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PERiSCOPE Public Employee Retirement Systems

New accounting rules for public pension plans in the United States are set to take effect beginning in 2014. Successful implementation of the new rules will require an understanding of a variety of technical concepts regarding the various newly required calculations. In this multi-part PERiScope *series, we will explore these technical topics in detail. The series begins with the current article, "GASB 67/68: Beginning implementation and overview," to introduce the technical concepts at a high level, as well as to outline important points for beginning implementation in 2014. See sidebar for more information on upcoming technical articles in this series.*

GASB 67/68: Beginning implementation and overview

Jennifer Sorensen Senta, ASA, MAAA

The Governmental Accounting Standards Board (GASB) in 2012 released new accounting standards for public pension plans and participating employers. These standards, GASB Statements No. 67 and 68, have substantially revised the accounting requirements previously mandated under GASB Statements No. 25 and 27. Required implementation is imminent, with GASB 67 effective for plan fiscal years beginning after June 15, 2013, and GASB 68 effective for employer fiscal years beginning after June 15, 2014.

Milliman has established a GASB 67/68 Task Force, one of the primary directives of which is the publication of a detailed miniseries of educational articles regarding the various key implementation and technical issues surrounding the new statements. Look for these articles to be published on a regular basis following the publication of this summary.

Fundamental changes to accounting

Perhaps the highest level of publicity for the new statements has centered around the new hard-line division of accounting from funding. The new GASB statements require a liability for pension obligations, known as the net pension liability (NPL), to be recognized on the balance sheets of the plan and participating employers. Similarly, a pension expense (PE) will be recognized on the income statement. These measures will be wholly unsuitable for measuring the funding of the plan, and GASB in fact intended them to be so. As stated by GASB in its "Setting the record straight" pension fact sheet, "[A]fter reexamining the prior standards for pensions, the GASB concluded that approaches to funding are not necessarily the best approach to accounting for and reporting pension benefits."[1]

Did you know? Milliman's GASB 67/68 Task Force will release an upcoming miniseries on technical and implementation issues surrounding GASB 67 and 68. Each article will be released through *PERiScope*. Look for the following articles in coming months:

- **Relationship between valuation date, measurement date, and reporting date**
- **Depletion date projections**
- **Long-term expected investment returns and the money-weighted rate of return**
- **Calculation specifics on individual entry age normal and recognition of deferred inflows/outflows**
- **Substantively automatic plan provisions**
- **Balance sheet items and projections from valuation date to measurement date**
- **Calculation of pension expense**
- **Proportionate share calculations**
- **Special funding situations**

Additionally, a Frequently Asked Questions document will be maintained, with links to relevant miniseries articles as they become available.
Visit www.milliman.com/GASB6768 for all the latest resources on the new GASB statements.

1 Governmental Accounting Standards Board, GASB's new pension standards: Setting the record straight. Accessed at **http://www.gasb.org/cs/ContentServer?c=Page&pagename=GASB%2FPage%2FGASBSectionPage&cid=1176160432178**

This means that pension plans that relied on the prior GASB definition of Annual Required Contribution (ARC) as a de facto funding measure will now need to define their own funding metric, whether through legislation or the implementation of a formalized funding policy. Significant attention is currently being paid to this area by the actuarial community; guidance already published by the Government Finance Officers Association (GFOA) is likely to be followed shortly by guidance from the Conference of Consulting Actuaries.

Getting started: Determining plan type

Implementation of the GASB statements should begin with a determination of GASB plan type, as the plan type under the GASB definition will determine specific requirements for the plan under both Statement 67 and Statement 68. The three types of plans for these purposes are single-employer, cost-sharing multiple-employer, and agent multiple-employer. Additionally, any of these plan types may also have a special funding situation, which will further impact calculations under GASB 68.

A *single-employer plan* is perhaps self-evident: a single pension plan that covers the employees of a single employer. A *multiple-employer plan* likewise is a single pension plan that covers the employees of more than one employer, e.g., a state-wide plan covering teachers. GASB has indicated that the difference between a *cost-sharing* multiple-employer and an *agent* multiple-employer plan hinges on the legal availability of plan assets to pay benefits. If plan assets are segregated for each participating employer and cannot legally be used to pay the benefits of other participating employers, then the plan may qualify as an agent multiple-employer plan under GASB. However, if plan assets are not legally segregated and may therefore be used to pay the benefits of any participating employer, then the plan would be classified as a cost-sharing multiple-employer plan under the new GASB standards. It is worth noting that many plans that consider themselves agent multiple-employer plans from an administrative standpoint may actually fall under the category of cost-sharing multiple-employer plan for GASB purposes. A multiple-employer plan should consult its attorneys when determining plan type for GASB purposes.

GASB 67: Accounting for the plan

GASB Statement 67 (replacing Statement 25) will be the first statement required to be implemented, as it applies for *plan* fiscal years beginning after June 15, 2013. Therefore, plan financial statements for fiscal years ending (FYE) in the latter half of 2014 (most commonly FYE June 30, 2014, or December 31, 2014) will be required to reflect the guidance of GASB 67. Note that a plan's fiscal year might not be the same as the employer's fiscal year. Even if the plan does not issue standalone financial statements, but rather is considered a pension trust fund of a government, it will be subject to GASB 67 implementation.

A broad technical overview

From an actuarial perspective, implementation of GASB 67 begins with the establishment of the GASB *measurement date* and the *actuarial valuation date* on which calculations will be based. For GASB 67, the measurement date must be the *plan's* current fiscal year-end. Thus, for initial reporting for a plan at fiscal year-end June 30, 2014, the measurement date will be June 30, 2014. Note that for GASB 67, there is no distinction between the reporting date and the measurement date (in contrast with GASB 68–see below for more on this).

The actuarial valuation date may be any date up to 24 months prior to the measurement date; however, the actuarial results must then be projected forward from the valuation date to the measurement date. This projection must reflect any source of material impact (e.g., a changing municipal bond rate's impact on the single equivalent discount rate; see below for details) between the valuation date and the measurement date. Additionally, if benefit changes are legally agreed upon or adopted prior to the measurement date, the actuarial valuation results must reflect those changes if material, even if the effective date of the change is later than the measurement date itself.

Once the valuation and measurement dates have been established, a depletion date projection for the plan would be performed to determine whether at any point in the future plan assets are projected to be insufficient to pay benefits to current members.

This calculation projects the *fiduciary net position* (i.e., the market value of assets) of the plan, subject to particular constraints imposed by GASB. In particular, projected contribution inflows to the plan are limited to contributions that are intended to fund the benefits of current plan participants. This means that normal cost contributions expected to be made for future participants may not be included in the projection of the fiduciary net position. Contributions expected to be made *by* future participants may be included if those contributions are anticipated to exceed the gross normal cost of benefits for those future participants, i.e., they are anticipated to be used to pay down the unfunded liability of current plan participants. Projected investment returns on fiduciary net position should be calculated using the long-term expected investment return assumption for the plan's portfolio, subject to certain requirements specified in the GASB statements.

The single equivalent discount rate

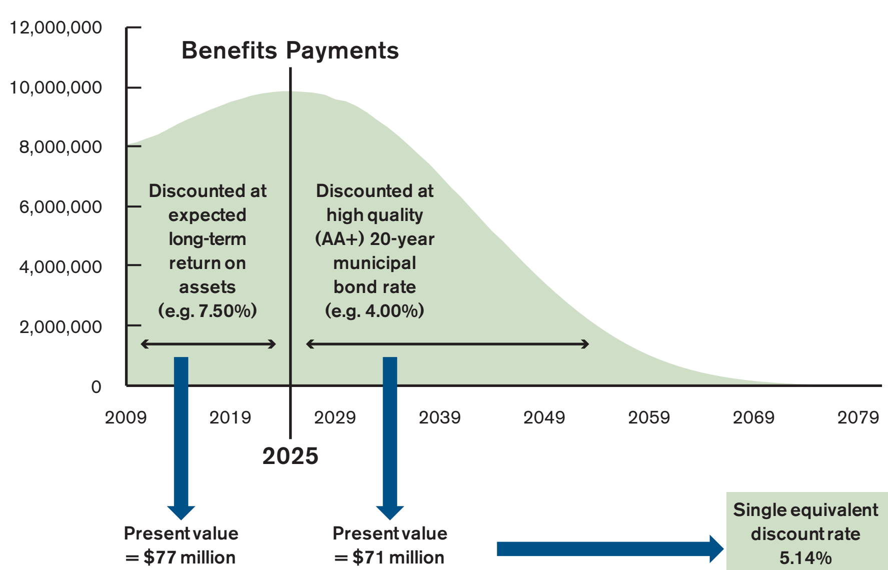
Once the fiduciary net position has been projected in accordance with GASB's specified methodology, this projection is compared with the projected plan benefit payments for current participants. Projected benefit payments for future participants are excluded. Benefit payments must reflect any benefits that are deemed to be "substantively automatic," regardless of whether they would typically be included for funding valuation purposes. For example, a plan with an ad-hoc cost-of-living adjustment (COLA) might not reflect this provision in the current actuarial valuation due to the uncertain nature of future granting. However, under the new GASB statements, if the COLA is determined to be substantively automatic, it must be reflected in the projected benefit payments. Whether a benefit is substantively automatic must be determined on a case-by-case basis. While the GASB statements indicate that an expectation of receiving the benefit may play into this determination, it will generally be up to the plan board, staff, and auditors to determine whether benefits for a given plan fall into this category.

For years in which the projected fiduciary net position is anticipated to be sufficient to cover projected benefit payments, the benefit payments may be discounted at the GASB-compliant long-term assumed rate of return. For years in which benefit payments are *not* projected to be covered by the projected fiduciary net position, a discount rate reflecting a 20-year tax-free municipal bond yield or index must be used. The resulting present value of benefits from this dual-discount methodology is then used to calculate the single equivalent discount rate for all years, which produces the same present value as the dual discount rates. This *single* equivalent discount rate is the plan discount rate for GASB purposes.

Total pension liability and net pension liability

The *total pension liability* (TPL) under the new GASB standards will be equal to the actuarial accrued liability for the plan, calculated under the GASB-specified individual entry age normal actuarial cost method, and using the single equivalent discount rate as determined above. This number, as of the GASB 67 measurement date, will then have the fiduciary net position as of the measurement date subtracted from it to obtain the GASB 67 total plan *net pension liability* (NPL). Note that the NPL is analogous to the figure typically referred to as the unfunded actuarial accrued liability.

FIGURE 1: EXAMPLE OF DUAL DISCOUNT RATES: PLAN IS PROJECTED TO RUN OUT OF ASSETS IN 2025



Disclosures

Implementation of GASB 67 will result in required enhancements to financial statement disclosures. For single-employer and cost-sharing multiple-employer plans, the notes to the financial statements will need to include information regarding the components of the NPL and the year-over-year change in NPL. For all plan types, a variety of other specific information regarding the pension plan will be required to be disclosed in the notes to financial statements.

In addition, certain required supplementary information (RSI) will be required under GASB 67. While single-employer and cost-sharing multiple-employer plans will be required to produce a number of 10-year schedules of various results, agent multiple-employer plans will be required to show only a schedule of money-weighted returns under this area of GASB 67. Note that the 10-year historical schedules need include only information for years in which the new GASB statements have been implemented; 10 years are not required to be shown in the early years of implementation (i.e., retroactive calculations are not required).

GASB 68: Accounting for the employer

GASB 68 governs the specifics of accounting for public pension plan obligations for participating employers. This statement must be implemented for *employer* fiscal years beginning after June 15, 2014. Because this places required implementation in 2015 and later, GASB has not yet released a detailed implementation guide for this statement. Further guidance is anticipated in early 2014.

The two key technical concepts of GASB 68 are calculation of pension expense and a determination of how NPL and pension expense will be recognized among employers (proportionate share). Under GASB 68, the plan type is key to determining how NPL and pension expense will be recognized among employers.

Calculations for a single-employer plan will generally be straightforward, particularly if no special funding situation applies. For agent multiple-employer plans, each employer will merit an individual calculation of a specific NPL, since individual employer TPL and fiduciary net position will be available. For cost-sharing multiple-employer plans, a "proportionate share" of the NPL and total pension expense must be calculated for each employer. A special funding situation may result in a similar proportionate share calculation being required for any plan type under GASB 68.

Pension expense

The pension expense in GASB 68 is an accounting item designed to recognize for the current period certain changes to the TPL. Additionally, changes to the TPL not fully recognized in a given year's pension expense will be tracked as deferred inflows and deferred outflows, and recognized incrementally in the pension expense over time. Differences between actual and expected investment return will be recognized over a closed five-year period; differences between actual and expected experience, and the impact of any changes in assumptions or inputs, will be recognized over a closed period equal to the remaining service life of all active and inactive members. Benefit changes will be recognized immediately in the year of adoption.

The basic formula for calculating pension expense is as follows: Service cost + interest on TPL + current-period benefit changes – member contributions – expected earnings on plan investments + administrative expenses + recognition of deferred outflows – recognition of deferred inflows.

The year-to-year pension expense number is likely to be volatile, and should not be considered a proxy for funding or contribution levels.

Proportionate share

Proportionate share calculations apply for cost-sharing multiple-employer plans or any plan for which a special funding situation applies. The purpose of the proportionate share calculation is to determine the amount of the total NPL and pension expense that should be recognized by each employer; the statements recommend that the "projected long-term future contribution effort" of the employer be considered in the determination of an employer's proportionate share.

However, GASB has specifically allowed flexibility with respect to this definition in the final version of its statements. In particular, the current contribution effort of an employer may be used if this is deemed to be a reasonable method of determining the proportionate share for a given plan.

Special funding situations

A *special funding situation* arises when a non-employer entity makes contributions directly to the plan and one of the following conditions holds:

1. The non-employer contributing entity is the only entity required to contribute to the plan, or

2. The amount of contributions legally required from the non-employer contributing entity is not dependent on a factor unrelated to pensions, such as tax revenues on certain items.

One example of a special funding situation is a state-wide plan covering teachers, where the state (which does not employ the teachers) is the legal source of contributions, and the employers of the teachers covered by the plan (i.e., local school districts) bear no part of the direct cost of the pension plan. Alternatively, if the school districts are required to contribute, the special funding situation will apply only if the state contributions are defined as specified above (for instance, if the state contributes a set percentage of plan payroll, a special funding situation applies; if the state contributes sales tax revenue, a special funding situation would not apply).

A special funding situation may apply to any of the three GASB plan types. When such a situation applies, the non-employer contributing entity will have its own proportionate share of the NPL and pension expense. The adjustment to the recognition of the employer NPL will be straightforward; the non-employer contributing entity's proportionate share of NPL will reduce the amount of NPL required to be recognized by the employers. However, the pension expense attributable to the non-employer contributing entity will be allocated among and recognized by the employers. Those employers will also recognize as revenue a share of the contributions made by the non-employer contributing entity to the plan.

Fiscal years ending 2014: Practical points

For public pension plan fiscal years beginning after June 15, 2013, GASB 67 will be implemented beginning in 2014. Following is a list of key milestones leading to a successful implementation of GASB 67:

- Determine GASB plan type as early as possible, as this will impact requirements under both Statement 67 and Statement 68. Again, note that plans that typically operate administratively as agent plans actually may not meet the GASB definition of agent plan under the new statements; legal counsel should be consulted.

- Form a committee to facilitate work on GASB implementation. Plan staff, the plan actuary, the plan auditors, and staff from any participating employers may need to be involved throughout the process.

- Form a timeline for implementation. Under GASB 67, additional financial statement disclosures will be needed. Staff must have sufficient time to produce these notes and exhibits, and auditors should be involved to ensure their familiarity with and approval of the process.

- If the plan provides an ad-hoc COLA or other benefit provision that may not be granted every year, begin discussion as to whether the benefit meets the definition of "substantively automatic" under GASB. This may be a complicated question, and sufficient time should be allowed to ensure the agreement of staff and auditors.

- Determine with the plan actuary which valuation date will be used for the first GASB measurement date. In some cases, this may be governed by the date on which information will be needed in order to produce the financial reports in a timely manner. For example, it may be best to project the prior valuation calculations forward to the measurement date if GASB results are needed before the new actuarial valuation is likely to be completed.

- Typically, the actuary will produce the depletion date projection and calculation of the single equivalent discount rate; a calculation of TPL and NPL; and a statement of changes in TPL, plan fiduciary net position, and NPL. Note that if a projected depletion date exists, the board may need to formally adopt the municipal bond rate assumption used by the actuary throughout the remaining GASB calculations.

- Design exhibits and rework the structure of notes to financial statements. Plans should carefully review the required disclosures for GASB 67 in order to ensure compliance. In particular, the notes to financial statements and the required supplementary information should be carefully reviewed to ensure compliance by plan type.

- Make use of the GASB implementation toolkit, recently released on the GASB website.[2]

- Contact your local Milliman consultant, and check back for *PERiScope* articles to assist with implementation!

Jennifer Sorensen Senta, ASA, MAAA, is a consulting actuary in the Seattle office of Milliman.

2 Governmental Accounting Standards Board, GASB toolkit helps pension plans implement new accounting standards. Accessed at: http://www.gasb.org/cs/ContentServer?c=GASBContent_C&pagename=GASB%2FGASBContent_C%2FGASBNewsPage&cid=1176163601459.