North Dakota Teachers' Fund for Retirement
North Dakota Public Employees Retirement System
North Dakota State Auditor's Office

GASB-68 Implementation Town Hall Meeting

December 2014

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CPAs & BUSINESS ADVISORS

A brief overview of the defined benefit pension provisions of GASB-68

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Some Basic Definitions of Defined Benefit Plans – just an introduction

- **PERS and TFFR are <u>both</u> Cost Sharing Multiple – Employer Plans – what are they?**
  - A plan that includes more than one employer
  - Assets and liabilities are pooled
  - All assets are available to pay for all benefits
- Most common statewide plans nationwide

Overview of the New GASB Requirements

- GASB 67 replaced existing guidance for pension plans contained in GASB-25
  - Financial statements are similar presenting, assets, deferred outflows of resources, liabilities, deferred inflows of resources, plan net position, additions, deductions and changes in net position
  - Full set of notes on plan operations, investments, actuarial information.
  - Required supplementary information
  - Some cost-sharing multiple employer plans presenting additional supplementary information on allocations to employers – not required
  - Both TFFR and PERS have implemented GASB 67 successfully and timely

Overview of the New GASB Requirements

- GASB 68 provides for financial reporting by employers (replaces old GASB 27)
  - “Employers” are the entities making the contributions (e.g., State, Cities, Counties, School Districts, etc.)
- Net Pension Liability reported on each employer’s balance sheet and in each Plan’s notes to the financial statements
  - Entry age cost method calculates the liability using a blended discount rate
  - Offset by Market value of assets
- Accounting and financial reporting divorced from contribution requirements
- Annual pension expense (for employers) is essentially equal to change in Net Pension Liability during the year, with deferrals of certain items

Why the Change Occurred

Focus on FINANCIAL REPORTING not operations

- GASB establishes accounting and financial reporting standards, not funding policies
- Focus on pension obligation, changes in obligation, and attribution of expense
- **Therefore – converting from modified cash to full accrual basis**
  - Many employers operate on a cash / modified cash / modified accrual basis for budgetary operations
  - Existing note disclosure contains minimal pension information
  - Existing Required supplementary information is not on a full accrual basis
  - Employers with law not requiring GAAP will have minimal changes under GASB-68

Assume Governments Last Longer than 1 year Unlike Businesses

- Cost of services to long-term operation
- “Interperiod equity” matches current period resources and costs

Why the Change Occurred

Use Federal Guidance (US DOL / SSA) on Who is an Employee and Who they Work For

- Employer incurs an obligation to its employees for pension benefits
- Transaction is in context of a career-long relationship
- **Therefore – EMPLOYER has reporting and not plan**

Pressure from the user community for better disclosure

- Bond holders and rating agencies have largely had to build their own models for pension calculations / disclosure
- Public interest research groups have focused on the full cost of government including post-employment benefits in recent years
- *Proposed* model for changing retiree health care (OPEB) financial reporting is similar

4 Big Deals

1. **Brand New Net Pension Liability** (or asset) on the face of the employer's statement of net position *based on allocations made by Plans*
2. **Brand New Pension Expense** in statement of activities based on allocations made by plan with *potential further allocations* to funds
   - Has nothing to do with funding / contributions
3. **Brand New Note Disclosure**
4. **Brand New Required Supplementary information**

Big Deal #1 – Brand New Net Pension Liability (or asset)

1. **Brand New Net Pension Liability** (or asset) on the face of the employer's statement of net position
   - Potential pension information in enterprise funds
   - Any current payable amounts to plans in governmental funds
   - Liability is a function of discount rate – more assets to pay benefits for longer period of time, higher rate
     - PERS / TFFR currently at 8%
   - Simple equation
     - Market value of pension assets held in trust at measurement date – less
     - Total pension liability

Big Deal #1 -Actual Net Pension Liability – June 30, 2014 Per Segal (in thousands) (*unaudited*)

	PERS Main	TFFR
Total Pension Liability at 8.00%	$2,846,580	$3,138,800
Net Plan Position (i.e., MVA)	(2,211,859)	(2,090,977)
Net Pension Liability (NPL)	**$634,721**	**$1,047,823**
Plan Fiduciary Net Position as a % of Total Pension Liability	77.7%	66.6%
Sensitivity to changes in discount rate		
• 1% decrease (7.00%)	$978,928	$1,414,755
• Current discount rate (8.00%)	**634,721**	**1,047,823**
• 1% increase (9.00%)	**346,917**	**739,222**

- NPL is calculated for each Plan in total
- Each employer is assigned a share of the NPL, based on contribution data

Big Deal #2 – Brand New Pension Expense

- **No change will occur in contribution rates *solely* due to implementation of GASB-68**
  - Old pension expense is based explicitly on an statutory rates
  - 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
  - ARC Specifically not intended to be a funding target or standard
- Allocation of Pension Expense to Employers will be different from cash outflow to Plans

Big Deal #2 – Brand New Pension Expense

- Changes in Total Pension Liability that are recognized (i.e., expensed) immediately—no deferrals allowed
  - Service cost – pensionable compensation x rate
  - + Annual interest on the TPL
  - - Projected investment returns over the year
  - + / - All plan amendments
- Immediate recognition of all plan amendments, whether for actives or retirees
  - Probably different from funding
- Changes in assumptions / demographics *may* be immediate expense *or* amortized over remaining service of covered employees

Big Deal #2 – Brand New Pension Expense

- Summary of New Pension Expense Components in table below – a great *communication tool* to decision-makers
- Changes in the employer's Net Pension Liability will be recognized in pension expense more quickly – could be confusing

<table>
<tr><th></th><th colspan="2">Current Standards</th><th colspan="2">New Standards</th></tr>
<tr><th>Source of Change in the Net Pension Liability</th><th>Expense</th><th>Deferral</th><th>Expense</th><th>Deferral</th></tr>
<tr><td>Service Cost</td><td>Immediate</td><td>None</td><td>Immediate</td><td>None</td></tr>
<tr><td>Interest on the TPL</td><td>Immediate</td><td>None</td><td>Immediate</td><td>None</td></tr>
<tr><td>Projected Investment Earnings</td><td>Immediate</td><td>None</td><td>Immediate</td><td>None</td></tr>
<tr><td>Changes in Benefit Terms</td><td rowspan="5">Initial period amount</td><td rowspan="5">Amortization over a period up to 30 years (closed or open)</td><td>Immediate</td><td>None</td></tr>
<tr><td>Changes in Assumptions</td><td rowspan="3">Initial period amount</td><td rowspan="2">Expense over average remaining service period of actives and inactives</td></tr>
<tr><td>Differences between Assumed and Actual Economic and Demographic Factors</td></tr>
<tr><td>Differences between Projected and Actual Earnings</td><td>Expense over 5-year closed period</td></tr>
<tr><td>Other Changes in the NPL</td><td>Immediate</td><td>None</td></tr>
</table>

Big Deal #2 Brand New Pension Expense - What Does it All Mean?

- Fiscal folk in the room will have some explaining to do to decision – makers
  - Decision – makers are used to compensation x statutory rate OR rate per employee
  - Budget and funding only a component of expense
  - **Suggestion – use the following slide to insert a schedule in MD&As to translate from annual contributions to annual expense as follows…**

A *Possible* Way to Translate for Decision-makers

Statutory Contributions	
Adjustments for annual amortizations of:	
Actuarial differences between payroll based contributions and GASB-68 expense, as well as recording of deferred inflows and outflows of resources	
Current year Amortization of prior differences between actual and expected experience	
Changes in assumptions	
Current year amortization of prior differences between projected and actual earnings on plan investments	
Changes in proportion and differences between contributions and proportionate share of contributions	
Contributions subsequent to measurement date recognized as deferred outflows of resources (GASB-71)	*Will need to be calculated by District**
Pension Expense	

GASB-71 requires adjustment of expense for contributions after measurement date – see later

Actual Pension Expense for FYE June 30, 2014 per Segal (in thousands) (*unaudited*)

	PERS Main	TFFR
Service cost	$91,683	$56,751
Interest on the Total Pension Liability	213,342	237,821
Projected earnings on plan investments	(152,171)	(145,453)
Member contributions	(65,623)	(58,589)
Recognized portion of current-period difference between expected and actual experience	4,378	1,335
Recognized portion of current-period difference between projected and actual earnings on pension plan investments	(30,975)	(29,759)
Administrative expense	2,169	1,586
Pension expense (benefit) for FYE 6/30/2014	$62,803	$63,694

Totals may not add due to rounding

Could Pension Expense Ever Be Negative?

- YES!
  - Key #1 - If fiduciary net position (level of assets) rises faster than level of total pension liability – could be a net benefit to employers
  - Key #2 - Demographics –
    - Younger demographics – longer amortizations of changes in plan
    - Amortization of investment return differences will be faster than demographic changes
  - Key #3 – large sustained increase in interest rates over discount rate
- Result - Amortizations of prior deferrals could release more negative expense (to the good) than positive expense (to the bad)

Big Deal #2 – Brand New Pension Expense - continued

- Current standards are simple
  - Pension expense is equal to the statutorily required contribution
    - No “ARC” on financial statements
  - “Balance sheet” only presents the sum of the difference (if any) since 1988 between the statutorily required contribution and the actual contribution – currently $0
  - Unfunded actuarial accrued liability is not reported at all on employers’ statements

Big Deal #2 – Brand New Pension Expense – continued - Accounting for Cost-Sharing

- Recognize <u>proportionate share</u> of *the plan's* total
  - Net Pension Liability
  - Pension Expense
  - Deferred Inflows and Deferred Outflows Positions

    NONE of these are to be reported on the plan financial statements due to employer : employee exchange of work for compensation

Big Deal #2 – Brand New Pension Expense – continued - Impact on Employers - Summary

- Each employer must disclose their proportionate share of:
  - Net Pension Liability (Asset)
  - Pension expense
  - Deferred outflows of resources and deferred inflows of resources related to pensions
- For both PERS Main and TFFR, the proportionate share is allocated based on covered payroll
  - PERS Main proportionate share allocations range from 0.000962% to 2.532988%, State is 56.152315%.
  - TFFR proportionate share allocations range from 0.000687% to 10.894306%

Proportionate Share of Accounting Elements – PERS Main System per Segal (in thousands) (unaudited)

	Total	State Employees	Large Employer	Small Employer
Payroll	$842,379	$473,015	$21,337	$8
NPL/Proportionate Share	634,721	356,411	16,077	6
Sensitivity to changes in discount rate				
• 1% decrease (7.00%)	$978,928	$549,691	$24,796	9
• Current discount rate (8.00%)	634,721	356,411	16,077	6
• 1% increase (9.00%)	346,917	194,802	8,787	3
Pension Expense/Proportionate Share	$62,803	$35,265	$1,591	$0.6
Deferred Outflows of Resources	24,957	14,013	632	$0.2
Deferred Inflows of Resources	(154,875)	(86,966)	(3,923)	(1)

Proportionate Share of Accounting Elements – TFFR per Segal (in thousands) (unaudited)

	Total	Large District	Small District
Covered Payroll	$580,053	$43,480	$4
NPL/Proportionate Share	1,047,823	$78,543	$7
Sensitivity to changes in discount rate			
• 1% decrease (7.00%)	$1,414,755	$106,047	$10
• Current discount rate (8.00%)	1,047,823	78,543	$7
• 1% increase (9.00%)	739.222	55,411	$5
Pension Expense/Proportionate Share	$63,694	$4,774	$0.44
Deferred Outflows of Resources	8,012	601	$0.06
Deferred Inflows of Resources	(119,035)	(8,923)	($0.82)

Big Deal #3 Brand New Note Disclosure

- **Information is being developed by the plan in a "template"**
- Descriptive Plan Information
  - Name of the Pension Plan
  - Identification as Single Employer/Agent Plan/Cost Sharing Plan and the Plan Administrator
  - Benefit Terms (classes of employees covered, types of benefits, key elements of the pension formula, automatic COLAs, authority under which benefit terms are established
  - Brief description of Contribution Requirements
  - Whether the pension plan issues a standalone financial report or included part of another government entity.

Big Deal #3 Brand New Note Disclosure

- Discount Rate Disclosures
  - Discount Rate applied and change from last measurement date.
  - Assumptions about projected cash flows related to the pension plan including contributions from employers, non-employers and employees.
  - Long-term expected rate of return and how it was determined.
  - Municipal bond rate used and source of that rate.
  - Breakdown of how projected benefit payments are allocated between those applied to the long-term expected rate of return and municipal bond rate to arrive at the discount rate.
  - Assumed Asset Allocation and long-term expected rate of return applied to each asset class.
  - NPL calculated using a discount rate that is +/-1% than stated Discount Rate

Big Deal #3 Brand New Note Disclosure

Significant Assumptions

- Inflation
- Salary Changes
- Ad Hoc post-employment benefit changes (COLA)
- Mortality Assumptions/Source of Assumptions (i.e. published mortality table/experience study)
- Dates of the Experience Study

Big Deal #4 Brand New Required Supplementary Information

- **Schedule 1:**
  - **10 Year** – Employer's Proportionate Share (%, Amount) of Collective NPL, Covered Employee Payroll, Net Pension Liability as a % of Employee Covered Payroll, Pension Plans Net Position as % of TPL
- **Schedule 2:**
  - **10 Year -** Statutory/Contractual Contributions to Actual Contributions and Payroll
- **Note disclosure to RSI**
- Existing information ends this year
  - Some plans / employers considering keeping it as a supplementary schedule for comparability –
    - Not required and **may confuse readers**

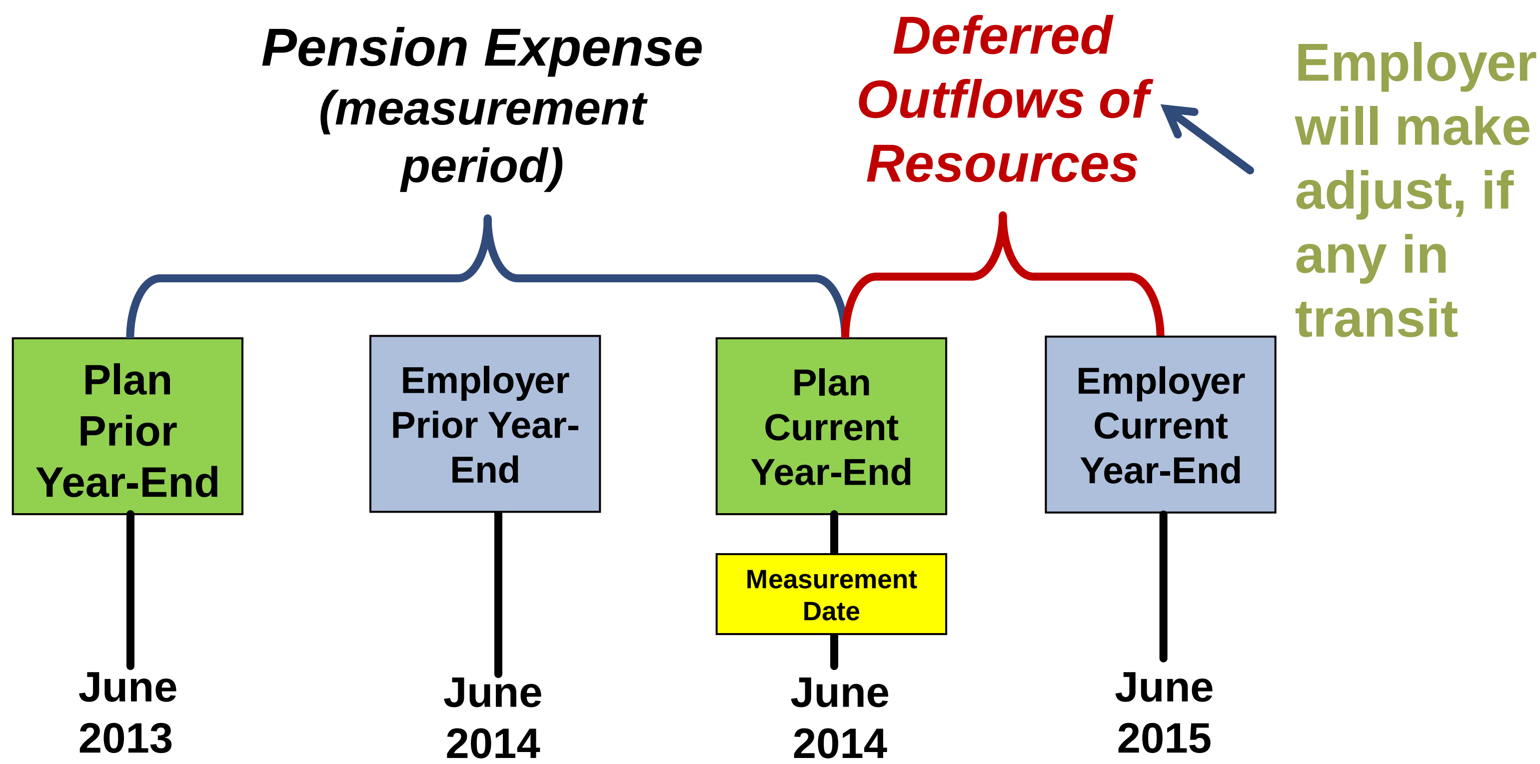
Effective Date and Transition Issues

- **Plans** – Done
- **Employers –** Fiscal years *beginning after* June 15, 2014
  - December 31 employers would be 1/1/15
- Prior period adjustments will likely take place for a number of years as deferred positions become clarified
- RSI
  - If data is unknown at transition – must include a text box on each schedule explaining why – similar to GASB-54

Key Dates

- Potentially 3 different dates we need to think about
  - Employer fiscal year-end
  - Measurement date (of NPL)
    - As of date no earlier than end of prior fiscal year
    - Both components (TPL/plan net position) as of the same date
  - Actuarial valuation date (of TPL)
    - If not measurement date, as of date no more than 30 months (+1 day) prior to FYE
    - Actuarial valuations at least every 2 years (more frequent valuations encouraged)
      - **PERS and TFFR are annual valuations**
- Coordination with pension plan

Timing of Measurement of Total Pension Liability 6/30 Example



Measurement date will most likely correspond to year-end of plan. Employer contributions made directly by the employer subsequent to the measurement date of the net pension liability and before the end of the employer's fiscal year should be recognized as a deferred outflow of resources.

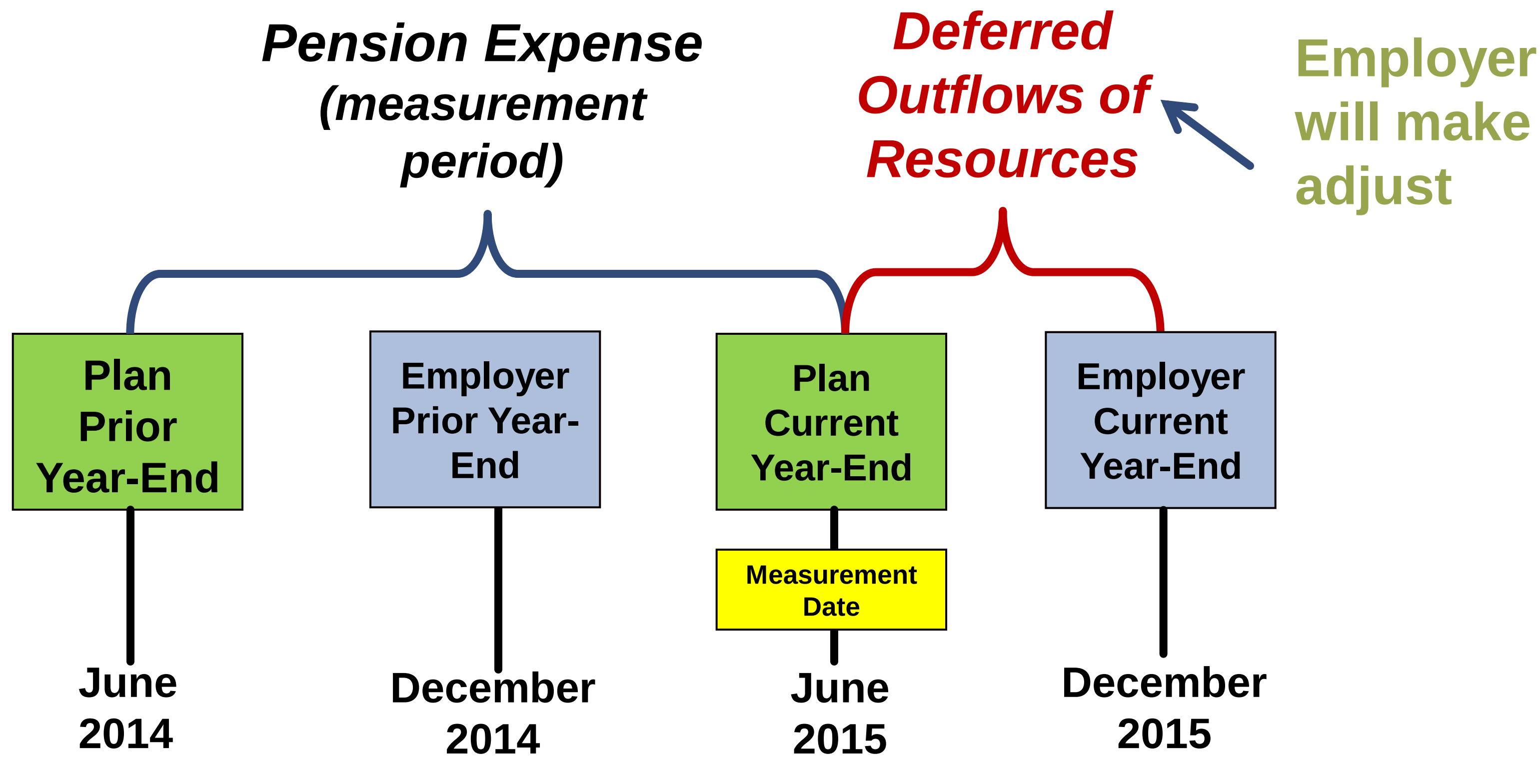
Example of Adjust After Year End

- The measurement date of TFFR is June 30, 2014. From July 1, 2014 to June 30, 2015, the next measurement date of TFFR is not until June 30, 2015 and will not be released in time for employers to issue 2015 financial statements ***but can be used for 2016 financial statements under GAAP.***
- ***Adjust is from 7/1/14 to 6/30/15***

Debit / Credit	Accounts	Amounts	
Debit	Deferred Outflows of Resources	$#,###,###	
Credit	Pension Expense		$#,###,###

- On July 1, 2015, reverse the transaction
- Similar structure (different numbers) annually after

Timing of Measurement of Total Pension Liability **12/31 year end**



Measurement date will most likely correspond to year-end of plan. Employer contributions made directly by the employer subsequent to the measurement date of the net pension liability and before the end of the employer's fiscal year should be recognized as a deferred outflow of resources.

Example of Adjust After Year End 12/31 Employer

- The measurement date of PERS is June 30, 2015. From January 1, 2015 to December 31, 2015 – report is done on a timely basis
- ***Adjust for contributions made after measurement date (7/1/15-12/31/15)***

Debit / Credit	Accounts	Amounts	
Debit	Deferred Outflows of Resources	$#,###,###	
Credit	Pension Expense		$#,###,###

- On January 1, 2016, reverse the transaction
- Similar structure (different numbers) annually

Census Data Audits

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Census Data to Be Audited

- Key census data
  - Date of birth
  - Gender (male or female)
  - Date of hire or years of service
  - Date of termination or retirement
  - Marital status
  - Spouse date of birth
  - *Eligible* compensation (may NOT equal W-2s, especially in higher education)
  - Employment status
- Auditing census data
  - Active employees
  - Inactive/retired
- Resolving exceptions

The auditor must test the reliability and completeness of the census data provided to the actuary.

Cost Sharing Employers

- 2 White Papers published by AICPA
  - Census data testing
  - Plan reporting to employers
- Census data testing would be **based on risk**
  - Testing coordinated by <u>plan auditor</u>
    - Employers > 20% of plan active employees tested annually
    - Between 5% and 20% - tested every 5 years **Any?**
    - Less than 5% - tested every 10 years **but some tested annually to get comfort**
    - Very small employers may never get tested – immaterial
  - Report is an attestation report

Cost-Sharing Plan Issues

- Audited plan financial statements don't give participating employers everything they need
- AICPA whitepapers at

  http://www.aicpa.org/INTERESTAREAS/GOVERNMENTALAUDITQUALITY/RESOURCES/GASBMATTERS/Pages/default.aspx

  Remember – these are "best practices"

Cost-Sharing Plan Issues – Solutions provided by AICPA

- Plan provides supplemental “schedule of employer allocations” for which plan auditor is engaged to provide opinion

Note: Above not required by standard, but other alternatives create inconsistency and additional audit burden

Cost-Sharing Plan Issues – Solutions Provided by AICPA

- Plan provides supplemental “schedule of plan pension amounts by employer” for which plan auditor engaged to provide opinion
  - Supplemental schedule showing the following amounts by employer
    - Net pension liability
    - Deferred outflows (by category)
    - Deferred inflows (by category)
    - Pension expense

Cost-Sharing Plan - Employer Auditor Considerations

- Evaluate plan auditor’s report on supplemental schedules (AU-C 805)
  - If plan auditor doesn’t report on, evaluate necessary audit procedures
- Test amounts in schedules relating to employer
- Test census data?
- Additional procedures as considered necessary
- Objective - sufficient appropriate audit evidence

Key Concerns and Decisions Made by TFFR and PERS

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Key Questions and Decisions Made

Key Question	**Decisions Made**
Timing of information	TFFR and PERS will have annual GASB 68 information posted to plan websites by March 1 (i.e. June 30, 2014 information **will be available March 1, 2015 so employers will likely use the prior year information**).
Who will be responsible for information	The pension plans and the employers **share responsibility**. TFFR and PERS will provide much of the required pension information. However, it will be the employer and employer auditor's responsibility to correctly incorporate the information into the employer's financials.
What's the basis of allocation and to how many decimal places?	TFFR and PERS have selected actual covered payroll to determine the employer allocation percentages. Each retirement plan will use the number of decimal places needed to allocate the total NPL down to an immaterial amount (i.e. 6 decimal places after % or xx.xxxxxx% for 2014 information).

Key Questions and Decisions Made

Key Question	Decisions Made
Will Plan prepare "templates" for employers with basic financial statement information / note disclosure / RSI?	Yes. TFFR, PERS, and plan actuary will prepare this information and make it available to employers annually on the plan's websites.
Who / When will auditing of census data take place?	TFFR and PERS plan auditors plan to conduct the census data audits between August and January of each year.
Who / When will auditing of "templates" take place?	Employer's auditor will review note disclosure as part of the financial statement audits
Who / When will auditing of Employer Allocation Schedule and Schedule of Pension Amounts take place?	TFFR and PERS plan auditors will audit these two schedules prior to the schedules being made available to employers on the plan's websites.

Key Questions - Employers

- Employers are ultimately responsible for amounts disclosed in basic financial statements, required supplementary information and information contained in the notes to the basic financial statements
- Cost-sharing multiple-employer plans
  - Obtain amounts and disclosures for the financials
  - Evaluating accuracy of information
  - What work will my auditors need to do?

Key Questions- Employer's Auditors

- Timing of information needed for audit
- Role in evaluating actuarial assumptions
- Need to engage auditor's specialist?
- Will plan engage auditors to provide assurance on employer information?
- Did plan auditors engage a specialist?
- Qualifications of plan auditor
- Implementation concerns (timing, resources)
- Sufficient appropriate audit evidence for unmodified opinion?

Talking Points to Your Decision Makers / Media

- Remember the 3 C's
  - **Consistent** messaging
  - **Concise** information (not data)
  - **Calm** not chaos
- **Talking points**
  - GASB Pension standards are for financial reporting, not overall decision-making or funding
    - But may drive changes in decisions in the future
  - Transparency in financials are increasing due to new standards
  - New financial statements reflect economic reality rather than historical cash flow
  - The plan is NOT changing solely due to new standards
  - Coordination and administration are being done very conservatively at the state level

Questions!

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