A HUMBLING EXPERIENCE

Lessons Learned in Implementing
the New GASB Pension Standards

BY JEFF MARKERT
The time is here for employers that participate in defined benefit pension plans to implement Governmental Accounting Standards Board (GASB) Statement No. 68, Accounting and Financial Reporting for Pensions, which is effective for fiscal years beginning after June 15, 2014. It comes on the heels of the GASB Statement No. 67, Financial Reporting for Pension Plans, implementation, which is effective for fiscal years beginning after June 15, 2013. If you have had the opportunity to talk with the plans or their auditors, you may have heard that implementation has been a challenging experience. This article discusses some of the more significant implementation issues affecting employers, as well as some of the lessons learned by the plans in implementing GASB Statement No. 67. This information will provide some clarity and an understanding of information that employers will need to receive from the plans.

**THE EMPLOYER'S STARTING POINT: SELECTING THE MEASUREMENT DATE**

Selecting a measurement date should be one of the first areas that employers focus on when implementing GASB Statement No. 68. The measurement date for employers to record pension amounts remains a source of confusion and miscommunication between employers, plans, and their auditors. It may seem counterintuitive that the employer can report the pension amounts on a measurement date that falls within 12 months of the employer’s year-end (as opposed to the employer’s year-end date).

Since information is needed from the plan, employers can make reporting easier by aligning their measurement date with the plan’s fiscal year-end — the plan year-end that falls within the previous 12 months of the employer’s year-end, to comply with GASB Statement No. 68. When the employer and the plan have the same fiscal year-end, the employer may choose to use either the plan’s current or prior year-end as the measurement date. The measurement date should be based on the availability of audited information from the plan.

**COMPREHENSIVE ACTUARIAL VALUATIONS**

What employers receive from actuaries in terms of an actuarial valuation appears to be inconsistent. Plans often have different actuarial valuations performed; one is generally prepared for accounting purposes (e.g., GASB Statement No. 68), and one is prepared for funding purposes (e.g., the actuarial determined contribution). Employers and their auditors need to receive a complete actuarial valuation report that corresponds to the measurement period and has been prepared for accounting purposes. An “accounting valuation report” usually includes the following:

- Actuarial certification.
- Total pension liability as of the valuation date.
- Roll forward of the total liability to the measurement date.
- Roll forward of components of net pension liability since prior measurement date.
- Sensitivity of net pension liability.
- Other accounting disclosures for GASB Statement No. 68.
- Discount rate calculations.
- Detailed schedules of deferred outflows/inflows of resources.
- Summary of actuarial methods and assumptions.
- Summary of plan provisions.

In implementing GASB Statement No. 67, many plans received a complete funding valuation report but were missing many of the above components that should be included in the accounting valuation report. Additionally, many actuaries did not initially provide an actuarial certification for the accounting valuation report. Such a certification is important because it is a mechanism for the actuary to communicate whether there are any known deviations from actuarial standards of practice or GASB Statement No. 68, including inappropriate methods or potentially incomplete or inaccurate data.

Another common misunderstanding is the level of responsibility that an actuary is taking with regard to the underlying assumptions. Typically, the actuary assumes responsibility...
for the valuation methodology and application, but not for the underlying assumptions. Actuaries do provide advice to management in considering certain assumptions (for example, mortality rates). Additionally, actuaries have a professional responsibility to disclose in the actuarial report if there are any assumptions that they believe are not reasonable. Management and auditors often place undue reliance on the actuary in terms of the actuarial assumptions (e.g., discount rate). The employer is solely responsible for its financial statements, including the actuarial assumptions.

**ELECTING ACTUARIAL METHODS AND ASSUMPTIONS**

Historically, the plan and its governing body have assumed primary responsibility for selecting the actuarial methods and assumptions used to measure the plan’s funded status and to determine actuarially required employer contributions. In many cases, the employer had very little, if any, input. Now that GASB Statement No. 68 requires employers to record the pension amounts (i.e., net pension liability, deferred outflows of resources, deferred inflows of resources, and pension expense) in their financial statements, the role and responsibilities of the employer have increased.

Because the employer is solely responsible for its financial statements, employer management is responsible for the actuarial methods and assumptions used in measuring the pension amounts. This may present challenges for some employers, especially when the plan has historically viewed these choices as its role. In the case of single-employer plans, they will likely disclose the same net pension liability in the notes to the financial statements that the employer records in its statement of financial position. Further, GASB Statement No. 68 requires that pension plans and participating employers use the same assumptions when measuring similar or related pension information. Because many plans have been reluctant to recognize the role of employers in selecting actuarial assumptions, however, this may present a challenge, if there is a disagreement between the plan and employer on the appropriateness of the assumptions. Early communication and coordination between the plan and the employer will be important in trying to bridge the expectation gap that likely exists.

**SUBSTANTIATING THE APPROPRIATENESS OF ACTUARIAL ASSUMPTIONS**

Employer auditors will be looking for evidence from the employer that supports the appropriateness of the actuarial assumptions and management’s consideration thereof. Employer management should consider the appropriateness of actuarial assumptions each year based on updated information that is (or should be) available. Past practices of solely relying on the plan and/or on actuarial experience studies performed periodically (for example, once every five years) will probably not be considered sufficient support of the annual assumptions.

For example, GASB Statement No. 68, paragraph 30, requires the long-term expected rate of return used in calculating the discount rate to be forward-looking and to be based on the appropriate expected long-term rate of return, considering target asset allocations. It is often developed using a building-block approach based on portfolio modeling. New audit guidance to be included in the AICPA Audit and Accounting Guide, *State and Local Governments* (SLG Audit Guide), will likely remind auditors that the appropriateness of the long-term expected rate of return should be evaluated each year. The guide is also likely to remind auditors not to support the reasonableness of this assumption based solely on retrospective analysis of historical investment returns or comparison to the rate used by other plans.

The discount rate is one assumption that has been somewhat problematic for plans to substantiate in their implementation of GASB Statement No. 67. The discount rate (for both GASB Statement No. 67 and Statement No. 68) is the single rate of return that, when applied to all projected benefit payments, results in an actuarial present value of projected benefit payments equal to the total of the actuarial present values. The discount rate is based on a projection of future benefit payments and plan fiduciary net position.
To the extent that fiduciary net position is expected to be available in future periods to pay projected benefits, the projected benefit payments should be discounted using the long-term expected rate of return. At the point that fiduciary net position is no longer available to pay projected benefits in future periods (commonly referred to as the cross-over point), the payments should be discounted using the a yield or index rate for 20-year, tax-exempt general obligation municipal bonds with an average rating of AA/Aa or higher.

Some actuaries have not included a discount rate calculation in their actuarial valuation report. Instead, they have included a statement that the pension plan’s fiduciary net position was projected to be available to make all projected future benefit payments of current plan members (and, accordingly, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability). Supporting this is potentially problematic for plans, employers, and their auditors. When using a management specialist (actuary), it is generally considered appropriate to rely on the specialist for the actuarial valuation (including methodology). However, it is generally not considered appropriate to rely solely on a management specialist to support the appropriateness of the assumptions.

Related to the actual discount rate calculation, one of the areas that has proven to be challenging is the projection of benefit payments when a statute or formal written policy exists that requires increasing contribution rates in future years or when the plan has a history of not making the specified contributions. In these circumstances, the professional judgment of employer management will be challenged with respect to determining whether to consider such funding in projected cash flows for contributions. Further, in evaluating the appropriateness of employer management’s judgment about future contributions, the auditor will need to consider the most recent five-year history and evaluate the likelihood that the increased contribution will be made. In doing so, the employer and employer auditor may consider whether the government has a history of amending similar statutes and written policies due to the inability to make the required contributions.

METHODS OF ALLOCATION

GASB Statement No. 68 does not establish specific requirements for allocating the net pension liability or other pension-related amounts to individual funds. However, question 36 of the Implementation Guide for GASB Statement No. 68 states, “For proprietary and fiduciary funds, consideration should be given to National Council on Governmental Accounting (NCGA) Statement 1, Governmental Accounting and Financial Reporting Principles, paragraph 42, as amended, which requires that long-term liabilities that are directly related to, and expected to be paid from, those funds be reported in the statement of net position or statement of fiduciary net position, respectively.” Most preparers and auditors are interpreting this to mean that pension amounts should be allocated to proprietary and fiduciary funds if those funds provide funding, either directly or indirectly, for employer contributions made to the plan.

From here, the discussion quickly shifts to how the pension amounts should be allocated. Many believe it is appropriate to allocate pension amounts to the enterprise funds, fiduciary funds, and/or the government-wide financial statements.
(that is, governmental and business-type activities) using the allocation methodology for employers participating in cost-sharing plans. This allocation methodology would potentially result in the recognition of additional deferred outflows of resources or deferred inflows of resources related to changes in proportions within the reporting entity (e.g., a change in proportion between two enterprise funds). Some have argued that recognizing changes in proportion within the reporting entity results in overly complex accounting. Assuming the changes in proportion are immaterial in a reporting period, this treatment may be appropriate. However, changes in proportion are often material and could have a significant effect on reported amounts within the funds.

**EVALUATING THE APPROPRIATENESS OF GASB 68 SCHEDULES**

To address the issues of how employers participating in a cost-sharing plan (and their auditors) obtain the necessary information to support their proportionate share of the collective net pension liability, the AICPA issued a whitepaper, “Governmental Employer Participation in Cost-Sharing Multiple Employer Plans: Issues Related to Information for Employer Reporting.” The paper’s recommendations include that plans should prepare a schedule of employer allocations and a schedule of pension amounts by employer, for which the plan auditor would be engaged to issue an opinion on the schedules (elements) in accordance with AU-C section 805, *Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement* (AICPA, Professional Standards). These schedules are commonly referred to as the “GASB 68 Schedules.”

As of mid-May 2015, cost-sharing plans remain at various stages of implementation related to the new GASB Statement No. 68 schedules recommended by the AICPA white paper. What has become clear, however, is that employers and their auditors need to evaluate the appropriateness of these schedules for their purposes. As a starting point, employers and their auditors should obtain the plan’s audited financial statements, the accounting valuation report used to measure the pension amounts (including the actuarial certification), and the GASB Statement No. 68 schedules that contain the auditor’s opinions. In evaluating these schedules, employers and their auditors should verify that the fiduciary net position reported by the plan is the same as the fiduciary net position used in calculating the collective net pension liability. If these two amounts are different, there likely is an error in one of the reports. From there, employers and their auditors should evaluate the reports for internal consistency, read the actuarial certification letter for potential exceptions reported by the actuary, verify employer amounts within the GASB Statement No. 68 Schedules, and recalculate employer’s specific amounts based on the allocation percentage. The professional competency of the auditor should also be considered, and whether the same auditor performed the audit of the plan financial statements and provided the opinion on the elements of the GASB 68 schedules. The plan auditor and the auditor engaged to issue opinions on the elements of the GASB 68 schedules will differ only rarely. In this circumstance, employers and their auditors should carefully consider how the auditor for the GASB Statement No. 68 schedules obtained sufficient appropriate audit evidence. The auditor of the GASB Statement No. 68 Schedules should not refer in its opinion to the auditor of the plan financial statements.
WHEN PLANS ARE AUDITED BY OTHER AUDITORS

When there are different plan and employer auditors, the information obtained from audited plan financial statements is not considered a component of the employer for purposes of AU-C section 600, as discussed in Interpretation No. 1, “Auditor of Participating Employer in a Governmental Pension Plan,” of AU-C section 600, Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors) (AICPA, Professional Standards, AU-C section 9600, paragraph .01—.02). Therefore, the employer auditor is solely responsible for determining the sufficiency and appropriateness of audit evidence necessary to reduce audit risk to an appropriately low level for the pension amounts in the audit of the employer’s financial statements. That is, the audited financial statements of the plan will not, by themselves, provide the employer auditor with sufficient appropriate audit evidence to support the components of net pension liability (i.e., total pension liability and plan fiduciary net position). Further, the plan does not report deferred inflows of resources, deferred outflows of resources, and pension expense.

An effective way for the employer and employer auditor to obtain additional evidence to support the pension amounts included in employer financial is for the plan to prepare a schedule of pension amounts that includes total pension liability, fiduciary net position, net pension liability, deferred inflows of resources by type, deferred outflows of resources by type, and pension expense. The plan would then engage its auditor to obtain reasonable assurance and report on net pension liability, total deferred outflows of resources, total deferred inflows of resources, and pension expense of the employer. In this circumstance, the plan auditor would form an opinion on each element described previously and report on the schedule in accordance with AU-C section 805, Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement (AICPA, Professional Standards).

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NOTING THE CHANGE IN RECOGNITION CRITERIA FOR MODIFIED ACCRUAL BASIS OF ACCOUNTING

An often overlooked change from the Exposure Draft to the final employer pension standard (GASB Statement No. 68) is the accounting for pension expenditures in governmental funds. Specifically, paragraphs 36 and 73 of GASB Statement No. 68 state:

Pension expenditures should be recognized equal to the total of (a) amounts paid by the employer to the pension plan and (b) the change between the beginning and ending balances of amounts normally expected to be liquidated with expendable available financial resources. Net pension liabilities are normally expected to be liquidated with expendable available financial resources to the extent that benefit payments have matured — that is, benefit payments are due and payable and the pension plan’s fiduciary net position is not sufficient for payment of those benefits.

Thus, pension expenditures will be recognized when employer contributions are remitted to the plan (i.e., on a cash basis) unless the plan does not have sufficient resources for the payment of benefits that are currently due. This may be a significant change for employers that previously recognized a liability in governmental funds for payments made shortly after year-end. For those employers that previously recognized such a liability, the change will result in the restatement of beginning fund balance in the respective governmental funds upon adoption of GASB Statement No. 68.

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