GASB Statement 68 Q & A

The Governmental Accounting Standards Board (GASB) recently issued Statement 68, Accounting and Financial Reporting for Pensions, which substantially changes the accounting and financial reporting of pensions for TFFR employers.

Here are answers to some frequently asked questions about this new reporting standard.

1) What is GASB?

The Governmental Accounting Standards Board (GASB) is the independent organization that establishes standards of accounting and financial reporting for U.S. state and local governments. The GASB is recognized by governments, the accounting industry, and the capital markets as the official source of generally accepted accounting principles (GAAP) for state and local governments. The GASB is not a government entity but is a private sector not-for-profit entity recognized as the oversight body of accounting in the United States.

2) When does this new standard go into effect?

Statement No. 68 replaces most of the requirements of Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*. This reporting requirement applies to the GAAP-based financial statements of employers and is effective for fiscal years beginning after June 15, 2014.

3) Does the new GASB 68 standard affect both GAAP and non-GAAP based employer financial statements?

Statement No. 68 reporting requirements apply to GAAP-based financial statements. Employers that do not prepare GAAP based financial statements should contact their auditor to discuss the requirements of this new standard.

4) Why did GASB make this reporting change?

GASB-68 was developed to improve the decision-usefulness of information in employer financial reports and to enhance its value for assessing accountability and inter-period equity by requiring recognition of the net pension liability and pension expense, along with new note disclosures and required supplementary information. The consistency and transparency of the information reported by employers about pension transactions will be improved. Previous GASB rules provided a standard that measured funding ratios and defined annual contributions needed to maintain healthy funding. New rules no longer provide that funding standard but merely tell governments how to account for and report pension costs.

5) What does this new standard mean for employers?

Each employer is part of one pension trust fund at TFFR. GASB will now require, for purposes of governmental financial reporting, that a proportionate share of the plan's net pension liability (calculated as the actuarially determined total pension liability offset by the market value of assets available to pay pensions) of the pension trust fund at TFFR be shown on the face of each employer's financial statements. Similarly, a proportionate share of the total pension expense and collective deferred inflows of resources and deferred outflows of resources of the pension trust fund at TFFR will also be shown on the face of each employer's financial statements. In addition, these standards will require employers to include additional footnote disclosures about the pension trust fund in their financial statements.

6) What's wrong with showing this information more prominently?

Transparency and disclosure are good, but it's important to provide context for the numbers. The presence on local government or school district balance sheets of a large number representing unfunded pension costs could give the incorrect impression that employers/taxpayers have an immense debt that must be paid immediately, in one year. This is not the case. Pension costs are amortized or paid off over long periods – much like home mortgages. Like a home owner who makes manageable monthly payments and pays down the mortgage debt over time, this is what governments do when they make regular contributions to the retirement system.

7) Won't people be alarmed if pension costs loom large on employer balance sheets?

They shouldn't be. The net pension liability number required by GASB on employer balance sheets will reflect a liability that's amortized or paid down over many years and therefore not "due in full" in the fiscal year during which the number is reported. The pension liability amount reported on the employer balance sheet will represent the employer's proportionate share of liabilities and will be paid down by employers' annual contributions to the pension funds over many years. Again, the net pension liability is similar to a home mortgage as a liability to be managed and paid over time with assets either currently available or to be received in the future.

8) Is this pension liability due and payable immediately?

No. The net pension liability is unlike most other liabilities and debts reported on an employer's Statement of Net Position (balance sheet), in that it is not immediately due and cannot be paid off under any accelerated schedule. Contribution rates are set in statute. As a result, an employer would not be able to remit payment, in addition to their statutory contribution amount, for their proportionate share of the net pension liability in order to remove this liability from their financial statements.

9) How do the new GASB standards affect a pension plan's funded ratio?

They don't. GASB standards have nothing to do with statutory funding requirements of TFFR. The new rules only address *accounting and financial reporting* for pension expenses, not how to fund them.

10) Will these changes affect the amount of contributions sent to TFFR?

No. Only the North Dakota Legislature has the power to change the member and employer contribution rates through the statutes that govern TFFR. Although a proportionate share of the collective net pension liability is shown on the face of each employer's financial statements, contribution requirements to TFFR are not impacted by this change.

11) Does the new GASB Statement establish requirements for how governments should fund their pensions?

No. The new reporting standard breaks the link between actuarial funding and financial reporting for pensions. Previous GASB standards for pension plans included an annual required contribution (ARC) and reporting of payments toward the ARC. This measured the plan's funding of the pension obligation. The new standards consider only how systems account for and report the net pension liability, pension expense and related deferred inflows of resources and deferred outflows of resources.

12) Is the employer liable for the pension liability that will be recorded on the employer financial statements under GASB 68?

GASB 68 requires that for accounting purposes only, the entities that are actually making the pension contributions (i.e. school districts, cities, counties, or state) are required to report their proportionate share of the collective net pension liability in their financial statements, regardless of whether the entities are legally required to fund the plan. The ND state legislature has the authority to set member and employer contribution rates, and employers are liable for paying those contributions required by law.

13) Will the new GASB Statement affect an employer's bond rating?

While we cannot speak for rating agencies, it is important to 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.

14) What steps is TFFR taking to reduce the collective net pension liability of the pension trust fund?

The financial crisis of 2008-09 resulted in a significant reduction in TFFR's investment portfolio, which brought into question the sustainability of the system. In response, the TFFR Board of

Trustees engaged stakeholders throughout North Dakota to gather input and develop a legislative proposal to improve TFFR's funded status. The plan included member and employer contribution increases, and benefit changes for certain non-grandfathered and new members of the plan. The plan was studied by the Legislative Employee Benefits Programs Committee during the 2010 interim, and given a favorable recommendation. The plan (HB 1134) was then carefully considered and approved by the 2011 Legislature, and signed by the Governor. Time is needed for the changes made to show positive funding results. With the contribution and benefit changes, plus 8% investment returns in the future, TFFR's funded level is projected to reach 80-100% in 20-30 years. A long term focus is important in financing pensions. Due to legislative action, TFFR's long term funding outlook is positive, and benefits are secure for past, present, and future ND educators.

15) Will TFFR provide net pension liability and other pension-related amounts to assist employers with GASB Statement No. 68?

Yes, TFFR will provide several calculated items to assist employers. These items will be at the employer level including: net pension liability, deferred outflows of resources, deferred inflows of resources, and pension expense amounts. The information for the prior fiscal year ended June 30, will be available the following March on the TFFR website. Although TFFR will provide most of the needed financial information, it will be the employer and employer's auditor's responsibility to correctly incorporate the information into the employer's financial statements.

16) Will TFFR provide the allocation percentage necessary to derive an employer's proportionate share of the collective net pension liability and other collective pension-related amounts?

Yes, TFFR will prepare a schedule of employer allocation percentages and schedule of employer pension amounts on an annual basis. These schedules will be audited by TFFR's auditors to ensure the employers are receiving accurate information.

17) What is the basis used for calculating the employers' allocation percentages?

TFFR will calculate the allocation percentage using the actual covered payroll reported by the employer for that year.

18) Will employers need to maintain amortization schedules for deferred outflows of resources and deferred inflows of resources?

No. TFFR's actuary will maintain amortization schedules for pension-related information at the employer level.

19) Will TFFR assist employers with the note disclosures required by the new reporting standards?

Yes. TFFR will provide a template footnote disclosure document which employers can choose to use. The template will include the plan information required and guidance on where to draw the information the employer auditor needs to enter. The template will also be available on the plan's website.

20) In the note disclosure template provided by the pension plan, the employer is required to disclose any employer contributions paid subsequent to the measurement date. Should the amount of employer contributions include any employer paid member contributions?

No. The employer contributions referred to in the disclosure notes and required supplemental information should only be the TFFR employer contribution (currently 12.75%) and should not include any employer paid member contributions under employer payment model 2 or 3.

21) Who will audit the employer payroll and employee data?

TFFR plan auditors will test the payroll and employee census data at the employer level. This data will be tested on a risk basis. Not all employers will be tested annually or on a certain schedule. TFFR will contact the employer prior to the census data audit.

22) Do ND state agencies that participate in TFFR need to comply with the new reporting standards?

Yes. If the state agency issues its own financial statements, the agency must implement the changes in Statement 68. However, if the state agency does not issue its own financial statements, the state agency may still be audited by the TFFR plan auditor as part of the census data audit testing requirements. Contact Ron Tolstad (701-328-2243) at the State Auditor's Office to discuss implications on your agency.

Glossary

Net Pension Liability (NPL)—Each employer's share of the unfunded liability (Total Pension Liability minus the Pension Plan's Fiduciary Net Position) associated with their employees who participate in TFFR.

Discount Rate—A blended or single rate (expressed as a percentage) that reflects (1) the long-term expected rate of return on pension plan investments to the extent (a) this rate will support projected benefit payments of the plan, and, (b) assets will be invested using the current allocation targeted to achieve that return, and (2) for the period of benefit payments not supported, will incorporate an index rate for 20-year tax-exempt municipal bonds.

Employer's Proportion—A measure of the proportionate relationship of an employer of a cost-sharing pension plan like TFFR to all employers of the plan.

Pension Expense—Represented by changes in TFFR's Net Pension Liability, recognized in the current reporting period. There are some exceptions that include changes due to differences between expected and actual experience, changes in economic and demographic assumptions, and the difference between projected and actual earnings on pension plan investments.

Pension Plan's Fiduciary Net Position—TFFR's plan net assets at market value.

Proportionate Shares—Measures of the collective Net Pension Liability, collective Pension Expense and other disclosure items of the plan related to pensions—attributable to a specific employer, based on the Employer's Proportion.

Total Pension Liability—The portion of the actuarial present value of projected benefit payments (reflecting projected service and anticipated salary increases) that is attributed to past periods of TFFR member service, similar to current Actuarial Accrued Liability (AAL), determined under the Entry Age Actuarial Cost Method, calculated using the Discount Rate.