# New GASB Accounting Standards:

## Statements 67 and 68

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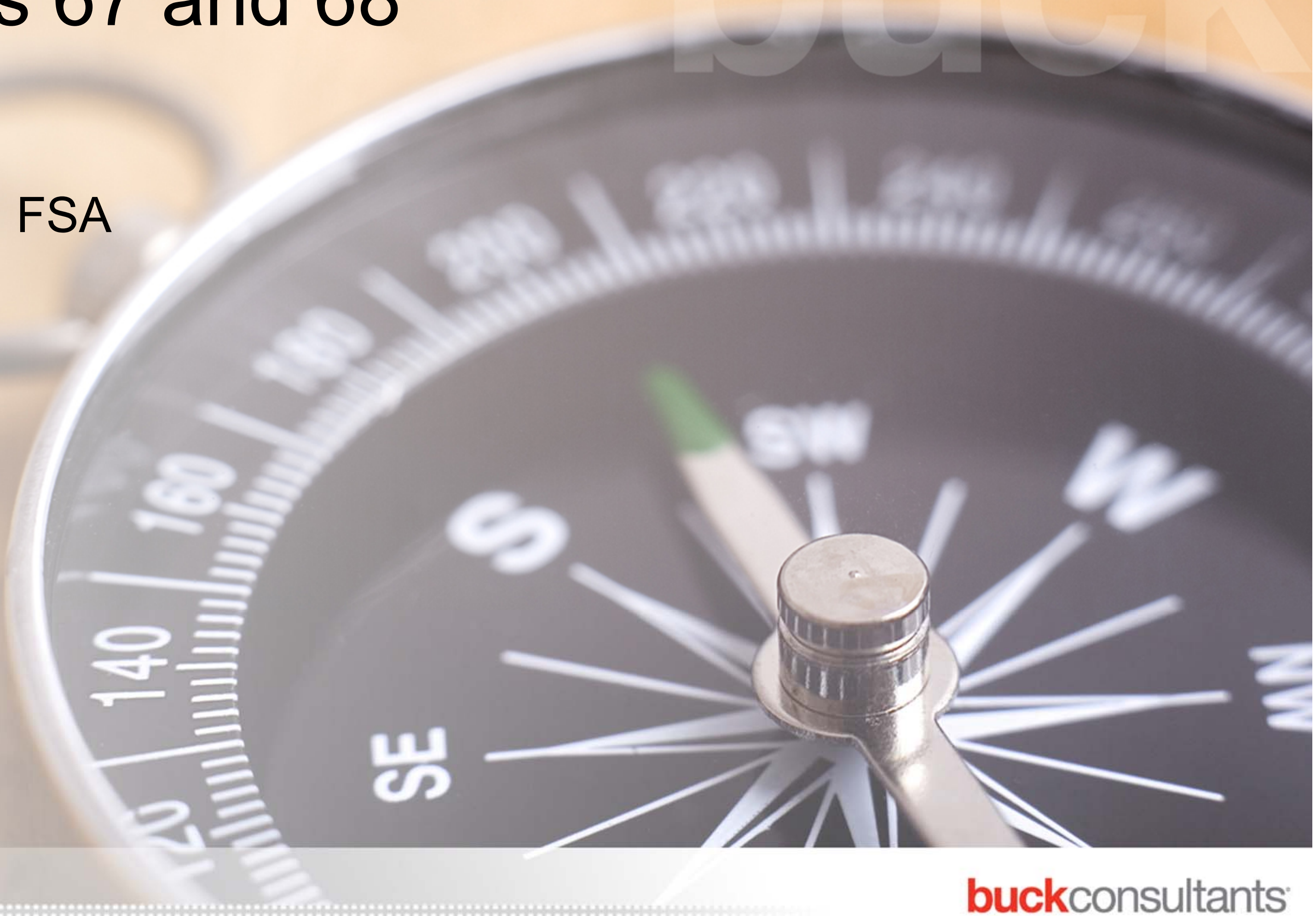


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## What's on the menu today

- A brief review of public-sector pension accounting
- A brief review of the genesis of GASB 67 and GASB 68
- A not-so-brief account of how GASB 67 and GASB 68 work
  - Major changes from current standards (GASB 25 and 27)
  - Net Pension Liability
  - Discount Rate Determination
  - Cost-sharing plans
- Example: Balance Sheet disclosure for the State of Disbelief's Plans under the new standards

## A brief review of public-sector pension accounting

- GASB established in 1984
- First GASB accounting standards for pensions (GASB 4 and 5) issued in 1986
- Current GASB standards for public-sector pension plans adopted in November 1994:
  - GASB 25: accounting for the plan by the plan
  - GASB 27: accounting for the plan by the sponsor
- Current standards embody a strong link between funding and accounting
  - If funding contributions ≥ accounting expense, no liability (Net Pension Obligation) on balance sheet
  - Many options for funding method and amortization for UAAL

## A brief review of the genesis of GASB 67 and GASB 68

- GASB 25 and 27 were considered a substantial improvement over GASB 5, and for years there was no pressure to change
- Various factors led to a decision to revisit the accounting standards
  - Refinements of GASB's accounting theory (as embodied in GASB's Concept Statements)
  - Development by other standards-setting organizations of accounting standards based on a mark-to-market approach
- GASB added the project to its agenda in 2006
  - Invitation to Comment issued in 2009
  - Preliminary Views issued in 2010
  - Exposure drafts of new standards in 2011
  - GASB 67 and 68 in 2012

# GASB 67 and 68: major changes from current standards

- Requirement to use individual level-percent-of-pay entry age normal cost method as the basis for financial reporting
  - Current GASB standards allow use of any one of six funding methods (although EAN is most commonly used)
  - Required method is "pure" EAN (eliminates the modifications sometimes used in practice)
- **Fundamental measure of "net pension liability" under new standards is EAN accrued liability less assets at <u>market</u>**
  - Replaces NPO
  - Discount rate to be used may differ from the expected long-term rate of return on assets (more on this later)

# GASB 67 and 68: major changes from current standards (cont'd)

- EAN is to be applied using assumptions selected in accordance with Actuarial Standards of Practice
- Assumptions will have to be specified in greater detail than under present standards
  - The date of the most recent experience study must be provided
  - If there are COLAs, an assumption must be made about their future level and occurrence (including ad hoc COLAs, "to the extent they are substantially automatic")
  - The assumed asset allocation, the long-term expected real rate of return for each major asset class, and whether these are presented as arithmetic or geometric means

## GASB 67 and 68: major changes from current standards (cont'd)

- Discount rate selection requires a projection of future asset adequacy
  - Project future asset levels, using best estimates of future benefit payments and expected rates of return on assets
  - Projection also incorporates estimates of future contributions, made on the basis of statutory requirements, and the most recent five-year history of contributions
- To the extent future assets ("net fiduciary position") are not projected to be adequate to cover projected benefits, the discount rate is determined by blending the expected rate of return on assets with the yield on 20-year, tax-exempt general obligation bonds rated AA/Aa or higher

## GASB 67 and 68: major changes from current standards (cont'd)

- Under current GASB standards, as long as funding policy satisfies certain fairly liberal requirements (e.g., 30-year amortization of the UAAL), accounting expense for pensions is equal to contributions
- Expense is quite differently defined under the new GASB standards
  - Benefits earned during the reporting period (service cost)
  - Interest cost on the total pension liability
  - Projected earnings for the reporting period
  - Changes in benefits that affect the total pension liability, as follows
    - Assumption changes / non-investment gains and losses: over average expected remaining service lifetime (for actives and inactives)
    - Amendments: full and immediate
  - Asset gains and losses : over a five-year period

# GASB 67 and 68: major changes from current standards (cont'd)

- Further notes on expenses
  - Amounts of gains/losses and effects of assumption changes deferred for later recognition: "deferred inflows and outflows of resources"
  - Amortization method is that used in applying FASB standards (i.e., division of the outstanding balance by amortization period, with interest charged on outstanding balance
  - Additional components in the case of a cost-sharing plan

# GASB 67 and 68: major changes from current standards (cont'd)

- Cost-sharing plans
  - Minimal reporting requirements for participating employers under current GASB standards
  - Quite different treatment under new standards
    - Each participating employer must report its proportionate share of the net pension liability, pension expense and deferred inflows and outflows
    - Proportionate shares should be determined on the basis of "the manner in which contributions to the pension plan, excluding those to separately finance specific liabilities of an individual employer or non-employer contributing entity to the pension plan, are determined."
    - Accounting treatment for change in proportionate shares analogous to that for gains and losses

# GASB 67 and 68: major changes from current standards (cont'd)

- Special funding situations
  - Non-employer entities that contribute funds toward pensions of public sector employees (e.g., states that fund teachers' retirement systems)
  - Where the obligation to contribute is dependent on events or circumstances unrelated to the pension plan, no need to account for the obligation in the entity's financial statement
  - Otherwise, the entity is required to account for its obligation to the pension plan as if it were a cost-sharing employer

# GASB 67 and 68: major changes from current standards (cont'd)

- Note disclosure and required supplementary information to accompany financial statements is greatly expanded under the new standards
  - Of particular note is the information needed to substantiate the discount rate determination
    - assumed future cash flows,
    - asset allocations,
    - real returns on asset classes
  - Also must disclose effects of using discount rate that is 100 bp higher or lower than that ultimately used

# Now, let's consider the State of Disbelief*

- There are two plans maintained by the State of Disbelief
  - The first plan is a plan covering all of the state's employees
  - The second plan is a cost sharing plan covering a number of municipalities within the state that have elected to participate
- The fiscal year of the employer is July 1 – June 30
- The following slides illustrate the compliance dates and the effect of the new balance sheet disclosures as if the rules had been in effect in past years
- Also shown are the key new disclosure pieces that will be presented in the plan's and plan sponsor's financial statement disclosures

*Figures shown in the State of Disbelief examples are based on actual governmental plans located outside Vermont.

# Additional Disclosures

- Notes to the Financial Statements are to include:
  - Components of TPL (total pension liability) and NPL(net pension liability), net position, and ratio of assets to TPL
  - Descriptions of methods and assumptions used in calculating the actuarially determined contribution
  - Investment policy, asset allocation, the assumed long-term investment rate of return (discount rate) and how it was determined
  - Sensitivity of the NPL to changes in the discount rate illustrated by showing a 1% increase and a 1% decrease in the discount rate

# Additional Disclosures

- Required Supplementary Information for each of the most recent 10 fiscal years to be disclosed includes:
  - Sources of changes in the NPL
  - Information about the components of the NPL, including total pension liability, assets (net position), net pension liability, payroll, and related ratios
  - Information about the actuarially determined contribution, amounts contributed, and related ratios
  - History of annual money-weighted investment rates of return
  - Changes in benefits, assumptions, and membership

# Effective Date for Pension Plan Financials

- **Pension plans** are required to meet the new standards for financial reporting under GASB No. 67 for fiscal years beginning after June 15, 2013
  - 2013-2014 Fiscal Year for the State of Disbelief
  - All required disclosure / supplemental information required other than Pension Expense
    - Will require disclosure of the Total Pension Liability (TPL) and Net Pension Liability (NPL) a year before required in employer financial statements

# Effective Date for Employer Financials

- **<u>Employers</u>** are required to meet the new accounting standards under GASB No. 68 for fiscal years beginning after June 15, 2014
  - 2014-2015 Fiscal Year for two plans established by the State of Disbelief
  - Inclusion of NPL on employer balance sheet rather than NPO
  - Inclusion of Pension Expense in employer income statement
  - All required disclosure / supplemental information required
  - Will require allocation of Pension Expense and NPL for cost sharing employers

# GASB Estimates for the State of Disbelief

- We have estimated the impact of GASB Changes
  - Compared estimated NPL (GASB 68) to NPO (GASB 27)
  - For State and Cost-sharing plan
  - As if GASB 68 in effect for current and prior two valuations
- Basis for NPL estimates:
  - Assume current discount rate (7.25%) not impacted by asset “run out” date as the potential crossover date is around 2065-70
  - Entry Age Normal cost method for accrued liabilities (method already in use for State employees plan, so no significant effect)
  - Market Value of Assets
  - All other assumptions based on actuarial valuations as of 12/31/2009, 12/31/2010 and 12/31/2011
- Results presented on next two slides

# GASB Estimates for State Plan

Estimated NPL (GASB 67/68) vs. NPO (GASB 25/27)

| GASB 67/68 | | | |
|---|---|---|---|
| **Valuation Date** | **12/31/2011** | **12/31/2010** | **12/31/2009** |
| Market Value of Assets | $ 53,402,204,951 | $ 54,108,134,326 | $ 50,382,551,504 |
| Entry Age Accrued Liability | $ 61,846,696,903 | $ 59,876,065,931 | $ 58,178,272,142 |
| Unfunded Actuarial Accrued Liability | $ 8,444,491,952 | $ 5,767,931,605 | $ 7,795,720,638 |
| Funded Ratio | 86.3% | 90.4% | 86.6% |
| Run Out Date | None | None | None |
| Discount Rate | 7.25% | 7.25% | 7.25% |
| Measurement Date | 12/31/2011 | 12/31/2010 | 12/31/2009 |
| **Reporting Date (fiscal year ending)** | **6/30/2012** | **6/30/2011** | **6/30/2010** |
| Net Pension Liability (NPL) (balance sheet liability) | $ 8,444,491,952 | $ 5,767,931,605 | $ 7,795,720,638 |

| GASB 25/27 | | | |
|---|---|---|---|
| **Valuation Date** | **12/31/2011** | **12/31/2010** | **12/31/2009** |
| Actuarial Value of Assets | $ 58,125,010,880 | $ 57,102,198,448 | $ 55,818,099,117 |
| Entry Age Accrued Liability | $ 61,846,696,903 | $ 59,876,065,931 | $ 58,178,272,142 |
| Unfunded Actuarial Accrued Liability | $ 3,721,686,023 | $ 2,773,867,483 | $ 2,360,173,025 |
| Funded Ratio | 94.0% | 95.4% | 95.9% |
| Run Out Date | N/A | N/A | N/A |
| Discount Rate | 7.25% | 7.25% | 7.25% |
| **Reporting Date (Fiscal Year Ending)** | **6/30/2012** | **6/30/2011** | **6/30/2010** |
| Net Pension Obligation (NPO) (balance sheet liability) | $193,352,000 | $ 206,646,000 | $ (36,207,000) |
| **Increase in Balance Sheet Liability** | $8,251,139,952 | $5,561,285,605 | $7,831,927,638 |

# GASB Estimates for Local Plan

Estimated NPL (GASB 67/68) vs. NPO (GASB 25/27)

| **GASB 67/68** | | | |
|---|---|---|---|
| **Valuation Date** | **12/31/2011** | **12/31/2010** | **12/31/2009** |
| Market Value of Assets | $ 17,908,429,907 | $ 17,758,651,398 | $ 16,137,374,092 |
| Entry Age Accrued Liability | 19,899,555,149 | $ 19,042,111,838 | $ 18,335,809,427 |
| Unfunded Actuarial Accrued Liability | $ 1,991,125,242 | $ 1,283,460,440 | $ 2,198,435,335 |
| Funded Ratio | 90.0% | 93.3% | 88.0% |
| Run Out Date | None | None | None |
| Discount Rate | 7.25% | 7.25% | 7.25% |
| Measurement Date | 12/31/2011 | 12/31/2010 | 12/31/2009 |
| **Reporting Date (fiscal year ending)** | **6/30/2012** | **6/30/2011** | **6/30/2010** |
| Net Pension Liability (NPL)* (balance sheet liability) | $ 1,991,125,242 | $ 1,283,460,440 | $ 2,198,435,335 |

| **GASB 25/27** | | | |
|---|---|---|---|
| **Valuation Date** | **12/31/2011** | **12/31/2010** | **12/31/2009** |
| Actuarial Value of Assets | $ 19,326,359,293 | $ 18,570,513,903 | $ 17,723,253,496 |
| Frozen Entry Age Accrued Liability | $ 19,373,799,717 | $ 18,646,430,030 | $ 17,804,791,750 |
| Unfunded Actuarial Accrued Liability | $ 47,440,424 | $ 75,916,127 | $ 81,538,254 |
| Funded Ratio | 99.8% | 99.6% | 99.5% |
| Run Out Date | N/A | N/A | N/A |
| Discount Rate | 7.25% | 7.25% | 7.25% |
| **Reporting Date (Fiscal Year Ending)** | **6/30/2012** | **6/30/2011** | **6/30/2010** |
| Net Pension Obligation (NPO)** (balance sheet liability) | N/A | N/A | N/A |

# Questions?

**THANK YOU**