer allocates based on rates, you don't know if that same relative percentage goes to the liability

Example Schedule of Employer Allocations

EXAMPLE COST SHARING PENSION PLAN

Schedule of Employer Allocations

June 30, 2015

Employer/ Nonmployer (special funding situation)		2015 Actual Employer Contributions	Employer Allocation Percentage	
State of Example	$	2,143,842	38.9	%
Employer 1		268,425	4.9	
Employer 2		322,142	5.8	
Employer 3		483,255	8.8	
Employer 4		633,125	11.5	
Employer 5		144,288	2.6	
Employer 6		95,365	1.7	
Employer 7		94,238	1.7	
Employer 8		795,365	14.4	
Employer 9		267,468	4.9	
Employer 10		267,128	4.8	
Total	$	5,514,641	100.0	

* obtained from AICPA Audit Quality Center website

Cost-Sharing Multiple-Employer Plans – Potential Solutions

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

Example Schedule of Employer Pension Amounts

EXAMPLE COST SHARING PENSION PLAN
Schedule of Pension Amounts
June 30, 2015

		Deferred Outflow of Resources				Deferred Inflows of Resources				Pension Expense	
Employer/ Nonmployer (special funding situation)	Net Pension Liability	Differences Between Expected and Actual Economic Experience	Differences Between Projected and Actual Investment Earnings	Changes of Assumptions	Changes in Employer Proportion and Differences Between Contributions and Proportionate Share of Pension Expense	Differences Between Expected and Actual Economic Experience	Differences Between Actual and Projected Investment Earnings	Changes of Assumptions	Changes in Employer Proportion and Differences Between Contributions and Proportionate Share of Pension Expense	Proportionate Share of Plan Pension Expense	Net Amortization of Deferred Amounts from Changes in Propotion and Proportionate Share of Pension Expense
State of Example	$ 38,589,135	428,768	2,058,088	1,500,690	782,365	380,371	1,063,285	–	584,365	1,878,717	12,375
Employer 1	4,831,647	53,685	257,688	187,898	96,633	47,625	133,131	–	125,325	235,229	(1,793)
Employer 2	5,798,553	64,428	309,256	225,499	115,971	57,156	159,773	–	245,386	282,303	(8,088)
Employer 3	8,698,585	96,651	463,925	338,279	173,972	85,742	239,681	–	125,632	423,492	3,021
Employer 4	11,396,244	126,625	607,800	443,188	227,925	112,332	314,012	–	386,325	554,828	(9,900)
Employer 5	2,597,183	28,858	138,516	101,002	51,944	25,600	71,563	–	42,358	126,444	599
Employer 6	1,716,569	19,073	91,550	66,756	34,331	16,920	47,298	–	24,325	83,571	625
Employer 7	1,696,283	18,848	90,468	65,967	33,926	16,720	46,739	–	125,325	82,584	(5,712)
Employer 8	14,316,562	159,073	763,550	556,756	286,486	141,118	394,478	–	152,005	697,004	8,405
Employer 9	4,814,421	53,494	256,769	187,228	68,325	47,456	132,657	–	87,325	234,391	(1,188)
Employer 10	4,808,301	53,426	256,443	186,990	67,528	47,395	132,488	–	41,035	234,093	1,656
Total	$ 99,263,485	1,102,928	5,294,055	3,860,249	1,939,406	978,435	2,735,105	–	1,939,406	4,832,655	–

* obtained from AICPA Audit Quality Center website

Agent Multiple-Employer Plans – 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 needs 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 actuarial gains and losses
  - Pension expense

How does a participating employer determine and get comfortable that these amounts as of the measurement date are accurate and verifiable?

Potential Solution to Fiduciary Net Position

- Include supplemental condensed schedule of "changes in fiduciary position" by employer in plan financial statements for which plan auditor is engaged to provide opinion
- Plan auditor engaged to issue SOC 1 (type 2) report on allocation of inflows (i.e., contributions, investment income, etc.) and outflows (i.e., benefit payments, administrative expenses, etc.) of plan to individual employer accounts

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

* obtained from AICPA Audit Quality Center website

Potential Solution to Total Pension Liability, Deferred Outflows/Inflows, and Pension Expense

- **Plan auditor engaged to issue SOC 1 (type 2) report on census data controlled by plan (i.e. retired employees)**
  - User controls at the plan level - Plan controls most of the information needed by the actuary (inactives/retirees)
  - User controls at the employer level – Employer controls the active employee information
  - Another alternative would be to have an AUP performed by the Plan auditor to provide substantive evidence to cover the collection and transmission of retirees/inactives
- **Plan actuary issues separate actuarial report for each participating employer which includes net pension liability, deferred outflows/inflows by type and year, pension expense, <u>and discount rate calculation</u>**
  - Employer management and employer auditor rely on actuary as management specialist for total pension liability for individual employer
- **Employer auditor tests census data of active employees and confirms actuarial information used by actuary**
- **Employer and employer auditor responsible for validating deferred outflows/inflows and pension expense related to individual employer**
  - Deferred outflows/inflows resulting from current year can be recalculated from condensed statement of changes in fiduciary position (by employer) included as supplemental information in plan financial statements
  - Rely on actuarial report for deferred outflows/inflows related to actuarial experience

Agent Multiple-Employer Plans – Other Issues

- Differentiation of actuarial assumptions for each participating employer
- Involvement of employer in establishing actuarial assumptions
- Ability of auditors of employers to evaluate appropriateness of actuarial assumptions
- Communication of auditors with plan actuary
- Ability of plan actuary to provide actuarial report directly to each employer

RATING AGENCY PERSPECTIVE

Rating Agency Perspective

- Supportive of this standard
- Provides more information and transparency
- Limited immediate impact on ratings
- Want to see a long-term plan
- Follow Moody's proposal

Moody's Proposal

- Allocate underfunded actuarial liability in cost sharing plans based on ratable share of required contributions
- Accrued Actuarial Liability based on high grade long term corporate bond index (5.5% for 2011)
- No more smoothing – fair value of actuarial investments as of reporting date
- Annual pension contributions for **states** (not local governments) will be adjusted to reflect bond rates and 17-year level amount amortization

Moody's in Perspective

- The proposed adjustments nearly triple reported unfunded actuarial accrued liability to $2.2 trillion from $766 billion
- It's only money – will it impact bond ratings??
  - Moody's says not for States, maybe for some local governments
- This is about bond ratings and not funding or accounting

Impact on Bond Ratings

- State – Negligible Impact
  - Most ratings already have this factored in as liability is much more transparent already at state level
- Local – State of Flux
  - Want to see number
  - Need to have a plan
  - Everyone is in the same boat

Still Looking for Answers

- The GASB Implementation Guide which will include Plan guidance is due out in the 2nd Quarter of 2013 (June??) and for Employer guidance the 1st Quarter of 2014
- How best to communicate the employer proportionate share? What should be included?
- How are auditors going to deal with reporting the pension expense and liability?
- How are bond raters going to interpret the liability?
- Who will keep track of the amortization schedules for the employers?
- How to account for differences between the information provided in the Plan CAFR and the latest actuarial valuation.
  - Which information will the employers select for their financial statements?

The Most Interesting Accountant in the World

"I don't always read accounting statements, but when I do, I prefer GASB 67 and 68."