New Pension Accounting – Did I Just Lose $30 million in My Financial Statements?

What is GASB 68?

- New pension accounting standard for local governments
- Took effect for fiscal years ending June 30, 2015

What is GASB 68?

- For the first time the **unfunded liability for pension benefits** is now recognized as a liability in the government-wide financial statements of each local government

Basic Premise

- Pension benefits are:
  - Part of the cost of employee service
  - Promised in return for employee service
  - A liability owed to employees for services rendered to date
  - Need to be recognized in the financial statements

How is the Liability Calculated?

- Plan actuaries calculate how much of that pension benefit has been earned by employees so far
- That amount is then reduced by the funding already in the pension plan

Adjustment for Projected Future Investment Income

- It's also reduced to reflect the fact that some of this liability will never have to be funded by the employer
- Instead it will be funded by investment income that is earned by the assets that are in the pension plan
- This reduction factor is called the "discount rate"

The Discount Rate

- The actuary determines a discount rate that is appropriate for that local government
- A high discount rate:
  - Reflects a high expected return on investments
  - This means that less funding will be required by the employer
  - This allows the actuary to reduce the liability that will need to be reported in the financial statements
  - The actuary performs certain tests to see if the trust investments can qualify for a higher discount rate

More Accurate Measure of Cost of Government

- The new pension standard also changes the amount of pension expense that is reported in these financial reports

More Accurate Measure of Cost of Government

- In the past, pension expense equaled the amount that was actually funded to the pension trust that year

More Accurate Measure of Cost of Government

- Under the methodology of the new pension standard, pension expense will generally be higher than what has been recognized in the past
- Pension expense will no longer be tied to funding
- It will reflect the amount of the benefit that was earned that year whether funded or not

Which Government Financial Reports are Affected by These Changes?

- The agency’s “government-wide” financial reports
- And the financial reports of an agency’s “enterprise funds ” (water, sewer, etc.)

Which Financial Reports Are Not Affected By These Changes?

- The financial reports for an agency's "governmental funds" (general fund, etc.) are not affected by GASB 68
- Budget/actual reports for the general fund will not change
- In those reports, pension costs will continue to be reported based on the amount actually funded to the pension plan

Why Was GASB 68 Issued

- The Standards Board believes that GASB 68 provides important information for elected officials, citizens, and other users of local government financial statements
- The Standards Board was not trying to influence public policy or take a position on whether or not pensions should be more aggressively funded
- The Standards Board believes that pension funding is a part of the resource allocation decision-making that elected officials must balance in the performance of their duties

How Will Your Government-wide Financial Statements Look

- Your liabilities will be larger
- Your liabilities might exceed your assets
- Your “net financial position” will be significantly less, maybe negative
- If that happens, you will show a negative position in your “net financial position”

Will GASB No. 68 Affect Your Bond Rating?

- Will probably have a minimal impact
- In the past, rating agencies have always taken into account a local government's pension obligation and its ability to address the funding of that obligation (with sustained future revenues)
- GASB No. 68 simply reflects this very real obligation on the face of the financial statements
- Some investors might have concern if equity ("net position") becomes significantly diminished (or negative)
- Rate covenants may be impacted due to the higher pension expense created by GASB No. 68

What About OPEB

- OPEB stands for "Other Post Employment Benefits"
- Typically this represents **employer-paid retiree medical benefits**
- For OPEB, GASB has issued GASB 75
- Very similar to GASB 68
- Requires reporting of the entire amount of the unfunded liability for OPEB on government-wide and enterprise balance sheets starting with years ending June 30, 2018
- Even if you have an OPEB trust with CalPERS, the CalPERS actuaries will not help you with the actuarial work for OPEB
- You will need to engage your own actuaries to provide all of the information required by GASB 75 for financial reporting, disclosures, and required supplementary information