

Understanding the New Pension Accounting and Financial Reporting Rules

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mined based on traditional actuarial funding valuations. The Minnesota Legislature will make future decisions about required pension contributions based on the traditional funding actuarial valuations and not on the new accounting standards.

Governments will not need to budget more for pension expenses under the new requirements. While the NPL will be reported on the government's financial statements, there is no expectation that governments pay off the liability within a budget cycle or limited number of budget cycles. You can think of the pension liabilities as being similar to a home mortgage: homeowners pay off the mortgage gradually over time and are not expected to pay off the mortgage upon purchasing a home. So the only real difference is that governments now report the outstanding balance of their "mortgage" as a liability on their financial statements.

Won't Reporting the Pension Liabilities on Government Financial Statements Result in Increased Scrutiny and Criticism of Government Defined Benefit Plans?

Yes, we suspect that will happen. Pension plans in Minnesota, however, are in fairly good shape financially. Minnesota pension plans also have a positive standing nationwide in terms of funding and pension reform efforts. In 2010 (and subsequent years), the Minnesota Legislature enacted various pension reforms to ensure our pension plans remain financially viable and pension benefits remain sustainable.

The amount of government resources spent on public pensions will not change as a result of the new pension accounting requirements.

Even when government defined benefit plans are challenged by critics, the facts demonstrate that the percentage of state and local government spending on pensions remains low. Nationwide, public pensions currently account for about 3.7% of state and local government spending whereas they only account for approximately 2% of government spending in Minnesota.

Why are There Two Sets of Actuarial Valuations Now?

Historically, only one actuarial valuation was prepared by PERA's actuary each year because the amounts reported in local government financial statements were directly related to how PERA's pension plans were funded. Two sets of actuarial valuations are now required because pension accounting and financial reporting rules have changed and are no longer tied to the way pension plans are funded. The GASB sets the requirements for pension accounting and financial reporting, while the Minnesota Legislature continues to determine how the plans are funded. PERA's actuary will now prepare a "funding" actuarial valuation and a "financial reporting" actuarial valuation. The two sets of actuarial valuations have different purposes and therefore use different sets of assumptions and inputs.

What is the Key Difference Between the Two Sets of Actuarial Valuations?

The key difference between the "financial reporting" actuarial valuation and the traditional "funding" actuarial valuation is that the actuary uses PERA's market value of assets at June 30 each year to calculate the NPL for financial

reporting.

The "funding" actuarial valuation uses an actuarial value of assets by smoothing the market value of assets over five years. This lessens the impact of upturns and downturns in the stock market and is the measure legislators use to make funding decisions. Smoothing the market value of assets over five years results in more stable required contribution rates over time.

Since the two actuarial valuations use different assumptions and different asset values in their calculations, they result in different unfunded liability amounts. The actuarial assumptions, expectations, and actual experience change over time so it is difficult to predict future differences between the two perspectives.

Want More Information?

PERA has posted a lot of information on its website to help local government jurisdictions and their auditors implement GASB 68. Visit www.mnpera.org for more information. If you need additional information, or have additional questions about the new pension accounting requirements, contact us at gashb@mnpera.org.

This document is available in alternative formats to individuals with disabilities by calling 651-296-7460 or 1-800-652-9026, or through the Minnesota Relay Service at 1-800-627-3529.



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Understanding the New Pension Accounting and Financial Reporting Requirements

A Plain-Language Guide for Public Officials

Public Employees Retirement Association of Minnesota

Understanding the New Pension Accounting and Financial Reporting Rules

In June 2012, the Governmental Accounting Standards Board (GASB) issued new pension accounting and financial reporting requirements. GASB Statement No. 68 is effective for financial statements for fiscal periods beginning after June 15, 2014. The GASB is the authoritative standard-setting body for governmental accounting principles. The new requirements fundamentally change the way state and local governments and school districts account for public pension liabilities and expenses.

This guide is intended to provide plain-language answers to help public officials understand the new accounting requirements and the impact the new requirements will have on their jurisdictions.

What Are the Major Changes Impacting Governments Under the New Requirements?

The new pension accounting and financial reporting requirements will impact governments that prepare financial statements in accordance with generally accepted accounting principles in three major ways.

- First, governments will now be required to report their proportionate share of PERA's unfunded pension liability, referred to as the net pension liability or NPL, on their government-wide financial statements. The NPL is the difference between the present value of future pension benefit payments to employees and the amount of plan assets currently available to pay the future pension benefits. PERA will allocate the NPL to participating employers. PERA will calculate each employer's proportionate share of the NPL based on the employer's contributions to the pension plan as a percentage of the total of all employers' contributions to the plan.

- Second, pension expense will be calculated differently and will no longer be tied to contributions. In the past, pension expense was equal to

the amount of employer contributions paid to PERA.

As long as employers paid the contributions as required by state statutes, employers did not report a pension liability on their financial statements. Under the new requirements, pension expense will be equal to the change in the NPL from the prior year to the current year (with some adjustments for deferred amounts). Pension expense will be calculated by PERA's actuary, and similar to the allocation of the NPL, PERA will allocate pension expense and deferred amounts to participating employers each year.

- Third, employers will be required to include fairly extensive pension footnote disclosures and pension-related schedules as Required Supplementary Information. The GASB believes the additional pension information will better inform financial statement users how the pension liability changes over time and what economic events and assumptions impacted the changes in the liability.

Where Was the Unfunded Pension Liability Reported in the Past?

PERA has and will continue to report unfunded pension liabilities in its financial statement footnote disclosures. So while it is new that employers now report the information in their financial statements, the pension liabilities have been reported by PERA in the past.

Why Did the GASB Change the Pension Accounting Requirements?

Most importantly, the GASB concluded that, for financial reporting purposes, governments using the accrual method of accounting need to account for pension liabilities the same way they account for any other liabilities, that is, when the goods or services are received, not when they are paid for. GASB 68 requires governments to recognize pension liabilities when their employees provide the services to the government, not when contributions are paid to the pension plan to pay for future benefits. Prior to GASB 68, governments only recog-

nized the contributions they made to the pension plan as pension expense. They did not report the pension benefits their employees earned during the period that would be paid in the future.

The GASB also changed the pension accounting requirements to be responsive to financial statement users, primarily bond rating agencies and taxpayer associations, who told the GASB they felt that by including pension liabilities, financial statements would more accurately show the financial position of governments.

Finally, the GASB made changes in an attempt to increase transparency and comparability among governments. The GASB hopes to achieve this by requiring that all pension plans use the same actuarial cost method when developing financial reporting actuarial valuations and by requiring a uniform measurement of pension expense.

Won't the Pension Liabilities Negatively Impact Our Financial Position?

The pension liabilities are quite significant and in some cases will result in a negative net position on the Government-wide Statement of Net Position (i.e., balance sheet). A negative net position does not necessarily indicate a government will not be able to pay for its current obligations but it could be an indication that the government may not be able to meet its long-term obligations in the future.

It is important to note that the NPL will not impact the fund balance of governmental operating funds. The new accounting standards require that the NPL only be reported on the government-wide financial statements, which are prepared on the accrual basis.

Will the New Pension Accounting Requirements Affect Our Bond Ratings?

While we cannot speak for rating agencies, they 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. Based on our discussions with bond rating agencies, we do not think that reporting the pension liabilities will have a significant impact on credit ratings in Minnesota.

- Standard and Poor's has stated that it doesn't anticipate significant revisions to states' ratings solely based on the GASB changes.

- Moody's has said that for the majority of U.S. governments, their pension obligations remain manageable in the context of their revenues and resources.

How Will Government Jurisdictions Pay Off These Large Pension Liabilities?

Governments will continue to pay off unfunded pension liabilities in the same way that they always have. The timing of when pension plans will be funded does not change as a result of the new accounting and financial reporting requirements. Although governments will be reporting their proportionate share of the NPL on their government-wide financial statements, they will not be solely responsible for paying off those liabilities. In Minnesota, employers, employees, and retirees all share the responsibility to pay off unfunded pension liabilities. In addition, investment earnings on contributions fund the majority of pension benefits in Minnesota.

Will the New Requirements Result in Contribution Rate Increases for Employers?

The new accounting standards will not result in increases to employer pension contributions. Contribution rates will continue to be set in Minnesota Statutes and will continue to be deter-

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PERA has now posted the numbers you will need for your report. To find the numbers you will need for your SWCD, follow the instructions below:

- Access the toolkit by going to www.mnpera.org
- Click on the Employers tab, then click on GASB Public Pension Accounting Standards, then 2015 Financial Reporting Toolkit.
- The pension amounts you are looking for are in the Audit Opinion for Fiscal Year 2015, first link at the top on the page.
- After clicking on the link, select Control F (for find), enter your PERA employer ID including the hyphen.
- Clicking up or down on the arrows will bring you to the information for your employer.

GASB 68 became effective for all year-ends starting June 30, 2015 or later. GASB 68 requires the recording on any unfunded pension liabilities. To reflect GASB 68 changes the financials will have new titles on the balance sheet. Shown below is the definition of each of the new terms.

Net Pension Liability – Represents the districts share of MN PERA that is underfunded, based on current actuarial tables. This liability is considered long-term. To record the liability the first year the beginning fund balance has to be adjusted by the Net Pension Liability that existed on June 30, 2014.

Deferred Outflows of Resources – Represents the payments made to PERA by the district from July 1 through year-end. This is considered an asset on the balance sheet.

Deferred Inflows of Resources – Represents costs related to PERA for future periods. This is considered a liability.

JOURNAL ENTRIES

(Make "offbook")

- 1) Record beginning Net Pension Liability – per PERA report
 - a. Debit "Fund Balance"
 - b. Credit "Net Pension Liability"

- 2) Record Deferred Outflows for 7/01/14 – 12/31/14 – per payroll reports (employer portion)
 - a. Debit "Deferred Outflows"
 - b. Credit "Fund Balance"

- 3) Record Deferred Outflows for 1/01/15 – 6/30/15 – per payroll reports (employer portion)
 - a. Debit "Deferred Outflows"
 - b. Credit "Personnel Services" – employer PERA contributions

- 4) Record Deferred Outflows for 7/01/15 – 12/31/15 – per payroll reports (employer portion)
 - a. Debit "Deferred Outflows"
 - b. Credit "Personnel Services"

- 5) Record payment to Net Pension Liability for 7/01/14 – 6/30/15
 - a. Debit "Net Pension Liability" – this should match PERA contribution report
 - b. Credit "Deferred Outflows"

- 6) Record pension expense for 7/01/14 – 6/30/15
 - a. Debit "Deferred Outflows" – per PERA report
 - b. Debit "Pension Expense" – per PERA report
 - c. Credit "Deferred Inflows" – per PERA report
 - d. Debit or Credit "Net Pension Liability" – this needs to match PERA report after adjustment
 - e. Debit or Credit "Pension Expense" – to balance entry