Contra Costa County Employees' Retirement Association

GASB Statements 67 & 68

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The GASB Revolution

- New standards approved June 25, 2012
  - Statement 67 replaces Statement 25 for Plan reporting
  - Statement 68 replaces Statement 27 for Employer reporting
- Major Game Changers in the new rules
  - ❶ Placing the Net Pension Liability on the Balance Sheet
  - ❷ Decoupling Expense from Funding
  - ❸ Accounting for Cost-Sharing Plans
  - ❹ Expanding Disclosure Information (Notes & RSI)
- Changes since 2011 Exposure Draft
- "Mythconceptions" about discount rates, contributions

The GASB Revolution

- GASB's Postemployment Benefits Project
  - March 2009: GASB issues "Invitation to Comment"
  - June 2010: GASB issues "Preliminary Views" (PV)
  - July 2011: GASB issues two Exposure Drafts
  - June 25, 2012: GASB approves final statements
  - August 2, 2012 GASB releases final statements
- Effective dates (later than was in Exposure Draft)
  - For plan reporting: Effective for all plans for plan years beginning after June 15, 2013 (2013/2014 for fiscal year plans or 2014 for calendar year)
  - For employer reporting: Effective for fiscal years beginning after June 15, 2014 (2014/2015)
- GASB "Implementation Guide" will be essential

Net Pension Liability Reported on Balance Sheet

- Net Pension Liability (NPL)
  - Total pension liability (TPL) minus plan assets at market value ("plan net position")
    - TPL uses new "blended" discount rate and "Entry age" cost method
  - Similar to Unfunded Actuarial Accrued Liability (UAAL) but using market assets, not "smoothed" assets
    - Note asset smoothing still allowed (in determining pension expense), but reported separately
- NPL must be reported on the employer's balance sheet
  - Currently, UAAL is reported in the Required Supplementary Information (RSI)
  - Currently, only the Net Pension Obligation is reported on the balance sheet
    - Cumulative difference between annual required contribution (ARC) and actual contributions

The New “Blended” Discount Rate

- Discount rate is based on projected benefits, current assets, and projected assets for current members
  - Projected assets **include future contributions** that fund benefits for current members
  - Projected assets do **not** include employer or employee contributions that fund service cost for future employees
  - For projected benefits that are covered by projected assets
    - Discount using long-term expected rate of return on assets
  - For projected benefits that are **not** covered by projected assets (i.e., after the “cross-over date”)
    - Discount using yield on 20-year AA/Aa tax-exempt municipal bond index
  - Solve for a single rate that gives the same total present value
    - Use that single equivalent rate to calculate the total pension liability (TPL)

“Mythconceptions”

Scare	TRUTH
The new GASB rules will require Plan Sponsors to use a lower discount rate based on their current funded status. This will greatly increase the unfunded liability that they will now have to include on the balance sheet.	The “blended” discount rate is not based on the plan’s current funded status, but on projected benefits and assets. This includes future contributions to fund benefits for current employees. Most plans with contributions based on a written actuarial funding policy will continue to use their long-term earnings assumption as the discount rate.

Decoupling Expense from Funding

- Currently, pension expense is based explicitly on an actuarially determined funding requirement
  - The ARC, which is the "annual required contribution"
    - Even though is not required to be contributed!
  - Based on established practices for managing contribution volatility
    - Asset smoothing and UAAL amortization
  - The ARC served as a de facto funding standard
- New GASB pension expense is the change in NPL each year, with deferred recognition of only certain elements
  - Specifically **not** intended to be a funding target or standard

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New Pension Expense Components

- Changes in Total Pension Liability that are recognized (i.e., expensed) immediately - no deferrals allowed
  - Service cost
  - Annual interest on the TPL
  - Projected investment returns over the year
  - All plan amendments
- Unchanged from Exposure Draft:
  Immediate recognition of all plan amendments, whether for all actives or retirees

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New Pension Expense Components

- Changes in Total Pension Liability where some deferrals are allowed (i.e., expensed over multiple periods)
  - Changes in actuarial assumptions
  - Actuarial gains and losses
- These changes in TPL are recognized in expense over average expected remaining service lives of active and inactive members (including retirees)
  - Changed from Exposure Draft, where active and retired TPL changes were amortized separately
    - Simpler calculation than was in the ED, but similar impact on expense
    - Resulting amortization periods will still be very short

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New Pension Expense Components

- Changes in Assets where some deferrals are allowed (i.e., expensed over multiple periods)
  - Differences between actual and projected earnings over the year (i.e., investment gain/loss)
    - Recognized in expense over closed 5-year period
    - Similar to current five-year asset smoothing
  - So the NPL on balance sheet will be “market volatile”, but effect on expense and on employer net position will still reflect smoothing
  - Effect on expense will be different from funding (and current ARC), where investment gain/loss is:
    - Smoothed over (typically) five years <u>and</u>
    - Also amortized as part of the UAAL

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Decoupling Expense from Funding

- The faster — often immediate — recognition of net pension liability changes will introduce much greater volatility in the reported pension expense.
  - This volatility will be reflected directly on the income statements of plan sponsors.
- This volatility is what disqualifies this new expense as a basis for determining a funding policy.
  - Means there will be two competing measures of plan cost
- Plans will want to review or adopt funding policies, now that GASB expense no longer provides funding guidance.
  - Funding policy also needed for discount rate – and for disclosures.

"Mythconceptions"

Scare	TRUTH
The new GASB rules will require much larger contributions than are currently being made. Also those contributions will now vary much more from year to year.	The new GASB rules only redefine pension expense, not contributions. Employers and plans can still develop and adopt funding policies under current practices.

Cost-Sharing Plans

- Current standards have very simple reporting:
  - Pension expense is contractually required contribution
  - Balance sheet liability is the accumulated difference between the contractually required contribution and the actual contribution
  - No ARC or NPO (except as above)
  - Unfunded actuarial accrued liability is not reported at all
- New standards – treated like single employer plans:
  - Employers in "pooled" plans will now have that "pooled" liability and expense apportioned to each employer.
  - Recognize "proportionate share" of collective net pension liability, pension expense, and deferred inflows and outflows

Cost-Sharing Plans

- Determining an employer's "proportionate share"
  - Basis should be consistent with the way required contributions are determined
  - "The use of the projected long-term contribution effort of the employer(s) … is encouraged."
  - If "different contribution rates are assessed based on separate relationships that constitute the net pension liability … the determination of the employer's net pension liability should … reflect those separate relationships."
    - "For example, separate rates are calculated based on an internal allocation of liabilities and assets for different classes or tiers of employees"

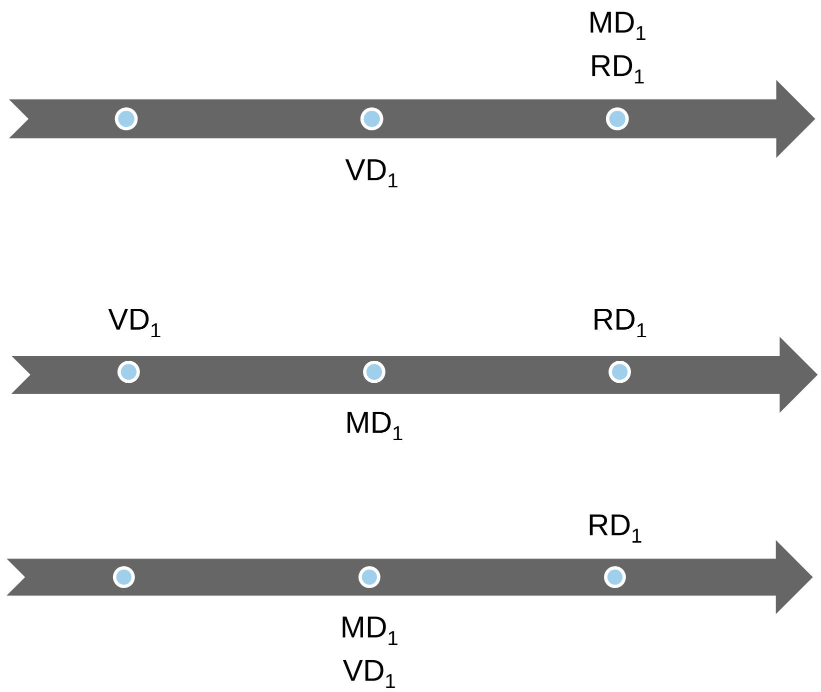
Cost-Sharing Plans

- Measurement date
  - Under the Exposure Draft, calculations were as of each employer's fiscal year end
    - Would have required liabilities <u>and assets</u> to be measured as of the fiscal year end for each employer
    - Could have been up to 12 dates each year (every month)
  - Now, a cost sharing plan can determine its NPL (total pension liability and market assets) at one date each year
    - Probably the plan's valuation date
    - Each employer's share can be as of that same date
    - This is a welcome improvement over the ED
  - Still a substantial new burden for cost-sharing plans.

Timing and Frequency

- Net pension liability <u>measurement date (MD)</u> can be earlier than the fiscal year end <u>reporting date (RD)</u>
  - No earlier than the end of prior fiscal year
- Total pension liability component determined by:
  - Actuarial <u>valuation date (VD)</u> as of NPL measurement date, or
  - As of a date no more 30 months (plus one day) before reporting date, rolled forward to NPL measurement date
- Asset component of net pension liability:
  - Must be fair value of assets as of NPL measurement date
    - No roll forwards allowed
  - Changed from Exposure Draft, where assets were valued on reporting date (fiscal year end)

Timing and Frequency - Alternatives



Expansion of Disclosure Information

- Includes both Notes and Required Supplementary Information (RSI)
- ***Greatly*** expanded plan and employer disclosures, including:
  - Description of the plan and assumptions
  - Policy for determining contributions
  - Sensitivity analysis of the impact on NPL of a one percentage point increase and decrease in the discount rate
  - Changes in the NPL for the past 10 years
  - Development of long-term earnings assumption
  - Annual rates of investment return for past 10 years (plan only)

Expansion of Disclosure Information

- More new disclosure information
  - "Actuarially determined employer contribution"
    - ADEC is the "New ARC"
    - Basis and amount – if determined!
    - Comparison to amount actually contributed
    - May encourage review (or creation) of actuarial funding policy
- Expanded disclosures greatly increase the pension information needed for plan and employer's financial statements.
  - New and challenging questions for <u>employer's</u> financials:
    - Which actuary develops this information?
    - Who pays for it?

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Effective Dates

- Exposure Draft said new rules effective FY 2012-2013 for certain large plans, FY 2013-2014 for all others
- Final statements: employer implementation delayed
  - Plan reporting: Plan year beginning after 6/15/2013 (FYE 2014)
  - Employer reporting: Fiscal Year beginning after 6/15/2014 (FYE 2015)
- Comment: This should allow time for GASB staff to issue an "Implementation Guide"

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