Government Accounting Standards Board's

New Pension Accounting Standards

Report to the Ohio Retirement Study Council
December 2013

Overview

- New GASB standards create separation between accounting and funding
- While Ohio retirement systems disclose pension liabilities in their financial statements, employers will now be required to reflect a proportionate share of the systems' net pension liabilities in their annual financial statements
- Employers will continue to pay contribution rates as defined in statute
- Changes impact financial reporting only and *do not* impact the amount employers are required to fund

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What's happening?

- In 2012, GASB issued two new standards — GASB Statement No. 67, *Financial Reporting for Pension Plans* and GASB Statement No. 68, *Accounting and Financial Reporting for Pensions* — these standards change the accounting and financial reporting requirements for pension benefits
- The stated intent of the new standards is to:
  - Enhance the transparency of pension-related information in financial reports
  - Improve accountability
  - Standardize actuarial valuation practices
- House Concurrent Resolution 40, co-sponsored by Reps. Schuring and Ramos, expresses support for the standards and for the retirement systems – the resolution was passed unanimously by the Ohio House of Representatives

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GASB's perspective

- **GASB considers pensions to be a component of the compensation package**
- **To the extent the pension system is not 100% funded, GASB believes employers have a liability for the unfunded portion of the pension benefits earned by their employees to date**
- **Pension systems disclose these liabilities in their financial reports — GASB believes employers should recognize the liabilities in their annual financial statements**

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What are the old GASB standards?

- Retirement systems showed the current value of the trust assets on their financial statements
- Retirement systems reflected the assets, liabilities and unfunded liabilities for the pension in the Notes to Financial Statements and Required Supplementary Information components of the financial statements
- Employers reflected pension expense equal to the amount they remitted as statutory contributions
- Employers were required to include in their Notes to Financial Statements information describing the plan, contribution rates and where to find information on the plan; all this information was provided to the employers by the retirement systems
- During testimony period of the GASB pronouncement process, Ohio systems and participating employers were active with letters and testimony; comments to GASB attempted to highlight Ohio's model and how it differs from other states, as well as offering other alternative solutions

What are the new GASB standards?

GASB Statement No. 67, *Financial Reporting for Pension Plans*

- **Impacts accounting and reporting, not funding**
- **Applies to defined benefit plans (and some portions of defined contribution plans)**

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What are the new GASB standards? (cont.)

GASB Statement No. 67, *Financial Reporting for Pension Plans*

- **Calculation of net pension liability (unfunded liability) by the systems could be different**
  - **Requires use of the entry age normal attribution method for all plans — all Ohio systems already use this method**
  - **Discount rate calculation — current rate or blended rate**
    - Systems can use stated long-term expected rate of return on investments as long as fiduciary net position is projected to finance benefit payments and be invested in a strategy to achieve that return
    - At point long-term expected rate of return doesn't cover payment of projected benefits, systems must use a yield approximating a 20-year AA tax-exempt general obligation bond — stated as a blended rate
  - **Requires use of market value of investments, rather than actuarial value, for determining unfunded liability or net pension liability**

What are the new GASB standards? (cont.)

GASB Statement No. 67, *Financial Reporting for Pension Plans*

- **Retirement systems will also have added note disclosures and supplementary schedules**
- **Effective for retirement systems with fiscal years beginning after June 15, 2013**

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What are the new GASB standards? (cont.)

GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*

- **Employers will be required to reflect a proportionate share of the retirement system's net pension liability (unfunded pension liability) on their financial statements**
    - **Net pension liability is calculated as the difference between the plan's net assets and the total obligations to plan participants on a specific date in time**

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What are the new GASB standards? (cont.)

GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*

- **Requires new methodology for determination of employers' pension expense**
- **Change in net pension liability will be adjusted to reflect the amortization of some of the components of the change including:**
  - **Differences between actual and expected experience**
  - **Changes in actuarial assumptions**
  - **Difference between actual and projected investment earnings**

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What are the new GASB standards? (cont.)

GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*

- **Employers will have to add extensive disclosures in the notes to financial statements**
- **Effective for employers with fiscal years beginning after June 15, 2014**

Retirement systems' perspective

- Employer's proportionate share of the net pension liability and related activity (pension expense, deferred inflows/outflows) may represent a significant impact to employer financial statements
- For many employers, the liability that is reported will be larger than other liabilities
- Standards will likely create confusion due to the separation between reporting and funding
- Complexity of standards — main American Institute of CPAs audit guidance not issued yet and GASB 68 implementation guide not being issued until next year

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Retirement systems' perspective (cont.)

- May result in volatility from one year to the next — largely due to market volatility, some of which will be mitigated by amortization elements
- Need to effectively counter misinformation and misinterpretation with timely, accurate and relevant communication to employers, legislators and other interested stakeholders

Looking down the road

Effective for fiscal years ending after June 15, 2013

Retirement Systems Implement

Impacts accounting and financial reporting and in some cases the calculation of the Net Pension Liability (unfunded pension liability)

Effective for fiscal years ending after June 15, 2014

Employers Implement

Impacts accounting and financial reporting – proportionate share of net pension liability and related activity will be very large compared to other balance sheet and income statement items

Ongoing

Outreach to Various Groups

- Employer concerns
- Bond ratings affected
- Public concerns, repercussion
- Impact of implementation guidance

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Next steps

- Ongoing meetings with employers to share accurate, timely information
- Retirement systems' continuing discussions with:
  - External auditors
  - Auditor of State
  - Legislators
  - Stakeholder representatives
  - Other retirement systems
- Many systems are considering adopting a funding policy

Key takeaways

- New GASB standards create separation between accounting and funding
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