MLGMA Michigan Local Government Management Association

A State Affiliate of ICMA

GASB 67/68

The New Pension Standards

The Reasoning Behind the Pronouncements

buckconsultants

Rehmann

Presented by:

Stephen W. Blann, CPA, CGFM, CGMA

Director of Government Audit Quality

Rehmann, Grand Rapids, MI

Larry Langer, FCA, ASA, EA, MAAA

Principal, Retirement

Buck Consultants, Chicago, IL

buckconsultants

Rehmann

Session Outline

- Overview of GASB 67/68
- Key Actuarial Changes
- Implementation: The First Year
- Strategic Options

Overview of GASB 67/68

GASB Statement 67/68
The New Pension Standards

- GASB 67 (effective 06/30/2014)
  - Applies to the financial statements of pension plans (pension trust funds)
- GASB 68 (effective 06/30/2015)
  - Applies to the financial statements of employers providing pension benefits

GASB Statement 67/68

The New Pension Standards

- The GASB's stated reasoning:

  …to improve the decision-usefulness of reported pension information and to increase the transparency, consistency, and comparability of pension information across governments

GASB Statement 67/68

The New Pension Standards

- The GASB's stated reasoning:
  - Pensions represent compensation for employee services rendered prior to termination
  - Essentially, pension benefits are earned while employees are working
  - By the time an employee retires, the full amount needed to pay his/her benefits should be "on the books"

The Old Way vs. the New Way

GASB 25/27

- Liability calculated differently by entity
- Not booked (RSI)
- Focus is on funding

GASB 67/68

- Liability calculated the same by all
- Booked as a liability
- Focus is on benefits earned

Defining Pension & OPEB

- Pensions
  - Retirement income and benefits (other than healthcare) provided through a pension plan
- Other postemployment benefits (OPEB)
  - All postemployment healthcare benefits
  - Postemployment benefits other than retirement income not administered by a pension plan

Defining Pension & OPEB

- Two broad types of pension plans:
  - Defined benefit (DB)
    - Benefits are defined by plan terms (either a specific dollar amount, or calculated based on age, years of service, compensation, etc.)
    - No individual accounts by plan member
    - Primary focus of GASB 67/68

Defining Pension & OPEB

- Two broad types of pension plans:
  - Defined contribution (DC)
    - Individual account for each plan member
    - Identify the employer contributions to be made in each period of service
    - Benefits are limited to contributions made and the earnings thereon
    - Little changed by GASB 67/68

Defining Pension & OPEB

- Three types of defined benefit plans:
  – Single-employer pension plan
    - A primary government and its component units may be considered to be one employer
  – Agent multiple-employer pension plan
    - Assets are pooled, but each employer’s share is legally available to pay the benefits of only its employees

Defining Pension & OPEB

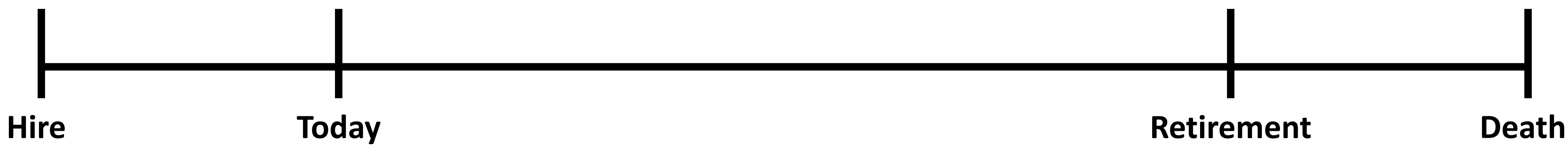
- Three types of defined benefit plans:
  - Cost-sharing multiple-employer pension plan
    - Assets are pooled, and may be used to pay benefits of the employees of any participating employer

Net Pension Liability

- Recorded by the employer (not the plan)
- Equal to the actuarially determined total pension liability, less the net position of the pension trust fund
- Recorded in full accrual financial statements (certain portions are deferred and amortized)

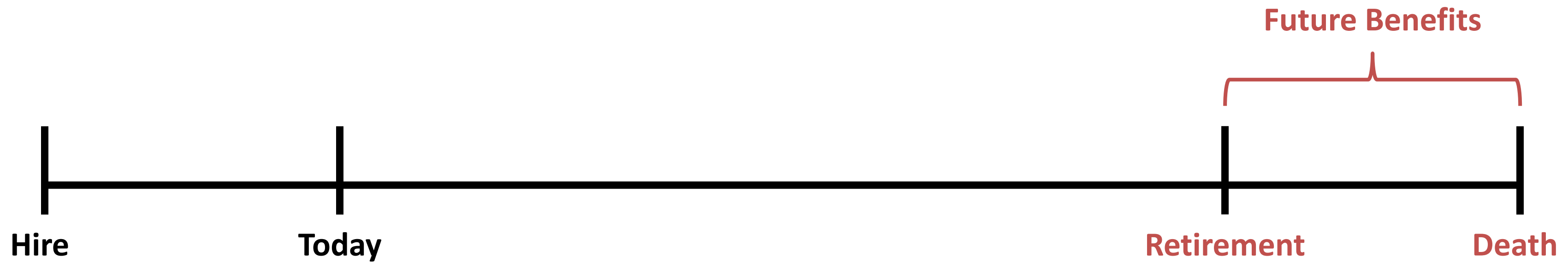
Total Pension Liability

- Calculated by the actuary:
  - Project future benefits
  - Discount to present value
  - Attribute present value to specific periods



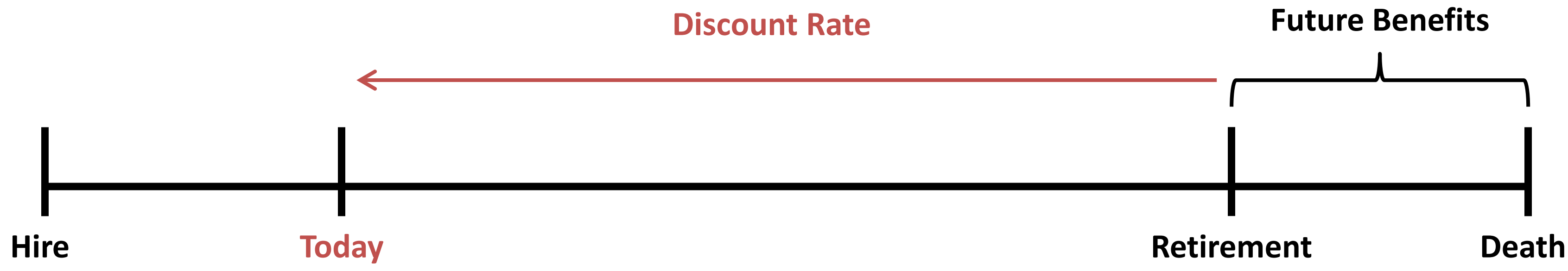
Total Pension Liability

- Calculated by the actuary:
  - Project future benefits
  - Discount to present value
  - Attribute present value to specific periods



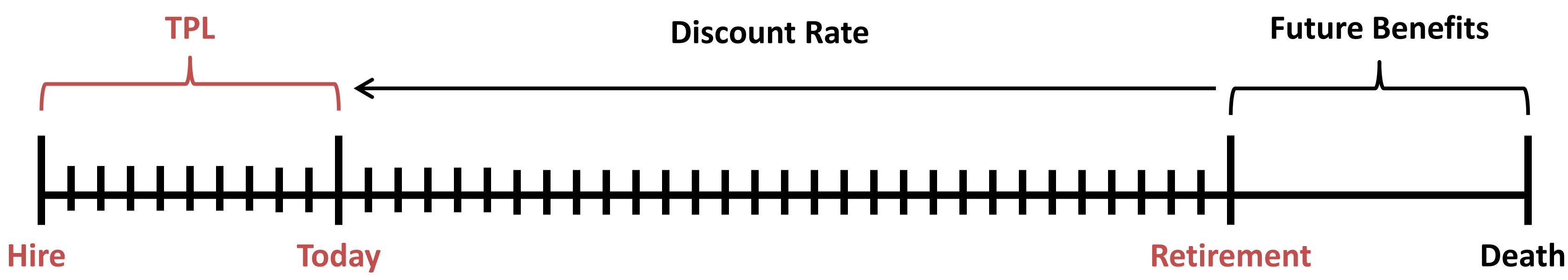
Total Pension Liability

- Calculated by the actuary:
  - Project future benefits
  - Discount to present value
  - Attribute present value to specific periods



Total Pension Liability

- Calculated by the actuary:
  – Project future benefits
  – Discount to present value
  – Attribute present value to specific periods



Actuarial Terms (Old and New)

- Actuarial Accrued Liability vs. Total Pension Liability
  - The amount of money you should have in the fund (AAL)
- Actuarial Value of Assets vs. Fiduciary Net Position
  - The amount of assets you actually have in the fund (AVA)
- Unfunded Actuarial Accrued Liability vs. Net Pension Liability
  - The shortfall between the liability and the assets (UAAL)
- Funded ratio vs. Funded Ratio
  - How many cents you have to cover each dollar of liability, or the assets divided by the liability

Actuarial Terms (Old and New)

- Normal Cost vs. Service Cost
  - The cost of benefits accruing during the year
- Employer Contribution vs. Pension Expense
  - The amount paid into the fund during the year. When done actuarially, it is the sum of the normal cost plus a payment to the unfunded actuarial accrued liability.

While the new terms are similar to the old, they should not be used interchangeably

Actuarial Valuations

Inputs

- Member Data
- Asset Data
- Benefit Provisions
- Actuarial Assumptions (either 3 or 4 sets)
- Actuarial Methods (2 sets)

Actuarial Valuation Process

Results

- Normal Cost
- Service Cost
- Actuarial Accrued Liability (AAL)
- Total Pension Liability
- Actuarial Value of Assets (AVA)
- Plan Fiduciary Net Position
- Unfunded Actuarial Accrued Liability (UAAL)
- Net Pension Liability
- Funded Ratio (2)
- Employer Contributions
- Pension Expense
- UAAL payment schedule
- Deferred inflows and outflows
- Experience Gain/Loss (2)
- Projections
- Discount rate and GASB 67/68 info
- Observations

(Items in red are new with GASB 67/68)

Key Actuarial Changes
Current to New Standards

- Actuarial cost method
  - GASB 25/27 allowed for use of one of six actuarial cost methods
  - GASB 67/68 requires use of the Entry Age Level % of Pay cost method
  - If currently using a method other than Entry Age Level % of Pay, the funded status of the plan will change

Key Actuarial Changes
Current to New Standards

- Expected return/discount rate
  – GASB 25/27 based on current or expected long-term rates of return
  – GASB 67/68 requires calculating a single blended rate
    - Expected rate of return (sufficient assets)
    - AA 20 year muni bond rate (insufficient assets)
  – A lower discount rate produces a higher liability and vice versa

Key Actuarial Changes

Current to New Standards

- Expected return/discount rate
  - Example:

	Target Allocation	Long-term Expected Real Rate of Return	Money Weighted Rate of Return
Domestic equity	46%	5.4%	2.48%
International equity	21%	5.5%	1.16%
Fixed income	26%	1.3%	0.34%
Real estate	6%	4.5%	0.27%
Cash	1%	0.0%	0.00%
	100%		4.25%
Inflation			3.50%
Investment rate of return			7.75%

Key Actuarial Changes

Current to New Standards

- The requirement to use a lower discount rate does not depend on:
  - The current funded ratio – a 100% funded ratio may not be sufficient
  - The investment return assumption used for the funding valuation
- Does depend upon:
  - Whether the funding policy for your plan achieves 100% funding in a reasonable amount of time – generally 20 to 30 years
  - This issue is not about where your fund is currently at actuarially, but where it is going

Key Actuarial Changes
Current to New Standards

- Discount rates

Development of Net Pension Liability under GASB 67/68 and Sensitivity Discount Rates

	Net Pension Liability NPL based on:		
	1% Decrease in Rate (5.85%)	67/68 Discount Rate (6.85%)	1% Increase in Rate (7.85%)
Total Pension Liability	207,849,843	183,937,914	162,776,915
Plan Fiduciary Net Pension	(167,365,001)	(167,365,001)	(167,365,001)
Net Pension Liability	40,484,842	16,572,913	(4,588,086)
Funded Ratio	80.52%	90.99%	102.82%

Village of Nirvana Employees Retirement System
June 30, 2014 Annual Actuarial Valuation

Key Actuarial Changes

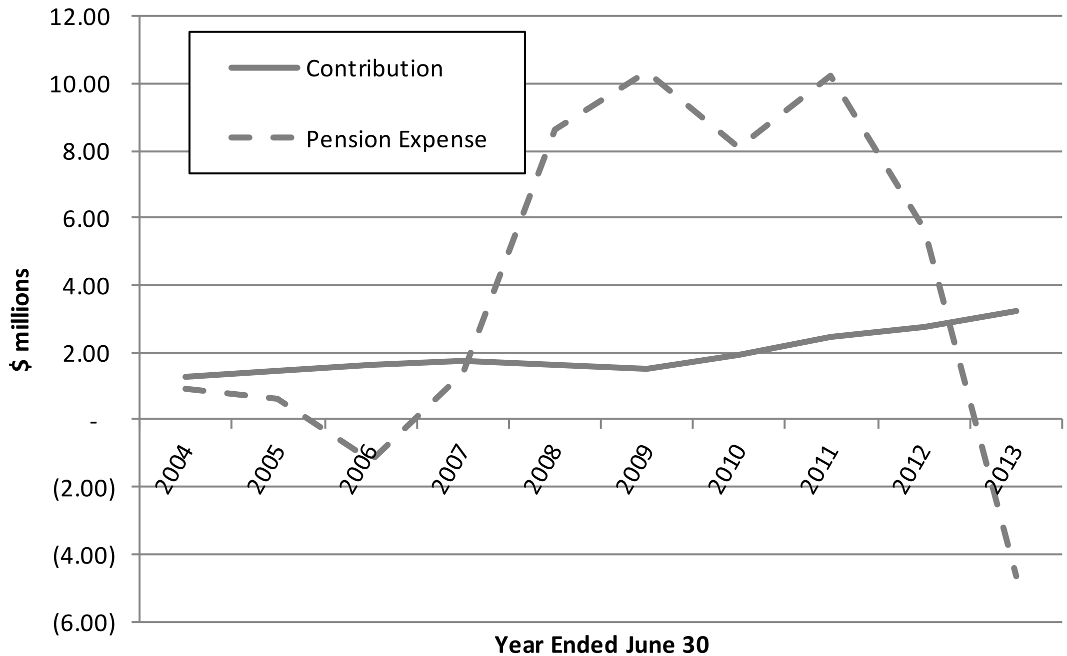
Current to New Standards

- Annual Cost
  - GASB 27 required calculation of a “Annual Required Contribution (ARC)” equal to the service cost plus amortization of the unfunded actuarial liability
  - GASB 68 requires calculation of Pension Expense equal to the change in the net pension liability with adjustments for deferred recognition of some gains/losses

Key Actuarial Changes

Current to New Standards

- Pension expense ≠ employer contributions



Pension expense may be far more volatile than contributions from year to year.

Village of Nirvana Employees Retirement System
June 30, 2014 Annual Actuarial Valuation

Key Actuarial Changes
Current to New Standards

- Asset method
  - GASB 27 permitted an actuarial asset method that smoothed gains and losses
  - GASB 68 requires market value of assets

Key Actuarial Changes

Current to New Standards

- Amortization of unfunded liability
  - GASB 27 permitted wide latitude in amortization periods
  - GASB 68 requires:
    - Plan changes – immediately
    - Assets returns other than expected – 5 years
    - Other actuarial liability gains and losses – average future service

Key Actuarial Changes
Current to New Standards

- Assumptions used
  - Largely consistent with funding approach
  - Discount rate may differ
  - Sensitivity analysis (calculate the TPL ±1% of the selected discount rate)
  - Auditors may need to apply greater scrutiny

Net Pension Liability

- Total pension liability less net position of the pension trust fund
- Single employer and agent multiple-employer plans
  - Record NPL and disclose information for the plan
- Cost-sharing plans
  - Record pro-rata share of overall plan amounts

Pension Expense

- Pension expense (full accrual) bears no direct relationship to the amounts actually contributed to a pension plan
- Governmental funds (modified accrual) continue to only report actual contributions made

Disclosures and RSI

- Extensive new footnote and RSI
  - Plan description
  - Investment policies
  - Annual money-weighted return (10 years)
  - Basis for calculating the net pension liability, including discount rate assumptions and a “sensitivity analysis”
  - 10 year trend information (prospectively)

Disclosures and RSI

- Extensive new footnote and RSI
  - 10 year schedule of annual changes in the NPL by type
  - Funded status and funding progress (if actuarially calculated)
  - Schedule of deferred inflows/outflows to be amortized in future periods (similar to long-term debt amortization)

Timing Implications

- In an ideal world, everything would be measured in real time at the employer's fiscal year end
- In reality, plans and employers don't always have the same year end, and actuarial valuations take time to complete

Timing Implications

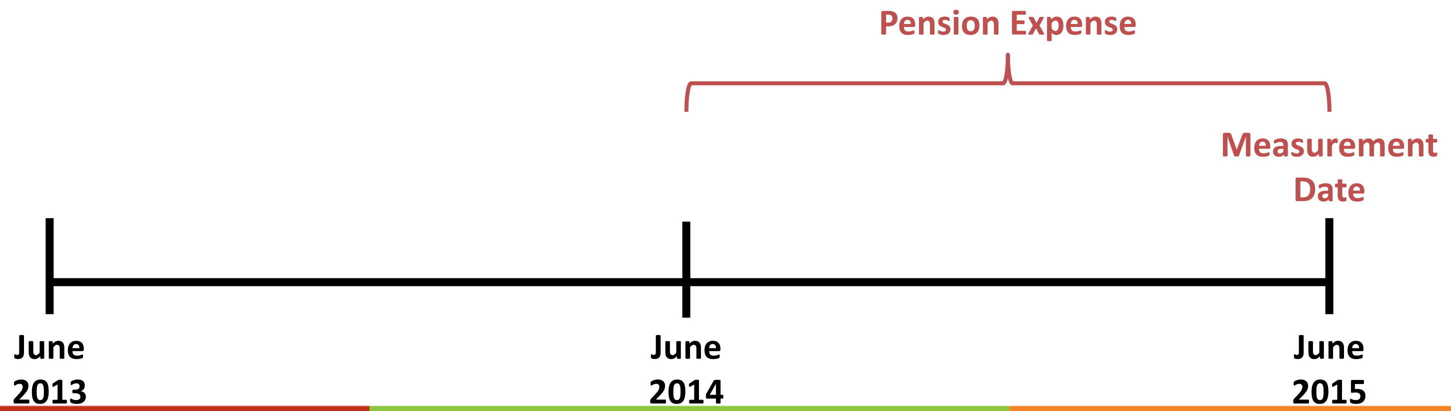
- Actual valuations
  - GASB 67 allows up to 24 months prior to the FYE of the pension plan
    - Use update procedures to roll forward to the pension plan's FYE
  - GASB 68 allows up to 30 months prior to the FYE of the employer
    - Use update procedures to roll forward to the measurement date

Timing Implications

- Measurement date
  - Date at which the NPL is measured
  - May be up to one year prior to the employer's FYE
  - Pension contributions made after the measurement date are reported as deferred outflows of resources

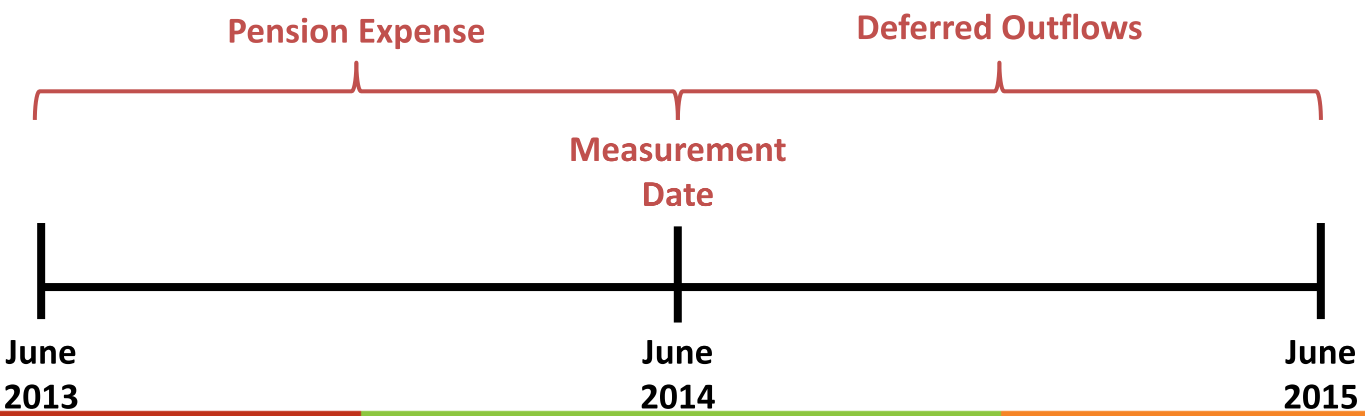
Timing Implications

- Examples
  - Plan FYE = June 30
  - Employer FYE = June 30
  - Measurement date = June 30, 2015



Timing Implications

- Examples
  - Plan FYE = June 30
  - Employer FYE = June 30
  - Measurement date = June 30, 2014

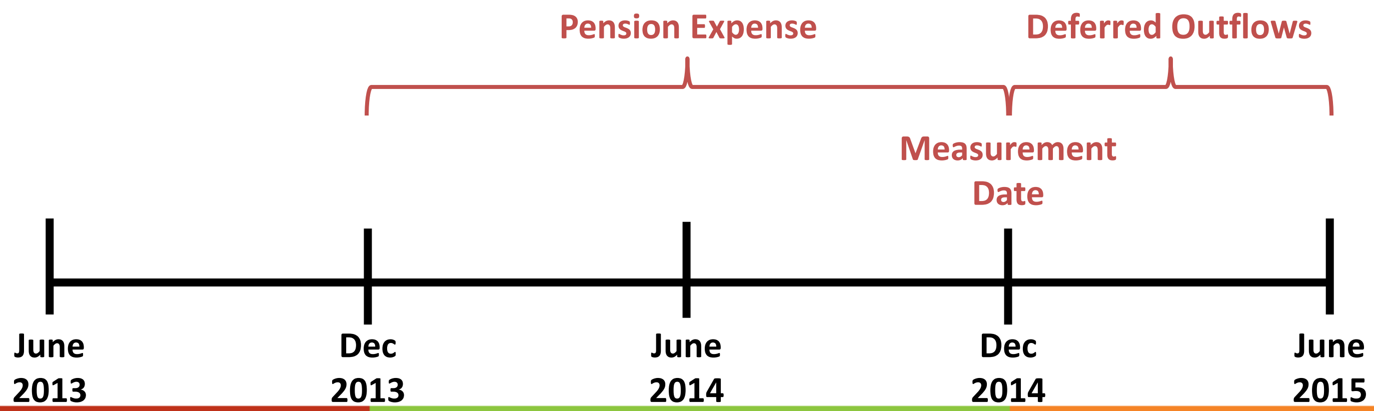


buckconsultants

Rehmann

Timing Implications

- Examples
  - Plan FYE = December 31
  - Employer FYE = June 30
  - Measurement date = December 31, 2014



Implementation: The First Year

Implementation

- Planning meetings
- Providing data to the actuary
- The new look of actuarial valuations
- Recording the net pension liability
- Auditing the net pension liability

Planning Meetings

- Who to include
  - Finance staff, auditor, and actuary
- Timing
  - Work backwards from when GASB 68 is due in your financials
- Issues to address
  - Availability of information
  - Who will do what, when?

Providing Data to the Actuary

- Census data
- Key assumptions
- Investment policy statements

Much of the information

is the same as pre-GASB 68

The New Actuarial Valuations

- Funding report unchanged
- Will need to replace GASB 25/27 requirements with GASB 67/68
  - NPL history
  - NPL sensitivity
  - Pension Expense
  - Deferred inflows and outflows
  - Discount rate support (100-year run out)
- Have discussion about what is to be included

Recording the NPL

- The net pension liability is only recorded in full accrual statements
  - Allocation options:
    - Governmental activities
    - Enterprise funds
    - Internal service funds
  - Restating beginning net position
  - Deferred items

Auditing the NPL

- The net pension liability may be the single largest amount on the government's F/S
- The AICPA is still finalizing standards for auditors (white papers issued)
  - Single employer
  - Agent multiple employer
  - Cost sharing

Strategic Options

Strategic Options

- One valuation or two?
  - Ideally include in one report
  - Which valuation will first include GASB 67
- Setting assumptions and methods
  - May need experience review
  - Revisit funding policy to avoid lower discount rate
- Other

The Bottom Line

- This does not require a change to funding
- This does not require a change to budgeting
- Changing the discount rate used does not change the actual cost of providing benefits
- The liability will only be booked in the government-wide financial statements and enterprise funds
- Implementation will still require time / money

In Conclusion…

Thank You!

Stephen W. Blann, CPA, CGFM, CGMA
Director of Government Audit Quality
Rehmann, Grand Rapids, MI
stephen.blann@rehmann.com

Larry Langer, FCA, ASA, EA, MAAA
Principal, Retirement
Buck Consultants, Chicago, IL
larry.langer@buckconsultants.com