

GASB 67 Implementation Deadline Nears

Are Pension Plans Prepared?

The effective date of the new Governmental Accounting Standards Board Statement No. 67 (GASB 67) is upon us! Plans will need to comply beginning with their first fiscal year that began after June 15, 2013. Do you know who will provide the information needed for each section of your accounting statements under GASB 67? This advisory will review the new disclosures as well as related issues and decisions that need to be made in advance of the preparation of the first statement.

Background

In 2013, the Governmental Accounting Standards Board (GASB) issued new statements 67 and 68. Statement 67 is applicable to pension plans, and statement 68 is applicable to plan sponsors. The new statements dramatically changed the reporting requirements with respect to defined benefit pension plans, particularly for plan sponsors. Pension plans with fiscal years ending June 30 that produce stand-alone Comprehensive Annual Financial Reports (CAFRs) will have to comply with GASB 67 beginning June 30, 2014. Thus, the first filing dates of GASB 67 are less than 6 months from now. Note that plan sponsors do not have to comply with Statement 68 until their first fiscal year beginning after June 15, 2014, generally one year later than the implementation of GASB 67 by the pension plan.

It is time to consider what will be needed for the upcoming CAFR in order to comply with GASB 67 and ensure that all parties are aware, and in

agreement, as to who will provide each necessary piece of information to complete the new disclosures.

GASB released an implementation guide for GASB 67 in June 2013, and we anticipate that they will similarly release an implementation guide for GASB 68 in the upcoming months. The Government Finance Officers Association (GFOA) may also update their guidance on the contents of a CAFR required to receive their certificate of achievement for excellence in financial reporting. We will report further on GASB 68 provisions likely to impact public employee pension plans following release of either or both of these publications. This advisory focuses on the reporting requirements for pension plans under GASB 67.

What's New?

The primary financial statements have not changed significantly for pension plans, but the note disclosures and required supplementary information (RSI) have. Many of the changes will be additional information supplied by your actuary, but other disclosures will need information from other professionals. For this Advisory, we will identify the changes to the note disclosures and RSI that may not be provided by your actuary or that may require decisions by the Board or staff.

Target Asset Allocation

Most pension plans have a formal investment policy that identifies the target asset allocation and

acceptable ranges around the target. Many pension plans already disclose the target asset allocation in their CAFR, but now the disclosure is required. Plans should be prepared to provide this disclosure. As an example:

Asset Class	Target Allocation
Domestic equity	46%
International equity	21
Fixed income	26
Real estate	6
Cash	1
Total	100%

Who supplies this information?

The investment advisor will typically supply this information.

Implications of this new disclosure

This disclosure is a component in the disclosure surrounding the long-term expected rate of return, discussed below.

Long-term Expected Rate of Return

In addition to providing a description of how the long-term expected rate of return was determined, the retirement plan will need to disclose its invested asset classes and the expected real rate of return for each of the asset classes in the plan's target asset allocation. Pension plans will also need to disclose whether the expected real rates of return were determined based on an arithmetic or geometric basis. As an example:

Asset Class	Long-Term Expected Real Rate of Return
Domestic equity	5.4%
International equity	5.5
Fixed income	1.3
Real estate	4.5
Cash	0.0

Who supplies this information?

The investment advisor will typically supply this information, but often uses a shorter time horizon than is called for in this disclosure. The pension plan may need to work with their investment advisor and actuary to ensure that the disclosure reflects the time horizon over which the long-term expected rate of return is determined for funding purposes. In addition,

if the investment advisor normally provides expected nominal rates of return, they will need to develop expected real rates of return.

Implications of this new disclosure

Some have criticized pension plans for using overly optimistic rates of return to determine contributions. This disclosure will allow users of the financial statements to compare the expected return by asset class to the discount rate used by the actuary to better judge whether the pension plan is being "overly" optimistic. Using real rates of return for this disclosure allows for an adjustment for the potential difference between the valuation inflation assumption and the inflation assumptions used by the investment advisor.

Discount Rate

If the pension plan's current assets (referred to as fiduciary net position in GASB 67), in combination with the appropriate projection of contributions and expected returns thereon, are not sufficient to cover all projected future benefit payments for current plan members, then the total pension liability must be determined using a blended discount rate. The blended discount rate is based on the pension plan's long-term expected rate of return for the period that current and projected assets can pay expected future plan benefits and a yield or index rate for 20 year, tax-exempt general obligation municipal bonds with an average rating of AA/Aa or higher for the period thereafter.

While the calculation of this blended rate is not a required disclosure, it is a necessary step, and the calculation must be available to justify the rates used upon audit. Note that the long-term expected rate of return for this purpose is net of investment expenses, but not net of administrative expenses. If a blended discount rate is necessary based on the projections, the plan must disclose the municipal bond rate used, the source of that rate, and the period for which the yield or index rate is used instead of the long-term rate of return. Accordingly, it is important to identify a source for the municipal bond rate that is acceptable to both the actuary and the auditor.

Who supplies this information?

This is an actuarial projection, so the actuary will provide the calculation of the blended discount

rate. However, the plan, the investment consultant, and the auditor may also need to provide input as to the long-term rate of return and the selection of the municipal bond rate used if necessary. For some contribution policies, no actual projection is needed to demonstrate that the GASB discount rate is equal to the long-term expected rate of return. However, since the auditor will also need to sign off on the calculation, plans may wish to discuss what demonstrations might be required with their auditor.

Implication of this new disclosure

While the demonstration is not a required disclosure, the use of a discount rate for accounting disclosures that is different from the expected long-term rate of return used to determine contributions may have a significant impact on the size of the Net Pension Liability (NPL) disclosed and may be viewed negatively by users of the financial statements and bond rating agencies. In pension plans where GASB 67 requires the use of a lower discount rate for disclosure purposes, plan sponsors may want to consider making changes to their funding policy in an attempt to close the gap. In addition, many pension plans use a discount rate for determining contribution rates equal to the long-term expected return net of both investment and administrative expenses. In such a case, the GASB discount rate could be higher than the rate used to determine contributions. It may also be higher if the pension plan uses a margin for adverse deviation (conservatism) to set the discount rate for determining contributions below the long-term expected rate of return.

Money-Weighted Rate of Return on Plan Investments

Investment consultants typically report investment performance based on time-weighted rates of return, which are calculated as if the pension plan had the same amount of money invested throughout the year, and may not be reported net of investment expenses. In fact, pension plans have different amounts exposed to the markets depending on the flow of contributions into the plan and benefit payments and administrative expenses out of the plan. The money-weighted rate of return calculation takes the net cash flow into account, on at least a monthly basis, to weight the rate of return net of investment expenses for different periods by the amount of assets exposed to the

markets during that period. Note that the calculations also exclude receivables and payables, so the money-weighted rate of return will differ from the return calculated by the actuary that is based on the fiduciary net position at the beginning and end of the year including receivables and payables.

Who supplies this information?

The actual calculation could be performed by the custodian, the plan, the actuary, or the investment advisor. However, it is important to know that someone is tracking the monthly cash flows and monthly asset values so that the elements of this calculation will be available at year-end.

Implications of this new disclosure

Disclosure of the money-weighted rate of return will provide pension plan financial statement users with a consistent, objective calculation with which to compare the investment performance of different plans on an after-fee basis. Plans in a persistent negative cash flow situation may notice that this calculation of investment return is different than the time-weighted returns they may have been used to receiving.

Actuarial Cost Method for Liability Calculations

Disclosure of the Net Pension Liability (NPL) is required by GASB 67. The NPL is the difference between the Total Pension Liability (TPL) and the market value of assets. GASB 67 requires determination of the TPL using the individual entry age normal, level percent of pay actuarial cost method and the previously discussed GASB discount rate. It can be projected from a prior valuation date, but the market value of assets must be as of the reporting date. The current GASB statements allow use of any one of a number of different cost methods, including the one now required by GASB 67.

Who supplies the information?

The actuary will supply the TPL.

Implications of this new disclosure

If the pension plan currently does not use the individual entry age normal, level percent of pay cost method prescribed in GASB 67, the actuary will need to run the valuation again under this method,

requiring additional work. Pension plans will also need to determine if they want to use a projected TPL from a valuation date prior to the plan's reporting date or based on the valuation as of the reporting date. We suspect that most pension plans will project the TPL from a prior date so that the financial statements can be completed in a timely manner. However, using a projection means the actuary will likely need to issue a separate GASB report or letter, and the TPL reported for GASB purposes will not be identical to the Actuarial Liability reported in the valuation, even if the discount rate and actuarial cost method are the same.

Net Pension Liability (NPL) with +1% and -1% Discount Rates

The NPL must also be disclosed as if it were calculated using a discount rate that is 1% higher and 1% lower than the rate used in the primary disclosures. This means that the TPL will need to be re-determined once using a discount rate that is 1% higher and once using a discount rate that is 1% lower than the rate used in the primary disclosures. The asset value will not change. See table below.

Who supplies the information?

The actuary will supply the figures for the TPL using the 1% differential. In cases where the TPL is projected from a prior valuation date, the projection will need to be performed separately at each of these discount rates.

Implications of this new disclosure

This will provide financial statement users insight into the sensitivity of the pension plan's liability measurements to changes in the discount rate.

Type of Plan

GASB 67 and 68 require different disclosures depending on the type of plan, delineated as simple employer, cost-sharing multiple employer, and agent multiple employer plans. In addition to the type of plan, pension plans should determine if they have any non-employer contributing entities and any special funding situations. These distinctions will become important under GASB 68, but preparing to develop the necessary information now would be prudent.

Who supplies this information?

The plan sponsors in conjunction with their auditors must determine the type of plan. Legal counsel's opinion about the structure of the trust may also be helpful.

Implications of this new disclosure

While the differences in the GASB 67 reporting requirements for the different types of plans are relatively minor, the differences can be significant for GASB 68 reporting requirements, and the plan may need to provide additional information to employers and non-employer contributing entities. Stay tuned for more on in a later advisory discussing GASB 68 implementation issues.

Discount Rate	1% Decrease (6.75%)	Current Discount Rate (7.75%)	1% Increase (8.75%)
Total Pension Liability	\$45,427,821	\$39,502,453	\$34,349,959
Fiduciary Net Position	(35,979,370)	(35,979,370)	(35,979,370)
Net Pension Liability	\$9,448,451	\$3,523,083	\$(1,629,411)

Measurement and Reporting Dates

The reporting date/measurement date for GASB 67 is the end of the pension plan's trust year. Many pension plans currently disclose liability and asset figures from the prior year's valuation in the current year's CAFR. The new GASB 67 permits an actuarial valuation up to 24 months prior to the reporting date to be used to determine the Total Pension Liability (TPL), but the TPL calculated on the valuation date must be adjusted using typical actuarial "roll-forward" techniques to approximate the TPL as of the measurement date. This roll-forward calculation must take into account any significant events occurring between the valuation date and the measurement date. Comparison of these adjusted liabilities to the actual market value of assets (on the measurement date, not projected from the valuation date) develops the plan's Net Pension Liability (NPL). Alternatively, pension plans can calculate the TPL directly as of the measurement date and avoid the need to use "roll-forward" techniques. A later Advisory addressing GASB 68 implementation issues will provide details regarding reporting dates and measurement dates for employers.

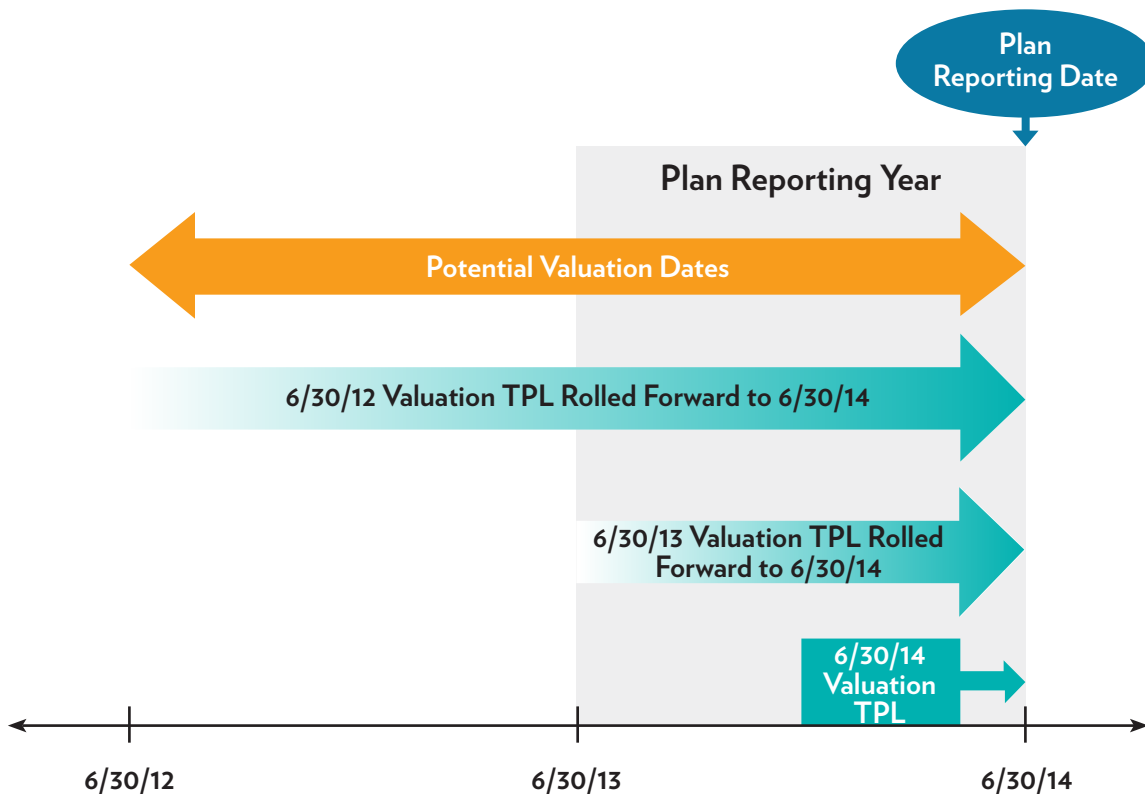
Who supplies this information?

The actuary will supply the TPL. If a roll-forward is performed, the actuary will need information provided by the plan on the actual benefit payments made during the year and whether there were any plan changes or other significant events during the year. The custodian of the pension plan's assets will need to report the market value of the assets as of the measurement date.

Implications of the choice of measurement date

The decision as to whether to use the prior year's valuation in conjunction with a roll-forward, or to use liabilities run as of the trust's year end is largely driven by the availability of data and the complexity of the annual valuation process. If the pension plan is using a blended discount rate as described above, calculation of the effective discount rate must be performed as of the measurement date, rather than as of the valuation date, including using an appropriate municipal bond rate as of the measurement date.

This Client Advisory provides information on what pension plans need to be planning for in order to



make their first disclosures under the new GASB Statement No. 67. Future Client Advisories will address issues related to plan sponsor reporting under GASB Statement No. 68. As always, if you have a specific question or concern, feel free to contact your Cheiron consultants.

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The issues presented in this Advisory do not constitute legal advice. Please consult with your own tax and legal counsel when evaluating their impact on your situation.