

GASB 67/68: Pension Accounting and Reporting FAQs Related to Georgia's Implementation

GENERAL

Q: What's new in the GASB rules?

A: The primary change is that accounting for pensions will no longer be based on the funding process. Today, employers record a liability on financial statements only if they do not fully fund the annual required contribution (ARC) as defined by the GASB. Under the new standards, GASB no longer defines an ARC because it is not within GASB's scope to set standards for financing pensions. Instead, liabilities, expenses and deferred items will be based on the cost of benefits that are earned as employees provide service. These unfunded liabilities and deferrals (based on earned benefits, not funding commitments) will be recorded on employer (and certain nonemployer) accrual basis balance sheets, whereas previously unfunded actuarial accrued liabilities were disclosed but not recorded.

Certain changes also affect measurement of the total pension liability to improve reporting consistency across plans. For example, only one actuarial cost method, the entry age method, will be allowed (instead of the six methods previously allowed). Also, automatic cost of living adjustments (COLA's) must be included in the measurement, including ad hoc COLA's that are substantively automatic. The GASB also tightened rules around selection of the discount rate used to determine the present value of expected future benefits. The changes to the discount rate are expected to lower the rate used by some plans. A lower discount rate would result in an increase to the liability.

The new rules also eliminate use of a smoothing method to value assets accumulated for payment of pension benefits. The net pension liability will now be based on the market value of assets as reflected in the plan's net position at the measurement date.

These changes are effective for plan financial statements in fiscal year 2014 and for employer financial statements in fiscal year 2015.

Q: How will these changes affect local governments and boards of education?

A: Local governments and boards of education will be required to record and disclose their share of pension expenses, liabilities and deferred items to the extent that the activity relates to their employees. Special rules apply if another nonemployer entity is legally obligated to contribute directly to a pension plan under a special funding situation. The changes affect accrual basis financial statements only and will not affect governmental fund balance statements reported under either statutory or modified accrual bases of accounting.

Q: What is a special funding situation?

A: Special funding situations are circumstances in which (a) a nonemployer contributing entity (such as a state government) is legally responsible for contributions directly to a pension plan that is used to provide pensions to the employees of another government (such as school districts located within that state) and (b) one or both of the following is true:

1. The amount of the contributions for which the nonemployer is legally responsible is not dependent upon one or more events unrelated to the pensions
2. The nonemployer is the only entity with a legal obligation to make contributions directly to the plan.

In a special funding situation, the nonemployer has essentially assumed a portion of the employer entity's pension obligation as its own. Consequently, if the nonemployer is a government, it will recognize its proportionate share of the net pension liability, pension expense, and deferred outflows

GASB 67/68: Pension Accounting and Reporting FAQs Related to Georgia's Implementation

of resources and deferred inflows of resources related to the employer's pensions in its own financial statements.

The government benefitting from nonemployer contributions in a special funding situation will disclose its net pension liability, pension expense, and deferred outflows of resources and deferred inflows of resources related to pensions prior to the nonemployer government's support, but would recognize in its financial statements only its proportionate share.

For revenue and expense purposes, the benefitting government recognizes the total expense related to its employees, but that expense is offset by recognizing revenue equal to the support provided by the nonemployer paying entity. Therefore, the net recorded impact reflects only the employer's proportion.

Q: How will local governments and boards of education get the information required to be reported?

A: Multiple employer pension plans sponsored by the State of Georgia are currently working with their actuaries to develop a process for calculating proportionate shares for employers and nonemployers with special funding situations. The plans are also working with their auditors to develop a plan for auditing the proportionate information so the auditors of local governments or boards of education may rely on it. The plans will communicate employer and nonemployer activity beginning with fiscal year 2015.

Q: Do the new GASB statements establish requirements for how governments should fund their pension?

A: No, the GASB concluded that it is not within its scope to set standards that establish a specific method of financing pensions or to regulate a government's compliance with the financing policy or method it adopts. Financing pensions is a policy decision for government officials or other responsible authorities to make. Therefore, the GASB established standards only within the context of accounting and financial reporting, not within the context of funding pensions.

Q: Will governments have to pay more each year for pensions because of the GASB's new statements?

A: No, as mentioned above financing pensions is a policy decision for government officials or other responsible authorities to make. Therefore, the GASB statements will not affect what governments pay to fund the plans.

Q: How will retirement plans, participating employers, lawmakers, and the public know whether the plans are adequately funded?

A: Now that GASB has moved away from funding standards, Georgia pension plans are working with their actuaries to develop a funding policy which will be adopted by the plan's board. The funding policy will outline the methodology for future funding.

Georgia's largest plans have annual actuarial valuations of funding status performed by certified independent actuaries.

The following factors, calculated by the actuaries, can be used to assess the sustainability of a defined benefit pension plan:

1. The employer's funding progress, and
2. Actual employer contributions as a percentage of actuarially determined employer contributions.

GASB 67/68: Pension Accounting and Reporting FAQs Related to Georgia's Implementation

The usual goal is to accumulate enough assets in the trust fund during an employee's active service life to pay promised benefits during retirement. The funded ratio is a key measure of funding progress to date. It reflects a comparison of the assets held in trust to the present value of promised benefits. The higher the ratio the better funded is the plan. Additionally, consistently funding the full amount of actuarially determined employer contributions should lead to accumulation of sufficient resources to pay promised benefits. Both of these factors, when monitored over multiple years, will help stakeholders assess whether the funded status and contribution trends indicate that a plan will meet its funding goal.

- Q: Won't people be alarmed if pension costs loom large on employer financial statements?
A: They should not be. The amount reported on the employer's balance sheet will reflect a long-term liability of many years and therefore not "due in full" in the current fiscal year. Think of it as similar to a home mortgage. Even though a homeowner may have a \$200,000 unpaid mortgage, there is no expectation that the homeowner pay the mortgage in a single year or have funds available to pay the mortgage off in a single payment. The liability amount reported on the employer balance sheet will represent the employer's proportionate share and will be paid down by employers' annual contributions to the plan over many years.

Plans and employers can help alleviate stakeholder fears by ensuring a sound funding policy, maintaining funding discipline, and providing accurate and transparent financial information to allow stakeholders to assess progress towards the funding of promised benefits.

- Q: There is speculation in the media that the new GASB statements will show that the public pension funds are financially worse than realized. Is this an accurate statement?
A: No. Each plan must be assessed individually based on the design of its benefit structure and the adequacy of its funding policy. Although the new GASB requirements may result in changes to liability measurements for some plans to achieve more consistency in reporting, the funded status of defined benefit plans has been calculated through the normal actuarial valuation process and disclosed in governmental financial reports for a number of years. Therefore, knowledgeable readers should already be aware of the fundamental financial status of many plans. The requirement to record unfunded liabilities on accrual basis financial statements, in addition to making note disclosures, should highlight the financial impact of pension plans in a more transparent manner.

SPECIFIC TO GEORGIA'S STATE-SPONSORED PLANS

- Q: What measurement date will be used for employer reporting of State-sponsored plans?
A: Georgia will measure employer liabilities as of one year prior to each plan's June 30 fiscal year-end.
- Q: Will Georgia use a roll-forward process to measure pension plan liabilities?
A: Yes, ERS and TRS will measure the total pension liability as of their current June 30 fiscal year-end using a valuation as of the prior June 30 rolled-forward to the plan's current fiscal year-end. The State, as a participating employer or nonemployer with a special funding situation, will measure its proportionate share of the total pension liability as of the State's prior June 30 fiscal year-end, using the measurement presented by the plan in its prior year financial statements. Therefore, the employer measurements for ERS and TRS will be based on a valuation as of a date that is 24 months prior to the employer's fiscal year-end and rolled-forward one year.
- Q: Are ERS or TRS expected to report larger liabilities by using lower discount rates to calculate the present value of expected future benefit payments?

GASB 67/68: Pension Accounting and Reporting FAQs Related to Georgia's Implementation

A: The discount rate required for accounting purposes under the new GASB standards is a blended rate based on the long-term expected rate of return and an index rate for 20-year, tax-exempt general obligation municipal bonds with an average rating of AA/Aa or higher. The long-term expected rate is used to the extent that:

1. The plan's fiduciary net position is projected to be sufficient to make projected benefit payments, and
2. Plan assets are expected to be invested using a strategy to achieve that return.

When projecting fiduciary net position, plans must limit benefit payment, contribution, and earnings projections to those related to current participants (active and inactive) as of the measurement date. ERS and TRS are currently working with their actuaries and auditors to determine the discount rate under the new standards. It is expected that both plans will use the long-term expected rate. Final selection of discount rates for ERS and TRS is not expected to be complete until the spring of 2014.

Q: Does Georgia have a special funding situation (SFS) for any plan sponsored by the State?

A: Yes, the State of Georgia has situations in which the State pays employer contributions on behalf of local governments or boards of education. The pension plans along with the State Accounting Office and Department of Audits are evaluating each of these situations to determine if the criteria for SFS's are met.

FOR MORE INFORMATION

Q: Where can I find more information about the GASB changes?

A: Refer to the "Pension Standards for State and Local Governments" page on the GASB website at www.gasb.org.