

CHANGES IN PENSION ACCOUNTING

GASB 67 & 68 FACT SHEET



INTRODUCTION

What are the new rules?

The Governmental Accounting Standards Board (GASB) issued two related statements which substantially change the accounting and financial reporting of pensions for OCERS and OCERS plan sponsors. GASB Statement No. 67 (GASB 67), *Financial Reporting for Pension*

Plans, affects the financial statements of OCERS. GASB Statement No. 68 (GASB 68), *Accounting and Financial Reporting for Pensions*, affects the government-wide financial statements of OCERS' plan sponsors.

OVERVIEW

What is going to change?

GASB 68 replaces the accounting and reporting requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, for OCERS' plan sponsors and is effective for fiscal years beginning after June 15, 2014. GASB 68 also replaces the requirements of GASB Statement No. 50, *Pension Disclosures*.

Prior to the new rules, each employer's obligation was simply considered to be the amount that the employer was contributing toward the plan on an annual basis. GASB now will require, for purposes of governmental financial reporting, that a portion of the total Net Pension Liability (this amount is similar to what was previously referred to as the unfunded liability but is prepared using the market instead of "smoothed" value of assets) be shown on each employer's balance sheet even though no employer will be required to pay-off this liability today or in any accelerated

fashion. As market value is used in the calculation, the pension expense (which is the annual change in Net Pension Liability) that will be reported by employers is expected to be volatile from year to year. The amortization period for recognizing items such as actuarial gains and losses and changes in assumptions for reporting purposes will be equivalent to the remaining service life of all members in the plan (including retired members who have no remaining service years). This will be a much shorter amortization period than what is used for funding purposes.

It is important to note that the new Statements no longer require disclosure of funding requirements but instead focus on accounting and financial reporting issues – how pension costs and obligations are measured and reported in financial statements. Although the appropriate portion of the Net Pension Liability will show on each employer's balance sheet,

contribution requirements to OCERS are not impacted by the new GASB requirements. Employer and employee contribution rates are set by the OCERS Board of Retirement annually in accordance with OCERS Funding Policy and as governed by the California Government Code.

Previously, there had been a close relationship between how governments fund pensions and how they account and report information related to pensions. The new guidance is a definitive shift from a **funding-based**

approach to an **accounting-based approach**. According to GASB, this shift will improve the decision-usefulness of employer-level reported pension information and increase the transparency, consistency and comparability of pension information across governments. Despite these new accounting and reporting changes for pensions it is important to note that the **factual situation of the pension plans** that our plan sponsors have been participating in **HAVE NOT CHANGED**, only the way those plans are accounted for and reported on is changing.

ITEMS REQUIRING DISCLOSURE AND DESCRIPTION

What can I expect?

The Total Pension Liability of the pension plan is annually calculated by OCERS' actuaries and accounts for each future benefit payment that will be made, decades into the future to current employees of all OCERS plan sponsors. The total Net Pension Liability, as described in the new Statements, is determined by subtracting the pension plan's Fiduciary Net Position from the Total Pension Liability. The Net Pension Liability can more commonly be described as the unfunded liability of plan sponsors for plan members' benefits provided through a defined benefit pension plan.

Under the new GASB standards, each plan sponsor will be required to report on their financial statements the proportionate share of the overall Net Pension Liability of OCERS. A plan sponsor's proportion is determined by first looking at the rate group(s) in which the plan sponsor is included. Rate groups are a collection of members who are or were employed by plan sponsors that offer similar pension benefit formula(s). Rate groups exist for the purpose of risk-pooling and the contribution rates developed by the actuary should, in the long-term, fairly and accurately

reflect the benefit plan offered/promised to members in each group. Rate groups can contain one or more plan sponsors and plan sponsors may be included in one or more rate groups. In rate groups that have multiple plan sponsors, a plan sponsor's proportion (a percentage) is determined considering the plan sponsor's contributions for the current year as a percentage of the current year total contributions from all employers in that rate group to the plan. In calculating a plan sponsor's contribution for the year only amounts paid by the plan sponsor (that are not considered to be part of the employees' salary) will be included (i.e. reverse pick-ups are considered employee contributions not employer contribution). This percentage is then applied to the major reporting elements, including the Net Pension Liability, deferrals related to pensions, and pension expense, to determine the employer's proportionate share of each of these items.

Keep in mind that the Net Pension Liability is similar to other long-term liabilities reported on an employer's balance sheet in that it is not immediately due. The funding of pension liabilities is now disconnected from how the

liability and pension expense (as discussed further below) is accounted for and reported. **The method in which entities fund their pension liability is systematic and assumed to occur over a long period of time. The Statements do not change the method or requirements on how to fund pension liabilities and expenses.**

It is important to also note that rating agencies have been aware of the funding policies and status of governmental pension plans. They have historically incorporated that information into their analysis of a government's ability to meet its debt obligations. These new reporting changes are not anticipated to result in drastic changes to the ratings of most governmental entities.

GASB 68 also requires employers to recognize a new measurement of the pension expense on their financial statements. The pension expense reported in a governmental entity's financial statement will no longer be equal to the contribution amount set by the actuary. Rather, the new definition of pension expense represents the change in Net Pension Liability from year to year and contains the following items:

- Annual cost of the current service accrual(normal cost);
- Interest on the Total Pension Liability;
- Amortization of experience gain/losses, changes in assumptions, expected vs.

CONCLUSION

GASB has released two new statements that will substantially change the accounting and financial reporting of pensions for OCERS plan sponsors and OCERS. The key implications of these changes are:

- A new balance sheet liability for plan sponsors (the Net Pension Liability)
- A new definition of pension expense (or income)
- Additional disclosures on the financial statements

OCERS will continue to work with our affiliated employers and their governing boards to understand and implement the changes required by GASB 68.

actual investment earnings, and changes in plan benefits (amortization period will over the remaining service life of all members, including retirees);

- Employee Contributions;
- Administrative Expenses;
- Expected return on plan assets

Because this new measure includes items that can change materially from one year to the next, it is imperative to recognize that the amount of the pension expense may be volatile from year to year. Pension expense as reported in accordance with the new Statements is NOT consistent with actuarially determined contributions. Again, ***the link between accounting and reporting of pensions and the funding or paying for pensions has been broken.***

Currently, plan sponsors are required to include basic note disclosures in their financial statements while expanded information is included in OCERS' financial statements. GASB 68 increases the amount of note disclosures that are required in the financial statements of OCERS plan sponsors. In order to draft the note disclosures, OCERS' plan sponsors will be able to utilize some of the extensive disclosures contained in OCERS' financial statements, as well as recommended language OCERS intends to make available to all OCERS' plan sponsors.