Preparing for the New Pension Standards – What to Expect and Best Practices

ICCCFO Conference
Thursday, April 18, 2013
Today’s presenters

- Linda Abernethy
  - Partner
  - linda.abernethy@mcgladrey.com

- Tara Leja
  - Director
  - tara.leja@mcgladrey.com
Statements issued in June 2012
GASBS 67 – Reporting of plans
  - Effective for fiscal years beginning after June 15, 2013
GASBS 68 – Employer/sponsor accounting/reporting
  - Effective for fiscal years beginning after June 15, 2014
Standards address
  - Changes in governmental accounting and financial reporting, principally accrual-based government-wide financial statements
  - A need among the users of governmental financial reports for comparable information about pensions
Establishes standards of accounting and financial reporting for defined benefit pensions and defined contribution pensions provided to the employees of state and local governmental employers through pension plans

Focus on accounting and reporting by pension plans is addressed in GASBS 67
GASBS 68 – Basic Considerations

- Defined benefit pensions originate from exchanges between the employer and employees resulting from employee services.

- Compensation expense should be recognized in the period employee services are provided.
GASBS 68 – GASB’s fundamental approach

- View the cost of pensions within the context of an ongoing, career-long employment relationship
- Use an accounting-based versus funding-based approach to measurement
- Produce measures of the employer’s obligation to employees and the current period cost to taxpayers of providing governmental services
GASBS 68 – Key GASB Conclusions

- An employer is primarily responsible for the unfunded pension obligation resulting from an employment exchange.
- The difference between the total pension liability and the plan net position would be reported as a net pension liability in the financial statements of the government(s).
GASBS 68 – major accounting change

- A government employer will report in its financial statements a net pension liability for DBPs equal to the difference between the total pension liability and the value of assets set aside in a pension plan to pay benefits to current employees, retirees and their beneficiaries.
  - Implementation of GASBS 68 would require a restatement of the financial statements to reflect this liability as of the beginning of the year.
GASBS 68 – another major accounting change

- A government participating in a cost-sharing DBP will report a liability in its own financial statements that is equivalent to its long-term proportionate share of the collective net pension liability.

  - proportionate share based on the employer’s expected contribution effort relative to that of all contributors.
GASBS 68 – yet another major accounting change

- Special funding situations for DBPs
  - Under certain conditions both governmental non-employer contributing entities and governmental employers will recognize a proportionate share of the collective net pension liability
  - i.e. College (employer) and State (non-employer)
State of Illinois example

- Current Illinois State Statutes
  - State currently covers 100%
  - Pension reform could reduce this percentage

- For example....
  - An employer whose pro rata share of a cost sharing defined benefit plan is 2%
  - State passes legislation that causes participating employers to fund 5% of pension plan, State is responsible for 95%
  - The employer would accrue a pension liability of its 2% share of 5% of the liability
    - Calculated as difference between actuarially accrued liability and assets available to fund liability
GASBS 68 – three step approach for measurement DBPs

1. Determine projected benefit payments
2. Discount future payments to determine present value of payments
3. Attribute PV of payment to employee periods of service

Selection of all actuarial assumptions should be made in accordance with Actuarial Standards of Practice (with consideration of specific guidance provided by the GASB).
Benefit projections

- The projection of pension benefit payments should include the effects of projected future salary increases and future service credits including automatic cost of living adjustments (COLAs)

- Ad hoc COLAs would be incorporated into projections of pension benefit payments only if an employer’s practice indicates that the COLAs are substantively automatic
GASBS 68 – actuarial considerations DBPs, continued

- Discount rate
  - Should be a single rate that reflects
    - The long-term expected rate of return on plan investments to the extent that
      - Plan net position is projected to be sufficient to make benefit payments that are projected to occur in the period, and
      - Assets are projected to be invested using a long-term investment strategy
    - A high-quality tax exempt municipal bond index rate to the extent that plan net position is projected to no longer be available for long-term investment
Timing and frequency of measurement

- Recognize a net pension liability that is measured as of a date (the measurement date) no earlier than the end of its prior fiscal year, consistently applied from period to period.

- Total pension liability component of the net pension liability at the measurement date is determined either by:
  - An actuarial valuation as of that date or
  - The use of update procedures to roll forward amounts to the measurement date from an actuarial valuation as of a date no more than 30 months (plus 1 day) prior to the fiscal year-end.

- Actuarial valuations at least biennially
  - More frequent valuations are encouraged.
GASBS 68 – measurement DBPs

- Plan net assets
  - Measurement of investments at fair value
- Pension expense
  - Immediate
  - Deferred
GASBS 68 – expense recognition DBPs

- **Immediate**
  - Pension benefits earned during the reporting period (service cost or normal cost)
  - Interest cost on the total pension liability
  - Changes in benefit terms that affect the total pension liability

- **Deferred**
  - Expense would be deferred and recognized over a period equal to the average remaining service periods of active and inactive (including retirees) employees for
    - Differences between expected and actual changes in economic and demographic factors
    - Changes in assumptions about economic and demographic factors
  - Differences between actual and projected earnings on plan investments would be deferred and recognized as pension expense over a five-year, closed period
GASBS 68 – disclosures

- General information
  - Plan name, type and administrator
  - A brief description of the benefit provisions
  - A brief description of contribution requirements
  - The number of employees covered by the plan
  - Whether the pension plan issues a stand-alone financial report and how to obtain the report
GASBS 68 – disclosures DBPs

- **Actuarial information**
  - Assumptions used in measurement of PBL
  - Discount rate
    - Assumptions
    - Expected LT rate of return
    - Municipal bond rate
    - Sensitivity analysis

- **Also**
  - Changes in net pension liability
  - Deferred inflows and outflows
GASBS 68 – required supplementary information (RSI) DBPs

- 10-year schedules for all governments, regardless of type of plan (plus notes)
  - Changes in the net pension liability by source
    • Collective level for cost-sharing employers
  - Components of the net pension liability and ratios:
    plan net position ÷ total pension liability;
    net pension liability ÷ covered-employee payroll
    • Collective and individual level for cost-sharing
  - Contribution information, if a government has an actuarially determined contribution:
    actuarially calculated contribution – actual contributions;
    contributions ÷ payroll
GASBS 68 – RSI for cost-sharing employer’s DBPs

- 10-year schedules
  - Changes in the net pension liability (cost-sharing at collective level only)
  - Cost-sharing at both collective level and employer level with employer proportionate share percentage
    - Total pension liability, plan net position, net pension liability, and
      - Plan net position as a percentage of the total pension liability
      - Net pension liability as a percentage of covered-employee payroll
    - Statutory/contractual employer contributions, actual contributions made, the difference between them, and contributions made as a percentage of covered-employee payroll
Suggested Action Items and Best Practices

- Determine the measurement date you plan to use, and discuss it with your actuary. If the actuarial valuation can be performed as of the measurement date, a roll-forward of the actuary’s calculation will not be necessary.
  - This should be a simple matter for most single employer plans, but is not as simple for multiple employer plans.
Suggested Action Items and Best Practices, continued

- If you are in a multiple employer plan, try to arrange a meeting of all the employers involved (and the plan’s administrator).
  - Discuss the timing and frequency of the actuarial valuation and how (and when) information will be disseminated to each employer.
  - If the actuarial valuation date is before the measurement date, discuss how an individual employer can obtain sufficient detail to enable an independent roll-forward of the calculation (unless this will be provided by the administrator).
Suggested Action Items and Best Practices, continued

- If the measurement date and actuarial valuation date will not coincide, **determine who will perform** the necessary roll-forward. This calculation is a significant estimate, and major changes since the original valuation date could have a material impact on the calculation.
  - Your auditor may be unable (or unwilling) to perform this work. Consider if you will need to engage another actuary to update the original valuation.
Cost sharing plan participants – make sure you understand the contribution requirements as they will significantly impact the “proportionate share” of the liability you will record.
- Determine how frequently the cost sharing allocations will be reviewed and the manner in which this will take place. Identify and communicate any concerns early in the process.
Meet with your governing body. Discuss the requirements of the new standard, the expected impact on net position, the significant assumptions selected by management, and discuss the level of involvement of other entities (other governments, plan administrators, etc.)
Be informed about the impacts of underfunding. A significantly underfunded plan will not go un-noticed by the rating agencies and certain other users of your financial statements.

- Be prepared to discuss the impact this may have with your governing body. A rating decrease will likely increase your borrowing rate and could make debt issuances less affordable.
Suggested Action Items and Best Practices, continued

- If you are responsible for engaging the actuary, meet with them early and make sure they are aware of the requirements of the new standards (both 67 and 68).
  - Determine what they will need from you in order to perform a timely and accurate actuarial valuation.
  - Discuss deadlines, both on your end and theirs.
Suggested Action Items and Best Practices, continued

- Meet with your auditors. Discuss your plan for implementing this standard and ask for feedback.
  - Find out what the auditor will require in terms of documentation and support.
  - Provide information about the actuary to be engaged and what you know of their qualifications and professional reputation. Involving the actuary in this meeting would be beneficial.
  - Consider allowing your auditor to evaluate the significant assumptions you plan to use, particularly the long-term rate of return on investments, before the actuary finalizes the calculation.
Draft the new footnotes and RSI. This will likely take a sizeable investment of your time.

- If you will be asking your auditors (or independent consultants) to prepare this information, discuss what information they will need, the timing of the work, the assistance they can seek from the actuary, and any other concerns pertaining to these non-audit services.
Next Steps

- Read and become familiar with the text of both GASB Standards
- Be on-the-lookout for GASB implementation guidance
- Handouts provided to you today:
  - Read McGladrey’s whitepaper [GASB Statement No. 68, Accounting and Financial Reporting for Pensions](#)
  - Illustrative examples of disclosures from GASB Statement No. 68 text
Thank you for your participation!

Questions???
Disclaimer
The information contained herein is general in nature and based on authorities that are subject to change. McGladrey LLP guarantees neither the accuracy nor completeness of any information and is not responsible for any errors or omissions, or for results obtained by others as a result of reliance upon such information. McGladrey LLP assumes no obligation to inform the reader of any changes in tax laws or other factors that could affect information contained herein. This publication does not, and is not intended to, provide legal, tax or accounting advice, and readers should consult their tax advisors concerning the application of tax laws to their particular situations.

Circular 230 Disclosure
This analysis is not tax advice and is not intended or written to be used, and cannot be used, for purposes of avoiding tax penalties that may be imposed on any taxpayer.

McGladrey LLP is the U.S. member of the RSM International ("RSMI") network of independent accounting, tax and consulting firms. The member firms of RSMI collaborate to provide services to global clients, but are separate and distinct legal entities which cannot obligate each other. Each member firm is responsible only for its own acts and omissions, and not those of any other party.

McGladrey, the McGladrey signature, The McGladrey Classic logo, The power of being understood, Power comes from being understood and Experience the power of being understood are trademarks of McGladrey LLP.

© 2012 McGladrey LLP. All Rights Reserved.