CalPERS

Finance & Administration Committee

California Public Employees' Retirement System

Agenda Item 6a

September 11, 2012

ITEM NAME: New GASB Statements 67 and 68

PROGRAM: Pension and Health Benefits

ITEM TYPE: Information

EXECUTIVE SUMMARY

The purpose of this agenda item is to inform members of this Committee that the Governmental Accounting Standards Board (GASB) issued two new Statements in June 2012. Both Statements relate to the financial reporting of governmental pension plans. Statement 67 replaces Statement 25 which relates to the financial reporting by the pension plan or administrator, i.e. CalPERS. Statement 68 replaces Statement 27 which relates to the financial reporting by the governmental entities that provide pension plans for their employees through trusts.

BACKGROUND

GASB issued two new Statements in June 2012, Statement 67 and Statement 68. The journey to issuing the Statements was lengthy and arduous. The following table summarizes the path taken to final issue:

Activity	Date
Added to GASB research agenda	January 2006
Added to GASB project agenda	April 2008
Invite to comment was issued	March 2009
Preliminary Views issued	June 2010
Exposure Drafts issued	July 2011
Final Statements issued	June 2012

CalPERS provided comments to GASB throughout the process, including comments on the Exposure Draft of September 30, 2011.

The objective of each Statement is to improve financial reporting by state and local governments with respect to their pension plans. The new standards were designed to provide improved decision-useful information, increased transparency and comparability of pension information across governments.

Statement 67 replaces Statement 25 which relates to the financial reporting by the pension plan or administrator, i.e. CalPERS. Statement 68 replaces Statement 27 which relates to the financial reporting by the governmental entities that provide pension plans for their employees through trusts.

It is important to note that the new Statements relate to the accounting and financial reporting issues only. The Statements do not address how governments approach the funding of pension plans. While historically there has been a close relationship between how governments fund pensions and how they account for and report financial information, the new guidance establishes a distinct change from a funding based approach to an accounting based approach. This new accounting approach outlines details on calculating and reporting net pension liabilities (or assets) and the recognition of pension expense. These changes are intended to have the effect of presenting more transparency of the government's long-term financial status and, due to an overall acceleration of pension expense recognition, cause the financial status to be more volatile from year-to-year.

The assumed discount rate used in determining the net pension liability has been prescribed by the new Statements. The discount rate used to discount projected benefit payments will be based on a single blended rate that reflects (a) the long-term expected rate of return to the extent that assets and contributions under the current funding policy are expected to be sufficient to pay pensions of current employees and retirees; and (b) a yield or index on tax-exempt 20 year, AA-or-higher rated municipal bonds to the extent that the conditions in (a) are not met. Cash flow testing is required to ensure that assets cover projected benefit payments. If the cash flow test fails in covering projected benefits the lower discount rate will result in larger net pension liabilities and higher financial statement volatility. Staff anticipates recommending new funding methods that guarantee that the cash flow testing will not be necessary for the vast majority of plans.

ANALYSIS

Summary of Statement 67 and the impact to CalPERS

The standards of accounting and financial reporting related to CalPERS are covered under GASB Statement 67. This Statement affects three areas of the Consolidated Annual Financial Report.

1) **Basic Financial Statements**
   Under GASB 67, defined benefit pension plans will continue to present two financial statements: the Statement of Fiduciary Net Position and Statement of Changes in Fiduciary Net Position. The recognition, measurement, and presentation of amounts in the financial statement are generally similar to current guidance.

2) **Notes to the Basic Financial Statement Section**
   The major changes to this section include additional information on money-weighted internal rate of return on plan investments, net of investment expenses, and an explanation of the concept of a money-weighted return. It

also includes a new note disclosure on the “net pension liability or asset” which is the total pension liability less the plan’s net position (asset) and prescribes disclosures on discount rates determined by cash flow testing. Current disclosures in this section in the CAFR are asset related only.

3) **Required Supplemental Information (RSI) Section**
Major changes were made under the Required Supplementary Information section. A series of ten-year schedules to be reported are:
   - annual money-weighted rate of return on plan investments,
   - net pension liability and related ratios,
   - changes in net pension liability, and
   - employer contributions.

Notes to the RSI schedules should now also include factors that significantly affect trends in the above schedules such as changes to benefits, demographics or assumption changes.

Another final important note is that the measurement of the net pension liability (total pension liability less plan’s net position) will now be as of the fiscal year end. If a valuation is not conducted as of the plan’s fiscal year-end, measurement of the total pension liability should be based on update procedures to roll forward amounts from the most recent actuarial valuation to the plan’s fiscal year-end. The Plan’s net position must be of the fiscal year end.

The provisions in Statement 67 are effective for fiscal year 2013-14.

Summary of Statement 68 and the impact to Employers

The standards of accounting and financial reporting related to employers providing governmental pension plans to their employees are covered under Statement 68.

Probably the most important impact of the amended Statement 68 other than the reporting requirements above is that the employers will now be required to report the net pension liability in their accrual-based financial statements (i.e. the employer-wide statement of net position). This change will provide a clearer picture of the employer’s financial position. The financial position of certain employers will appear weaker due to most employers currently experiencing an unfunded liability position. However, the financial reality of the employer’s financial position will not have changed. This may affect the employer’s relationship with its constituents (i.e. the taxpayers) which may result in pressure to change the benefits that the employers provide.

Another important impact of the new Statement is that the calculation and reporting of funding and accounting of pensions will be distinctly different under the new standards. Because of these differences, the Actuarial Office may not be able to provide sufficient information for employers to complete their financial statements without significant resource, systemic and methodology changes. Note that currently there is a close relationship between funding and accounting and the Actuarial Office is able to provide the necessary accounting information to employers with minimal additional effort.

With the large increase in work to provide the new calculations and reporting requirements associated with GASB 68 the question arises as to who will do this work. Currently expenses charged to the Public Employees' Retirement Fund Trust are only for work done in relation to the members and their beneficiaries. GASB work is an employer related expense and cannot be paid from the PERF Trust. There are two possible ways to solve this problem. One is to put the onus on the employers to hire an outside actuary to obtain the necessary accounting information in order to comply with the new Statements. The second would be to set up a fee for service system where employers could contract with CalPERS to provide the GASB information.

The provisions in Statement 68 are effective for fiscal years beginning after June 15th, 2014.

What CalPERS needs to provide additional required information

For CalPERS to provide the necessary information to the State of California, as well as for those agencies that contract with CalPERS for their pension benefits, CalPERS must be in a position to be able to report new required data elements. The June 30, 2014 actuarial valuations are scheduled to be completed in October of 2015 for the public agencies. While some employers will be able to wait for the June 30, 2014 actuarial valuations in order to report financials for fiscal 2014-15, others will use the June 30, 2013 actuarial valuations. The June 30, 2013 actuarial valuations are scheduled to be completed in October of 2014 for the public agencies.

If the Actuarial Office is to provide the required data elements it will need to upgrade and test the software in the Actuarial Valuation System (AVS) by the spring of 2014. Additional hardware will be necessary to store all of the additional required information. Due to the additional complexity and workload required for GASB compliance, the Actuarial Office anticipates that additional staff would be necessary to review and to calculate the supplementary required information and field additional phone calls from employers. Also, as a result of providing this service outside the PERF's regular administration costs, a new billing and payment tracking system would need to be created to properly account for the expected fee for service structure.

BENEFITS/RISKS

Complying with Statements 67 and 68 will mitigate the risk that the Board fails to meet the Board fiduciary duties or are not consistent with the CalPERS mission and core values. Further risks could include the risk of losing employers to other systems. If CalPERS does not provide the GASB information employers may seek other providers as they may be desirous of a one-stop shop for all pension related work.

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