Update on GASB Changes

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Ahead of the Curve

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What Is GASB?

- Gonna Ask for Something Big
- Gotta Allocate Some Benefits
- How Good Accounting Should Be
- "The Great GASB"

What Is GASB? cont.

Standard-setting Board for governmental accounting and <u>financial reporting</u>

- Decided to “divorce” funding and reporting for pensions
- Aiming for more transparency
- In June, 2012, after exhaustive due process, issued GASB Statements No. 67 and 68
- Now requires pension liability to be reported on the face of the employer’s financial statements

GASB Statement 67

- Applies to the Plan (TMRS)
  - Effective for fiscal years beginning after June, 2013
  - As such, TMRS as a Plan (PERS – Public Employee Retirement System) will apply this standard with their December 31, 2014 CAFR
- No impact to TMRS cities

GASB Statement 68

- Applies to the individual employers (TMRS cities)
  - Effective for fiscal years beginning after June, 2014
  - As such, the <u>first</u> TMRS cities = fiscal year ending June 30, 2015
- SIGNIFICANT impact to TMRS cities and their financial statements

GASB Statement 68, cont.

	"The Old" GASB Stmt. 27	"The New" GASB Stmt. 68
"Balance Sheet"	**Liability/Asset only recorded if NPO/NPA (i.e., city paid other than full rate ARC)**	**Record Net Pension Liability (NPL)**
"Income Statement"	**Pension expense = Annual pension cost i.e., contributions remitted to TMRS (mainly the ARC)**	**Very different calculation of pension expense (PE)**
Note Disclosures	**Plan description, membership data, benefits, and contributions**	**The "old," plus plus plus… (more expanded)**
Required Supplementary Information (RSI)	**3-year schedule of Funding Progress**	**10-year schedules: NPL, Changes in NPL, employer contributions (vs. actuarially-calculated)**

Accounting and Funding Are Disconnected

	Funding	Accounting
Discount Rate	Long-term investment rate of return	Long-term investment return (but only to extent assets can cover liabilities)
Asset Valuation	May be smoothed	Fair (market) value
Amortization	Considerable flexibility	Strict requirements; likely shorter periods
Actuarial cost method (the liability)	Considerable flexibility (choice of 6 methods)	Entry age normal (required)

Pension Expense (PE)

- Under GASB Stmt. 27 (the “old”), pension expense mainly reflected the annual required contribution, or ARC (normal cost + amortization of UAAL) needed to pay future benefits.
- Under GASB Stmt. 68 (the “new”), pension expense largely represents the <u>change</u> in the net pension liability (NPL) from the prior year, with provisions for deferring certain items.
- In general, a higher pension expense will be recognized than previously reported.

Pension Expense, cont.

- Items <u>immediately recognized</u> in pension expense include:
  - Service (Normal) cost (additive)
  - Interest on TPL (additive)
  - Projected investment earnings (subtractive)
  - Actual member contributions (subtractive)
  - Administrative costs (additive)
  - Changes in TPL due to changes in benefits

Pension Expense, cont.

- Certain other changes are treated as “deferred outflows of resources” and “deferred inflows of resources”
  - Changes in the plan’s fiduciary net position due to differences between projected investment earnings and actual investment earnings
    - Recognized over a closed 5-year period
  - Changes in total pension liability due to (1) changes in assumptions or (2) differences between assumed and actual actuarial experience
    - Recognized over a closed period reflecting average remaining service life of all members (active, inactive, and retirees)

The Net Pension Liability (NPL)

- Under Statement 68:
  - Pension Liability is the "Net Pension Liability" (NPL) – counterpart to funding UAAL
  - Equal to the "Total Pension Liability" (TPL) minus the "Plan Fiduciary Net Position" (PFNP)
    - PFNP is essentially the fair (market) value of assets
    - For a TMRS city = essentially their BAF (Benefit Accumulation Fund)
  - The NPL is reported as a balance sheet item in the employer's financial statements.
  - Most cities will disclose a higher NPL and lower funded ratio than prior disclosures have reflected.

Total Pension Liability (TPL)

Total Pension Liability (TPL) – counterpart to funding AAL

- The liability for projected benefits attributable to past service including:
  - Automatic COLAs and
  - Substantively automatic ad hoc COLAs and USCs
    - Must be valued as repeating
    - Determined based on historical patterns
- TPL determined using the traditional entry age normal cost method and the "single discount rate." EAN normal cost is expressed as a level percentage of payroll.

Total Pension Liability (TPL), cont.

- Single (blended) Discount Rate:
  - Based on the long-term expected return (7% for TMRS plans) to the extent projected plan fiduciary net position is sufficient to pay future benefits.
  - However, a portion is based on a tax-exempt municipal bond index rate (currently about 4%) to the extent projected plan fiduciary net position is not sufficient.
    - 20-year, tax-exempt general obligation municipal bond index rate
  - We expect most, if not all, TMRS plans to pass this test and be able to use 7% as TPL discount rate

Estimated GASB 68 Impact on Sample City 1 — 1:1 match, no repeating COLAs (as of 12/31/12)

Note: the below variance in funded ratios is due to differences between AVA ("smoothed" value of assets) and MVA (market value of assets); currently, MVA exceeds AVA (deferred gains)	Current Valuation (PUC, AVA)	Estimated EAN Results (EAN, AVA)	Estimated GASB 68 Results (EAN, MVA)
Actuarial Accrued Liability / Total Pension Liability	$19,380	$21,297	$21,297
Actuarial Value of Assets / Net Position	12,559	12,559	12,964
Unfunded Actuarial Accrued Liability / Net Pension Liability	$6,821	$8,738	$8,333
Funded Ratio / Plan Fiduciary Net Position as a Percentage of Total Pension Liability	64.8%	59.0%	60.9%

Source: GRS, "GASB Examples," 10/9/13

Estimated GASB 68 Impact on Sample City 2 — 2:1 match, no repeating COLAs (as of 12/31/12)

Note: the below variance in funded ratios is due to differences between AVA ("smoothed" value of assets) and MVA (market value of assets); currently, MVA exceeds AVA (deferred gains)	Current Valuation (PUC, AVA)	Estimated EAN Results (EAN, AVA)	Estimated GASB 68 Results (EAN, MVA)
Actuarial Accrued Liability / Total Pension Liability	$86,732	$93,153	$93,153
Actuarial Value of Assets / Net Position	84,206	84,206	87,284
Unfunded Actuarial Accrued Liability / Net Pension Liability	$2,526	$8,947	$5,869
Funded Ratio / Plan Fiduciary Net Position as a Percentage of Total Pension Liability	97.1%	90.4%	93.7%

Source: GRS, "GASB Examples," 10/9/13

Estimated GASB 68 Impact on Sample City 3 — 2:1 match, repeating COLAs (as of 12/31/12)

Note: the below variance in funded ratios is due to differences between AVA ("smoothed" value of assets) and MVA (market value of assets); currently, MVA exceeds AVA (deferred gains)	Current Valuation (PUC, AVA)	Estimated EAN (EAN, AVA)	Estimated GASB 68 Results (EAN, MVA)
Actuarial Accrued Liability / Total Pension Liability	$393,548	$420,223	$420,223
Actuarial Value of Assets / Net Position	357,883	357,883	370,917
Unfunded Actuarial Accrued Liability / Net Pension Liability	$35,665	$62,340	$49,360
Funded Ratio / Plan Fiduciary Net Position as a Percentage of Total Pension Liability	90.9%	85.2%	88.3%

Source: GRS, "GASB Examples," 10/9/13

Estimated GASB 68 Impact on Sample City 4 —
2:1 match, with consistent ad hoc COLAs and USCs (as of 12/31/12)

Note: the below variance in funded ratios is due to differences between AVA ("smoothed" value of assets) and MVA (market value of assets); currently, MVA exceeds AVA (deferred gains)	Current Valuation (PUC, AVA)	EAN, AVA with 0% COLA & USC assumption	EAN, AVA with repeating 70% COLA & 100% USC assumption	Estimated GASB 68 Results (EAN, MVA)
Actuarial Accrued Liability / Total Pension Liability	$359,377	$386,798	$480,753	$480,753
Actuarial Value of Assets / Net Position	343,956	343,956	343,956	356,735
Unfunded Actuarial Accrued Liability / Net Pension Liability	$15,421	$42,842	$136,797	$124,018
Funded Ratio / Plan Fiduciary Net Position as a Percentage of Total Pension Liability	95.7%	88.9%	71.5%	74.2%

Source: GRS, "GASB Examples," 10/9/13

Measurement and Timing

TMRS will continue with annual valuation process (as of December 31 year-end)

GRS (TMRS' consulting actuary) will complete:

- "Funding" valuation on entry-age normal = determines city contribution rate
- Additional "reporting" valuation on Entry Age Normal, with many additional requirements = determines pension expense and NPL for financial reporting

Measurement and Timing, cont.

- GASB 68 requires the employer to report their liability based on a measurement date (no earlier than their prior fiscal year)
- Measurement date = December 31 (valuation date)

Example: City with June 30, 2015, fiscal year-end

- Measurement date CANNOT be earlier than June 30, 2014.
- For GASB reporting, measurement date will be most recent valuation as of December 31, 2014.

Measurement and Timing, cont.

Example: City with March 31, 2016 fiscal year-end

- Measurement date CANNOT be earlier than March 31, 2015 (i.e., December 31, 2014 valuation is TOO early).
- For GASB reporting, measurement date will be valuation as of December 31, 2015.

Measurement and Timing , cont.

Similar to GASB, TMRS is planning to “divorce” funding and reporting.

So what can the City expect?

- “Rate Letter Package”
  - Provides city with contribution rate (effective January 1)
- “GASB Reporting Package”
  - Provides city with data needed for financial reporting
- Anticipate both to be issued in June each year

Other Considerations

- "New liability" = new audit considerations
- This liability will likely be volatile from year to year, and significant/"material" to the financial statements
- The auditing community is expecting:
  - Schedule of "Changes in Plan Fiduciary Net Position," by employer, in CAFR of PERS; plan auditor engaged to provide opinion
    - TMRS has "Changes in Benefit Accumulation Fund" (BAF) already in CAFR
  - Reliance on the actuary as "an expert" (SAS 73)
  - Multiple-employer plans to <u>give assurance</u> to the city and its auditors = SOC-1 audit for TMRS (which assesses and opines on internal controls)

In the Meantime…

- Cities should continue monitoring GASB
- Big or small, cities should work with auditors experienced in governmental accounting
- Cities should study and become familiar with GASB Stmt. No. 68 and its required disclosures (see examples in Illustration 2 found in the statement itself)

TMRS • Methods of Communication

- TMRS Website
- “Eye on GASB” — a continuing series about GASB pension reporting proposals (located under the “Citie Services” tab on TMRS website)
- E-Bulletins (e-mails sent to cities)

Questions