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Government Brief
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GASB Statement No. 68 Brings Needed Pension Transparency

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PURPOSE

This article is intended to serve as a high-level summary of the changes that will occur for state and local governments participating in governmental pension plans with the implementation of Governmental Accounting Standards Board (GASB) Statement No. 68, Accounting and Financial Reporting for Pensions.

OVERVIEW

The GASB issued Statement No. 68 and related Statement No. 67, *Financial Reporting for Pension Plans*, in June 2012. In these new standards, the Board's stated goals are to provide more decision-useful information, support users' ability to assess accountability and interperiod equity, and to create additional transparency. Although not listed among the GASB's goals, the new standards no longer tie pension accounting to pension funding, rather the new standards tie pension accounting to the amount of defined pension benefits that have been earned by current and former employees at the balance sheet date, regardless of whether resources are set aside to fund them.

GASB Statements 67 and 68 address pension benefits that are provided through trusts and that meet certain criteria—principal among them that contributions to the plans are irrevocable. These GASB Statements do not address pension benefits that are not funded by irrevocable contributions nor do they address other postemployment benefits—or OPEB. The GASB has on its agenda a separate project-to address OPEB benefits—presumably using the same model adopted in Statements 67 and 68. An Exposure Draft of a proposed Statement on OPEB is planned for the second quarter of 2014.

GASB Statement No. 68 will apply to state and local government employers in fiscal years ending after June 15, 2014. Pension plans administered as trusts or equivalent arrangements will implement changes required by GASB Statement No. 67 a year earlier. Changes must be adopted as an adjustment of prior periods, and financial statements presented for the periods affected should be restated.

Net Pension Liability Equal Government's Liability to Its Employees

GASB Statement No. 68 ushers in two *big* changes for state and local governments. The first is that each government that offers defined pension benefits to its employees will be required to report—on the face of its statements of net assets—a "net pension liability." As noted earlier, this new standard no longer ties reporting to annual funding conventions. Instead, the net pension liability will equal the total pension liability less the net position of the related pension plan. Single and agent-multiple employers will report 100% of the net pension liability on the face of their financial statements. Cost-sharing multiple-employers will report their proportionate share of the net pension liability. *Nonemployer governments*—such as some states—that are legally required to make contributions directly to another government's pension plan must also report a net pension liability to the extent that they are responsible for those benefits.

Calculating the Net Pension Liability

The *net pension liability* consists of two components:

- Actuarial present value of projected benefit payments attributed to past periods (Total Pension Liability)
- Less: Fiduciary net position as measured by the pension plan.

Under GASB Statement 27, *Accounting for Pensions by State and Local Governmental Employers*, governments previously reported a measure similar to this one for their single employer and agent multiple-employer plans but only in required supplementary information (*outside* the notes to the financial statements) under the heading, "total unfunded actuarial liability."

Just as important, GASB Statement 68 sharpens the procedures required to calculate the net pension liability. For example, projected benefits will be attributed to past/current/future periods using a *single* actuarial cost method—the entry age actuarial cost method. GASB Statement 27 permitted employers and plans to choose from among *six* different methods. As another example, most changes in the net pension liability from period to period (changes in estimates) will be charged to expense in full in the next period—not amortized, say, over the GASB Statement 27 maximum amortization period of 30 years. Actuarial valuations of the total pension liability are required to be performed at least every two years.

Big Changes for Governments Participating in Cost-sharing Multiple-employer Plans

The second big change ushered in by GASB Statement 68 is that employers participating in defined benefit *cost-sharing* multiple-employer pension plans will be required to recognize their proportionate share of the "collective" net pension liability on the face of their statements of net assets. In these plans, participating governments pool their assets and their obligations to provide pension benefits. The plan's assets can be used to pay the retiree benefits of any participating employer. Previously, these employers did not directly report *information* about their pension obligations. Instead, employers only reported a liability to the extent that they failed to make their required contributions. Users could only obtain a sense of the total liability by taking on the "task" of considering the financial condition of the entire multiple-employer plan. As an example, at June 30, 2012, California multiple-employer plan sponsor, CalPERS, reported that 1,576 public agencies and schools (representing more than 2,500 entities, including the State of California) contribute to its multiple-employer plans. CalPERS' combined *unfunded* actuarial accrued liability (4 plans) equaled $60.4 billion at June 30, 2011, based on GASB Statement 27 required measures.[1]

This big change for cost-sharing plans also raises a multitude of issues for participating employers. Most participants in cost sharing multiple-employer plans will have to now report a liability because even well-funded plans typically have not accumulated the resources needed to cover the entire actuarially-determined liability. Cost-sharing multiple-employer plan required contributions are not necessarily based on an actuarial calculation of pension benefits earned. Plan contribution rates may instead be based on statute or contract or even a pay-as-you-go basis.

1 Source: CalPERS Comprehensive Annual Financial Report, June 30, 2012.

A local government that dutifully made 100 percent of its required contributions to a state cost-sharing multiple-employer plan in the past may well be quite shocked to find that it has a proportionate liability at all—let alone a material one.

In addition, GASB Statement 68 encourages employers to calculate their proportionate share of a collective net pension liability based on each employer's long-term projected contribution effort compared to the total effort for all employers contributing to the plan. This calculation is intended to be flexible. Individual employers participating in the same multiple-employer plan may use different bases for their projections—for example one employer may base their proportionate share on contributions made in the past five years. Another may consider only the contributions it made during the measurement period compared to total contributions during the measurement period.

Change in Discount Rates

Discounting has always been a necessary part of the pension benefit/liability equation. Under GASB Statements 25 and 27, the investment return assumption or *discount rate* used to estimate the present value of future benefits is required to be based on an estimated long-term investment yield for the plan, and giving consideration to the nature and mix of current and expected plan investments and the basis used to determine the actuarial value of the plan's assets. More often than not, however, state and local governments have been criticized for selecting discount rates that seem unrealistic—for example, assuming that current and future plan assets will earn 8% each year.

In its new standards, the GASB establishes specific limitations on the discount rates that governmental actuaries and accountants may choose for their pension calculations. Specifically, it requires the discount rate to be dependent on the extent to which the government expects current plan assets to be sufficient to pay plan benefits. Governments are required to establish a single discount rate based on *two* rates, as follows:

- The estimated long-term rate of return to the extent that current plan assets are projected to be sufficient to pay pension benefits
- Yield or index rate for 20-year, tax-exempt general obligation municipal bonds to the extent that current plan assets are projected to be insufficient to meet benefits.

Looking Ahead

There are numerous implementation issues facing governments with regard to these new standards, especially governments that participate in multiple-employer plans. The AICPA's State and Local Government Expert Panel is working on several whitepapers that further describe these issues and related best practices that will be released in the coming months. Additionally, the AICPA will be adding a new chapter on governmental pension plans and related employer issues to the 2014 edition of the AICPA Audit and Accounting Guide, *State and Local Governments*. In the meantime, early discussion and interaction between plans and governmental employers is key to ensuring that implementation of the new standards by employers is successful.

For additional information about the AICPA's earlier work regarding the new GASB pension standards, read the stories in the August 2012 issue and the September 2013 issue of *The CPA Advocate*. Also, watch the new AICPA video about the two new pension standards that discusses how their implementation will improve transparency of public pension benefits on the finances of state and local governments.