Public Employee Pension Accounting Overview

Governmental Accounting and Auditing Symposium

June 19, 2013

- Agenda:
  - Summary of Provisions of New Pension Standards
  - Impact of the New Standards
  - Accounting Issues Related to Multiple- Employer Plans under New Pension Standards
    - Will focus primarily on VMERS
- What we will not cover:
  - Special Funding Situations (VSTRS)- this will be reviewed in a separate document for distribution to participating entities

An Overview of VMERS

- Vermont Municipal Employees' Retirement System (VMERS) is the public pension plan provided by the State of Vermont for participating municipalities' employees. It was created in 1975 and is governed by Vermont Statute Title 24, Chapter 125.

- Board of Trustees:
  - Steven Jeffrey Chair, Employer Representative
  - Thomas Golonka, Employer Representative
  - Peter Amons, Employee Representative
  - David Rowlee, Employee Representative
  - Elizabeth Pearce , State Treasurer Ex-Officio

- Plan has 444 participating entities

- As of March 31, 2013, the plan has assets of $459.1 million

VMERS Membership

(as of July 1, 2012)

Member Type	Group A	Group B	Group C	Group D	Total
Active, Vested	1,629	1,853	422	81	3,985
Active, Not Vested	1,071	1,245	262	43	2,621
Terminated Vested	354	246	21	2	623
Inactive	890	687	65	11	1,653
Retired	811	956	207	17	1,991
Total	4,755	4,987	977	154	10,873

VMERS Funding Progress

Year Ending 6/30	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	Unfunded ALL (UAAL)	Funded Ratio	Covered Payroll	UAAL as % of Payroll
2012	$417,443	$488,572	$71,129	85.4%	$215,075	33.1%
2011	402,550	436,229	33,679	92.3%	205,589	16.4%
2010	376,153	409,022	32,869	92.0%	202,405	16.2%
2009	331,407	366,973	35,566	90.3%	191,521	18.6%
2008	348,740	343,685	-5,055	101.5%	175,894	-2.9%
2007	325,774	309,853	-15,921	105.1%	162,321	-9.8%
2006	288,347	276,552	-11,795	104.3%	148,815	-7.9%
2005	259,076	248,140	-10,936	104.4%	146,190	-7.5%
2004	232,890	225,092	-7,798	103.5%	135,351	-5.8%
2003	222,854	218,533	-4,321	102.0%	126,216	-3.4%
2002	193,278	176,109	-17,169	109.7%	106,986	-16.0%
2001	177,928	158,786	-19,142	112.1%	101,873	-18.8%
2000	161,900	138,697	-23,203	116.7%	87,147	-26.6%
1999	137,454	114,481	-22,973	120.1%	70,808	-32.4%
1998	113,678	102,005	-11,673	111.4%	87,328	-13.4%
1997	96,196	85,686	-10,510	112.3%	70,800	-14.8%

Municipal Retirement System

Category	2010	2011	2012
Employee Contributions	$ 10,711,600	$ 11,702,728	$ 11,337,926
Employer Contributions	$ 10,592,919	$ 11,117,363	$ 11,532,230
Other Income	$ 203,549	$ 266,425	$ 118,191
Investment Income (Reduction)	$ 47,598,096	$ 66,957,781	$ 7,671,464
			$ 30,659,811
Retirement Benefits	$ 11,073,098	$ 12,298,902	$ 14,214,160
Refunds	$ 1,127,574	$ 1,275,979	$ 1,664,687
Administrative Expenses	$ 393,947	$ 569,603	$ 672,851
Other Expenses	$ 795,522	$ 886,709	$ 469,599
			$ 17,021,297
Addition (Reduction) to Net Assets Held in Trust for Pension Benefits	$ 55,716,023	$ 75,013,104	$ 13,638,514

VMERS Facts

- VMERS benefits are funded by member contributions, employer contributions, and net investment returns.
- Investment returns historically provide the majority of funding for pension benefits.
- VMERS is currently 85.4% funded. Much of the unfunded liability is related to investment performance in the Great Recession while smaller amounts are attributable to retirement experience, demographic or economic assumptions.
- Employer rates are set by the VMERS Board of Trustees every year after an annual actuarial valuation is conducted by an independent actuary.
- Member rates are set by the Legislature although the Board does make recommendations.

What Do the New Standards Mean for VMERS?

Current GASB:

- Employers only report a liability if they fail to make the full amount of their contractually required contribution to the plan. Not a current issue for participating employers.
- Pension expense= pension contribution
- Does not require actuarial presentation by participating employers

New Standard:

- The participating municipality will report a net pension liability based on its proportion of the collective net pension liability of all of the governments participating.
- Proportion is based on contributions - the use of the government's long-term expected contribution effort to the plan divided by those of all government in the plan is recommended.
- Since all employers (within each group) in VMERS pay the same actuarially determined contribution rate as a percentage of payroll, the proportionate share can be determined based on the proportionate share of expected payroll.
- Changes will begin in 2014 for the State CAFR, including VMERS disclosures (although State will have a zero NPL), effective FY2015 for participating municipalities.

GASB 67 & 68

In June 2012, the GASB approved two new accounting and reporting standards for pensions provided by state and local governments:

GASB ACTIVITY	YEAR
Added to GASB Research Agenda	2006
Added to GASB Project Agenda	2008
Invitation to Comment	2009
Preliminary Views Issued	2010
Public Hearings Held	2010
Exposure Draft Issued	2011
Public Hearings Held	2011
GASB 67 & 68 Statements Issued	2012
GASB 67 Implementation Guide (scheduled)	June 2013
GASB 68 Implementation Guide (scheduled)	January 2014

What Does it Change?

- GASB Statement No. 25 and 50:
  - Financial Reporting for Pension Plans
  - Amended by GASB Statement No. 67

- GASB Statement No. 27 and 50:
  - Accounting for Pensions by Employers
  - Amended by GASB Statement No. 68

When Does This Go Into Effect?

- GASB 67 Plan Reporting:
  - Effective for fiscal years beginning after June 15, 2013
  - For plans with a December 31 fiscal year end, December 31, 2014 financial statements
  - For plans with a June 30 fiscal year end, June 30, 2014 financial statements

- GASB 68 Employer Reporting:
  - Effective for fiscal years beginning after June 15, 2014
  - For employers with a December 31 fiscal year end, December 31, 2015 financial statements
  - For employers with a June 30 fiscal year end, June 30 , 2015 financial statements

Popular Misconceptions

Misconception	The Reality
GASB is requiring increased funding	NO change in the Plan’s current Funding Policy Contribution, methods or assumptions, but perhaps a need to state a Funding Policy to the extent the policy is linked to GASB 25/27 or a need to revise based on cross-over testing. (Source: Buck Consultants) “The new pension Statements relate only to accounting and financial reporting, or how pension costs and obligations are measured and reported in external financial reports… The new Statements mark a definitive separation of accounting and financial reporting from funding.“ (Source: GASB Fact Sheet)
GASB will create new pension obligations	Financial statement recognition and disclosures don’t create pension obligations; instead, they simply make existing obligations more transparent. (Source: GASB) The standards do set forth a different basis of recognition of pension obligations, while not creating any new obligation.

Popular Misconceptions

Misconception	The Reality
Government pensions now required to use lower discount rates	Per GASB: "The selection of an appropriate interest rate for discounting projected future benefit payments to their present value is based on what resources are projected to be used to make those payments: (1) assets of the plan that have been invested using an investment strategy to achieve the assumed long-term expected rate of return and their earnings; or (2) the general resources of the government employer."
Discount rate is based on funding ratio (low ratio = lower discount rate)	The discount rate is not based on the plan's funded status but the projected benefits, current benefits, and projected benefits for current members, including future contributions. Per GASB: "If a government reaches a *crossover point*—when projected benefit payments for current employees and inactive employees exceed projected plan net position related to those employees—then benefit payments projected to be made from that point forward will be discounted using a high-quality municipal bond interest rate. … However, it is true—all other factors being equal— that the less well-funded a pension plan is, the more likely it will reach a crossover point and therefore have to discount some projected benefit payments using the municipal bond index rate."

Types of Defined Benefit Plans

- **Cost-sharing multiple employer** plans provide benefits for multiple employers. Assets are pooled for investment purposes and can be used to pay the benefits of any employer.
  - Vermont Municipal Emplouees Retirement System (VMERS)
  - A single actuarial valuation is conducted for all of the employees of the participating governments combined.
- **Single employer** plans provide benefits for a single employer
  - Some Vermont municipalities have their own plans and do not participate in VMERS
- **Agent multiple employer** plans provide benefits to multiple employers. Assets are pooled for investment purposes, but held in separate employer accounts for the payment of benefits.
- **Some muncipalities have their own plan** for certain classifications of employees, as well as participate in the VMERS plan.

Plan Type	Assets	Liabilities
Single Employer	Distinct and Separate	Distinct and Separate
Agent Multiple Employer	Pooled for Investment	Distinct and Separate
Cost-Sharing Multiple Employer	Pooled For Investment	Commingled

If you have your own plan in place of, or in addition, to VMERS…

- Will report note disclosures for GASB 67 (FY2014)
- Will report your full Net Pension Liability (NPL) on your statements (FY2015)
- Will report any additional NPL from VMERS participation as well and related disclosures (FY 2015)

What are the Impacts of GASB 67?

- Few changes from GASB 25 for financial statements:
  - Continue to present two financial statements
    - Statement of Fiduciary Net Position
    - Statement of Changes in Fiduciary Net Position
    - Generally similar to current guidance
- Notes to Basic Financial Statement Section:
  - Additional Information on money-weighted internal rate of return on plan investments, net of investment expenses
  - New note disclosure on **Net Pension Liability or NPL**
  - Disclosure of discount rates determined by cash flow testing
  - Measurement of the NPL is as of fiscal year end
- Required Supplemental Information (RSI)
  - RSI changes primarily to reflect changes in measurement of liabilities of employers
  - RSI schedules prospective (except for contribution schedule) if information not initially available

What are the Impacts of GASB 68?

- Net Pension Obligation (NPO) on the government wide financial statements will be replaced by a Net Pension Liability (NPL)
  - On Market Value basis
  - Entry Age Normal Cost Method must be used (used in VSTRS and VSERS currently, different method for VMERS)

- Significant impact in first year due to NPL impact vs. NPO

- Discount rate equal to expected investment rate of return, except for:
  - Benefit payments not expected to be funded
  - Discounted at a high quality 20-year tax-exempt municipal bond index rate
  - “Run-out date” projections used to determine cross-over point
  - More problematic for systems currently using “open amortization”

- In prior standard, the Annual Required Contribution (ARC) was the basis of a funding strategy

- No ARC equivalent in the new standards

What are the Impacts of GASB 68?

- While this will have an impact on the financial statements, the basic financial reality of pension has not changed.

- "$1,000 owed to a retired employee in ten years under the current standards will remain $1,000 owed in ten years under the new standards."

  - Utah Retirement System

What are the Impacts of GASB 68?

- In current standard, the focus is on whether the government is making its ARC contributions to adequately fund the plan.
- Under the new standard, the focus is on the size and growth of the NPL.
- These standards do not change the VMERS funding methodology established in state statute.
- Will lead to more volatility in the NPL and funded ratio reported for accounting purposes.

Separates Funding Policy from Accounting Expense

- GASB clearly states that new standards are not intended as a funding strategy

- In prior standard, the Annual Required Contribution (ARC) was the basis of a funding strategy

- There will likely be increased volatility in the NPL and Pension Expense from year to year
  - Uses fair market values that fluctuate from year to year
  - Changes in liabilities will be recognized over a shorter period of time
  - All employers affected- Employers participating in cost-sharing plans will see their proportional share of the pension expense vary from year to year

- The annual pension expense will likely be too volatile and complex to serve as a funding policy

Actuarially Determined Contributions

"The Board has removed the specific link between (a) the accounting measures of the net pension liability and pension expense and (b) the actuarially determined funding-based measures. However, the Board concluded that, in circumstances in which an actuarially determined contribution rate is established, a 10-year schedule providing information about that contribution rate, the contractually required contribution rate for cost-sharing pension plans, contributions to the pension plan, and certain ratios is essential for providing historical and economic context for the amount of contributions reported as additions to the pension plan's fiduciary net position. Therefore, this information should be presented as required supplementary information."

Source: Paragraph 106, GASB Statement No. 67

GFOA Recommended Funding Policy

- "In the absence of ARC disclosures, it will be difficult for stakeholders, including policy-makers, employees and the public to determine whether obligations are being appropriately funded."

- **Recommendation**. The Government Finance Officers Association (GFOA) recommends that every state and local government that offers defined benefit pensions formally adopt a funding policy that provides reasonable assurance that the cost of those benefits will be funded in an equitable and sustainable manner. Such a funding policy should incorporate each of the following principles and objectives:
  - Every government employer that offers defined benefit pensions should continue to obtain no less than biennially an actuarially determined contribution (ADC) to serve as the basis for its contributions;
  - The ADC should be calculated in a manner that fully funds the long-term costs of promised benefits, while balancing the goals of 1) keeping contributions relatively stable and 2) equitably allocating the costs over the employees' period of active service;
  - Every government employer that offers defined benefit pensions should make a commitment to fund the full amount of the ADC each period. For some government employers, a reasonable transition period will be necessary before this objective can be accomplished;
  - Every government employer that offers defined benefit pensions should demonstrate accountability and transparency by communicating all of the information necessary for assessing the government's progress toward meeting its pension funding objectives.

- The GFOA intends to develop additional best practices that will provide specific guidance on the practical application of these principles and objectives to each of the three core elements of a comprehensive pension funding policy: actuarial cost method, asset smoothing, and amortization.

- Approved by the GFOA's Executive Board, February 2013

What is NPL?

- Net Pension Liability (NPL) = Difference between Total Pension Liability (TPL) and the plan's fiduciary net pension position
- Uses fair (market) value of assets
- Incorporates past service liability
- Includes effects of projected future salary increases and COLAs
- Must use Entry Age Normal (EAN) method (pure form, no variations)
- Discount rate requirement

What are the Changes to Liability Recognition?

Current Standard:

- UAAL = Actuarial Accrued Liability (AAL) minus Actuarial (smoothed) Value of Assets (AVA)
- AAL= The portion of the actuarial present value of projected benefits (and expenses, if applicable), as determined under a particular actuarial cost method, that is not provided for by future normal costs (source: Actuarial Standards Board)
- The funding method under the current standards may be any one of several methods
- Funded Ratio = Actuarial Value of Assets divided by Actuarial Accrued Liability (AVA / AAL)
- The above are disclosed, but not recognized on the financial statements
- NPO= Net Pension Obligation, the accumulated shortfall of the amount that the employer's contributions fall short of the required contribution, which is recognized in the financial statements

New Standard:

- NPL = Total Pension Liability (TPL) minus Plan Net Position (market value of assets)
- TPL = the present value of projected benefit payments to be provided through the pension plan to current active and inactive employees that is attributed to those employees' past periods of service
- Requires use of EAN method
- Funded Ratio = Plan Net Position divided by Total Pension Liability (MVA / TPL)
- The NPL will be recognized on the financial statements

NPL will likely be greater than UAAL at time of implementation if MVA < AVA

Recognition of Changes to the NPL

- Most recognized as pension expense in the period of the change:
  - Current period service cost (this is essentially the same as normal cost or pension benefits earned during the reporting period)
  - Interest on total pension liability
  - Changes in benefit terms
  - Long term expected rate of return on pension plan investments

- Others recognized as deferred outflows/inflows of resources with expense recognized over defined future periods:
  - Changes of economic and demographic assumptions
  - Differences between expected and actual experience from sources other than investments
  - Difference between projected earnings on investments and actual investment earnings

Recognition in Pension Expense

- Full amount of change in NPL due to all benefit changes (for actives and retirees) is recognized immediately
- Demographic gains /losses and assumption changes are expensed over average expected working lifetime of all members (includes retirees)
- Maximum five year expensing of investment gains and losses

To Summarize…

The following will be required on the financial statements of Vermont municipalities either in VMERS or with their own retirement plans:

- Net Pension Liability
- Pension Expense
- Pension-related deferred outflows of resources and deferred inflows of resources

For single-employer defined benefit plans, each employer will recognize 100% of the above amounts for each plan

For cost-sharing multiple-employer plans (VMERS), participating employers will recognize their proportionate share of the collective amounts for the plan as a whole

Sample Presentation of Impacts

Buck Consultants estimated the impact of GASB changes in a "Sample Plan"

- Compared estimated NPL (GASB 68) to NPO (GASB 27) for a local plan
- As if GASB 68 in effect for current and prior to valuations
- Basis for NPL estimates in the sample :
  - Assume current discount rate (7.25%) not impacted by asset "run out" date
  - Entry Age Normal cost method for accrued liabilities
  - Market Value of Assets
  - All other assumptions based on actuarial valuations as of 12/31/2009, 12/31/2010 and 12/31/2011

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

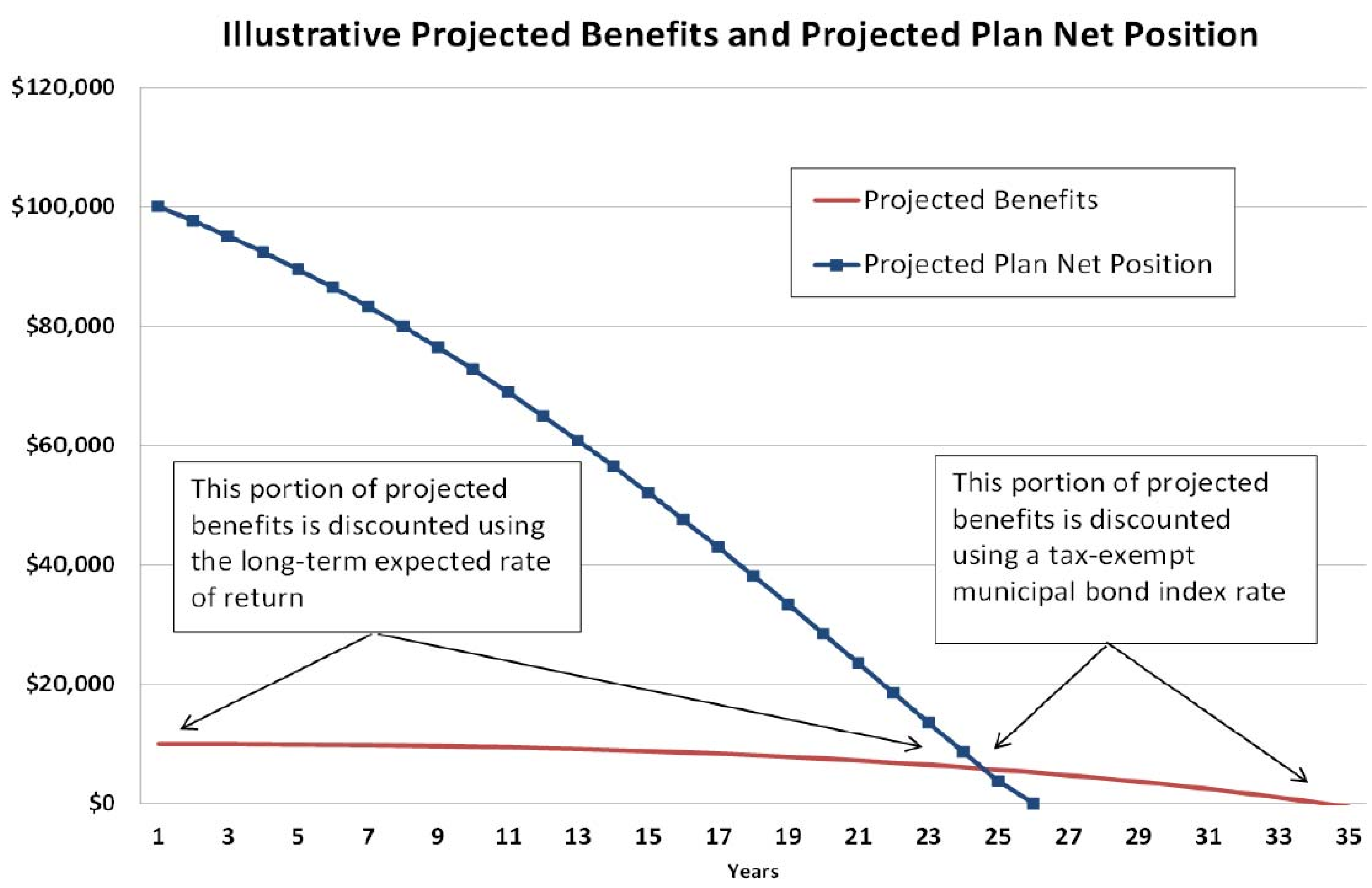
* Each participating employer will need to disclose their proportionate share of the Net Pension Liability

** Each participating employer reports their Net Pension Obligation

Source: Buck Consultants

Discount Rate Determination

- Project **benefits** for current actives, inactives and retirees
- Project **administrative expenses**
- Project **employee contributions** from current actives
- Project **contributions** from the employer and non-employer contributing entities and other sources:
  - *Professional judgment applied to (a) those contribution amounts are established by statute or contract or (b) a formal, written policy related to those contributions exists. Consider 5-year contribution history*
  - *In other circumstances, the amount of projected cash flows for contributions from the employer and non-employer contributing entities should be limited to an average of contributions from those sources over the most recent five-year period and may be modified based on consideration of subsequent events (GASB Statement No. 68, paragraph 28)*
- Project **investment return** under expected investment policy
- If there is a cross-over date, will depend on the funding policy



Source: Gabriel Roeder & Smith

Required Disclosures

- Plan description, including benefits and terms, covered employees and contribution requirements
- Information on NPL, including assumptions for its development
- NPL using a discount rate plus or minus 1%
- Plan's net financial position

Required Disclosures for Single and Agent Employers

- Changes in components of NPL by source
- Description of changes in assumptions and benefit terms
- Basis for employer's actual contributions
- Components of pension expense
- Components in changes in deferred outflows/inflows

Required Disclosures for Cost-Sharing Multiple Employers

- Basis for employers actual contributions
- NPL
- Deferred inflows/outflows
- Pension expenses
- Date of valuation
- Description of changes in assumptions and benefit terms

RSI Changes

- Including series of ten-year schedules (again, prospective)
  - Annual money-weighted return on plan investments
  - NPL and related ratios
  - Changes in NPL components by source (single and agent employers)
  - Schedule of proportionate share of NPL (cost-sharing multiple employer plans)
  - Contribution schedules

How Often and Who?

- "Actuarial valuations of the total pension liability are required to be performed at least every two years, with more frequent valuations encouraged. If a valuation is not performed as of the measurement date, the total pension liability is required to be based on update procedures to roll forward amounts from an earlier actuarial valuation (performed as of a date no more than 30 months and 1 day prior to the employer's most recent year-end)."

  -GASB, Summary of Statement No.67

- VMERS is expected to complete these annually as of July 1. Data will be available in the Fall.

- GASB does not specify who (plan or each participating employer) should calculate proportionate share of the collective amounts.

- VMERS current coding of employees provides breakdown of contributions by employer and the associated employees by plan and group for all active, vested, inactive and retired members. Our actuary states the data necessary to make these disclosures can be provided to every particpating muncipality.

Information to be Provided to Participating Municipalities (Proportionate Share)

- Pension expense
- Net pension liability
- Deferred outflows of resources
- Deferred inflows of resources
- Descriptions, census data and required disclosures for notes to financial statement
- Required supplementary information

What Do You Need to Do to Prepare?

- Communication issues:

  - Policymakers, general public will need information on the disconnect between pension accounting and funding.
  - Educate/Communicate with governing bodies about NPL, accounting and funding issues. This will add complexity to an already complex topic.

What Do You Need to Do to Prepare

- Actuarial & Audit Concerns:

- VMERS actuarial data is already sorted by participating entities and disclosures and allocations will be made available to all participating municipalities.
- Questions remain on how to audit this allocation to provide reassurance to non-Vermont state system auditors that the numbers are fairly presented.
- GASB 67 implementation guide, focused on plan implementation issues (including the calculation of the net pension liability), is scheduled for release in June 2013.
- GASB 68 focusing on additional questions related to employer-specific requirements in Statement No. 68, is set for publication in January 2014.
- AICPA's State and Local Government Expert Panel is currently analyzing the standards to determine appropriate actions and auditor guidance that will be needed.
- AICPA has stated it is communicating the significant implications for preparers and auditors via web events, email communications, risk alerts, and articles.
- Expect a significant update to the AICPA Audit and Accounting Guide, State and Local Governments.

GASB Implementation Guide–Pension Accounting and Financial Reporting—Project Plan

Project Description: The objective of this project is to publish guidance to assist pension plans, employers, and governmental non-employer contributing entities as they prepare to implement Statements No. 67, *Financial Reporting for Pension Plans,* or Statement No. 68, *Accounting and Financial Reporting for Pensions,* as applicable.

Background: Statements 67 and 68 were approved in June 2012. Statement 67 is effective for plans for fiscal years beginning after June 15, 2013. Statement 68 is effective for employers and governmental non-employer contributing entities for fiscal years beginning after June 15, 2014.

Project History: In the final third of 2012, an advisory committee was formed and staff began to compile issues to be considered for inclusion in the guides.

Current Developments: In the first third of 2013, staff continued to compile issues to be considered for inclusion in the guides.

Work Plan: The following work plan anticipates the issuance of two Implementation guides—the first focused on plan implementation issues, including calculation of the net pension liability (collective net pension liability), and the second focused on additional issues related to employer-specific requirements in Statement 68. The projected timetable for the project is as follows:

Board Meetings	Topics to be considered
May 2013	Review ballot draft of plan guide.
June 2013	Issue Plan Guide.
July 2013-November 2013	Staff development of additional material for employer guide and review of proposal by Advisory Committee.
December 2013	Review ballot draft of employer guide
January 2014	Issue employer guide

Source: GASB Web Site

Funding Concerns

- Vermont and its local governments and their pension boards/committees will need to proactively address funding strategies. Some are explicit in statute (although an opportunity to review exists), others are not.

- Prior funding policies likely based on GASB Statements 25 & 27.

- With their absence, municipalities with single employer plans should develop explicit policies for funding (see GFOA recommendation).

- Need clear funding strategy and discipline necessary to ensure improvement in funding status and to accumulate funds to pay retirement benefits on a reasonable and stable basis over time.

In Conclusion

- Single employer plans will implement GASB 67 disclosures in FY 2014.
- Though the changes for VMERS municipal employers will not go into effect until fiscal year 2015, we encourage employers to discuss these changes and their implications with the policy makers and preparers of your financial statements now.
- The Treasurer's Office and VMERS will provide more information about implementation as it becomes available.
- State Treasurer's Office will have a GASB 67/68 Resource Page on its web site in July 2013.