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MWM Consulting Group

Taking Measure of Tomorrow ™

UPDATE

Actuarial and Benefits News

New Accounting Standards for Public Pension Plans GASB Statements Nos. 67 and 68 Adopted

The new accounting standards for public sector retirement plans and systems adopted by the Governmental Accounting Standards Board (GASB) in June of 2012 began to become effective in 2014. The new standards amend Statements Nos. 25 and 27, and have been developed over the past four years with significant input from the public and professional communities. The new standards, which require balance sheet recognition of unfunded obligations, were developed with the focus of accounting requirements only, and encourage sponsors to develop funding and contribution policies independently.

In General

Under the new standards, governments that provide benefits through single employer or agent plans will be required to report the amount of unfunded pension obligations in their balance sheets. Statement No. 67 applies to financial reporting for pension plans, and Statement No. 68 applies to financial reporting for the sponsoring employers. For employers, the liability that must be recognized (Net Pension Obligation) is the total pension liability less the amount of plan assets formally set aside for payment of benefits as of the reporting date. Annual pension expense will be based on a measure of the change in the net pension liability over the year, with some adjustments for deferred amounts, rather than on required funding amounts.

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GASB 67/68 WILL SUBSTANTIALLY IMPACT THE FINANCAL STATEMENTS OF PUBLIC SECTOR SPONSORS
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Cost sharing employers (governments that participate in multi-employer plans) are also affected. Cost sharing employers will be required to report a proportionate share of the total net pension liability of the collective plan. The proportion would basically equal the government's long term expected contributions to the plan divided by those of all governments in the plan. Each cost-sharing employer will also be required to recognize its allocated share of the plan's collective expense.

Effective Dates

Statement No. 67 is effective for plan fiscal years beginning after June 15, 2013. Statement No. 68 is effective for employers' fiscal years beginning after June 15, 2014. Earlier adoption is encouraged. Under the statements, the employer standard requires retroactive application to the extent it is practical.

Specifics

Balance Sheet Impact

The new standards require the entire unfunded pension liability (Net Pension Liability NPL) to be recognized as a liability on the balance of the CAFR. Prior standards recognized as an accrued liability the progress of actual contributions as compared with the Annual Required Contributions. Unfunded pension liabilities under the prior standards were reported as off balance sheet supplementary information.

Measurement Basis and Methodology

Under the new standards only one actuarial cost method is permitted – the Entry Age cost method – to allocate costs to accounting periods, as opposed to the prior standard which permitted sponsors to elect from as many as six possible actuarial cost methods.

Assumptions

Discount rates for determining plan liabilities must be developed based upon the projected cash flows and sufficiency of the trust. To the point that assets are projected to remain sufficient to cover benefit payments, the assumed return on invested assets may be used to discount liabilities. To the degree assets are insufficient to pay assets, the discount rate forward from that period must reflect the interest rate payable on an index of 20 year municipal bonds.

Funding Policies

In order to project future asset sufficiency, contributions must be projected based upon an established funding policy.

Pension Expense

Pension expense will essentially be the difference in the NPL over the period, with some adjustments. Similar to FASB pension expense, the elements will include the Service cost, interest on the total pension liability, amortization of gains and losses over relatively short periods, offsets for projected investment returns and employee contributions, but immediate costs of plan amendments. Based upon the components, pension expense is expected to be much more volatile under the new standard.

Expanded Disclosures

Employers will need to provide significantly more information about plans in which they participate. Extensive documentation must be provided about the establishment of the discount rate used in the calculations. This includes assumed future cash flows, asset allocations, real returns on asset classes and the effect of using a discount rate that is 100 basis points higher or lower than that developed in accordance with the new standards or sponsor.

Sponsor Next Steps

Sponsors will wish to know the estimated impact of these new standards before their implementation dates.

- Project future impact upon balance sheet and pension expense
- Evaluate contribution histories and funding practices to make decisions regarding a formal funding policy.
- Review sample disclosure requirements
- Evaluate possible implications of new standards for individual sponsor

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