Georgia Department of Education

Richard Woods, Georgia's School Superintendent
"Educating Georgia's Future"

FISCAL YEAR 2015

GADOE – FINANCIAL REVIEW SECTION
Implementation of GASB 68 for School Districts

HOW THE IMPLEMENTATION OF GASB 68 AFFECTS THE SCHOOL DISTRICTS

Background Information

In June 2012, the Governmental Accounting Standards Board (GASB), issued two new standards that have a significant impact on the accounting and reporting of public employee pension plans and the state and local governments (including school districts) that participate in these plans. The most significant of these statements for all of the school districts is GASB Statement No. 68, Accounting and Financial Reporting for Pensions. This statement requires the school districts to report the district's proportionate share of the collective net pension liability for each cost sharing benefit pension plan in which the district participates. It is anticipated that this liability will be large enough to force most, if not all, districts to report a deficit Net Position in the District-wide Statement of Net Position.

Additionally, GASB Statement No. 71, Pension Transition for Contributions Made Subsequent to the Measurement Date was issued in November 2013 as an amendment to GASB 68. This statement requires that, at transition, a government recognize a beginning deferred outflow of resources for its pension contributions, if any, made subsequent to the measurement date of the beginning net pension liability.

Why the difference now between pension funding principles and the accounting for the pension?

Previous accounting for pensions only reported a liability in the financial statements if the government's contributions were less than the amount of required contributions. Basically, a school district previously only recorded a liability if the school district did not make a payment for the entire amount of required contributions for the year. That method does not fully represent the pension liability.

Using the new methodology set forth in GASB 68, the accounting approach will report a liability for the amount of pension benefits that have yet to be financed as of a specific point in time, as well as report the actual pension expense that was incurred by the pension plan during the reporting period.

Why did the implementation of GASB 68 create a liability?

The pension liability is not created by GASB 68. The pension liability is the result of the school district's promise to provide pension benefits to its employees. The accounting standards establish a consistent methodology for accounting for that liability.

If GASB did not create the liability, where did the liability come from?

The pension liability is the obligation of the school district to make a payment in the future. School districts have pension liabilities because of the promise to provide pension benefits to the employees in the future when those employees retire. For cost-sharing multiple-employer pension plans (defined below), the school district's contributions to the plan ensure that sufficient resources are available to make pension benefit payments. This relationship constitutes a liability.

Defined benefit pension plan

A defined benefit pension plan is defined in GASB 68 as a pension plan that specifies the amount of benefits that an employee will receive during retirement. A cost-sharing multi-employer defined benefit pension plan includes employees from more than one employer government reporting entity. The assets of the employer entities are pooled and are available to pay benefits to all employees of the participating employers. (See below for definition of cost-sharing multiple-employer defined benefit pension plan)

Prior to the implementation of GASB 68, the school districts only had to report a pension liability on the financial statements to the extent that school districts were behind in making the annual actuarially determined payments (the required employer TRS and ERS contributions) to the pension plan. With the implementation of GASB 68, the school districts will have to report a liability for their portion of the entire underfunded status of the plan. By recording the liability in the Statement of Net Position, the school districts are taking ownership for their share, as actuarially determined, of the liability of the pension plan.

Cost-sharing multiple-employer defined benefit pension plan

Because TRS and ERS are cost-sharing multiple-employer defined benefit pension plans, the school districts, as employers within the plans, will be required to recognize a liability as employees earn the pension benefits. The school districts will have to report its proportional share of the liability on its statement of net position to the extent that the long-term obligation to provide pension benefits (pension liability) is larger than the value of the assets available in the plan to pay those pension benefits.

Measurement date (measurement period) of the pension plan

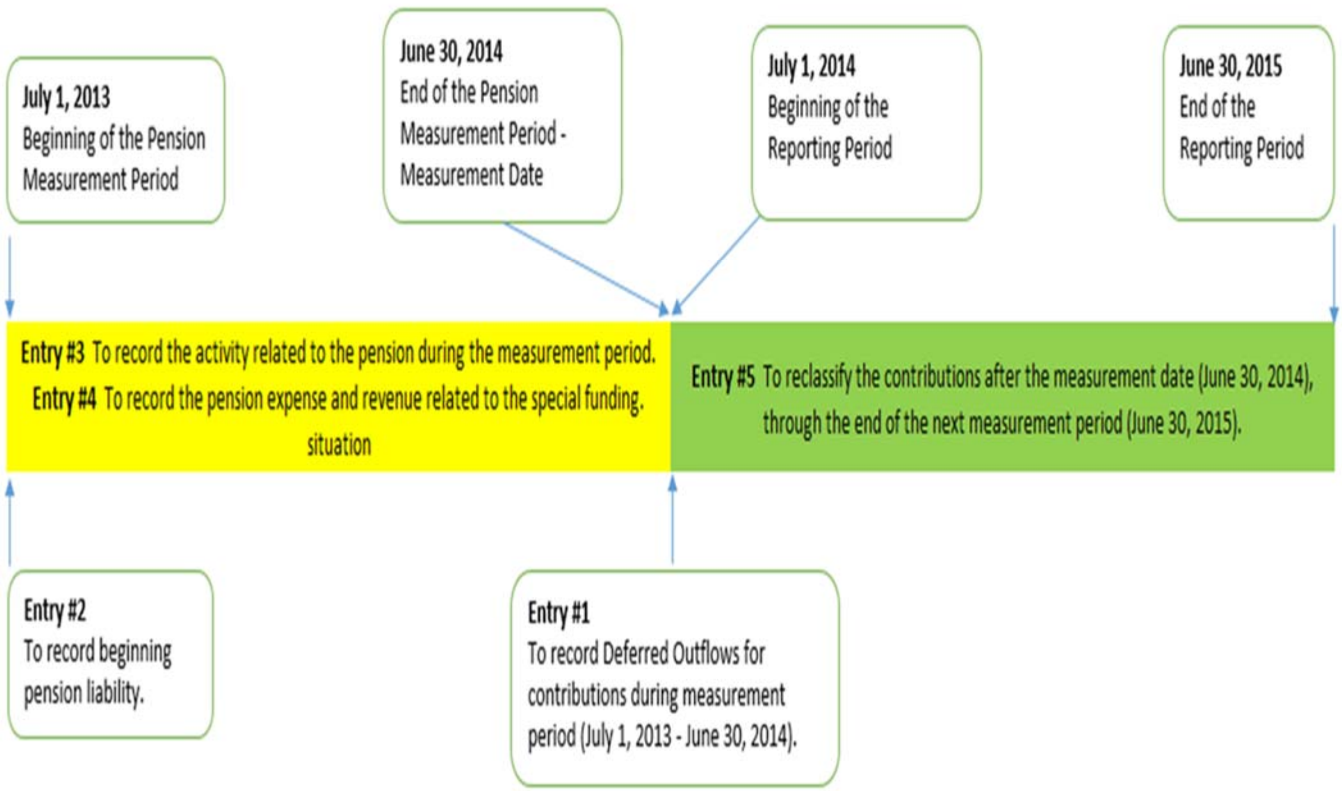
TRS and ERS have agreed to provide the actuarial information for each school district. One important item to note is that the plan information that will be used to record the liability is one year earlier than the reporting date. So for June 30, 2015, the amount that is included is the amount actuarially determined as of June 30, 2014. The current pension activity posted by the school district will also be one year earlier than the reporting period of July 1, 2014 through June 30, 2015. GASB 68 provides for this one year lag in paragraphs 22-32. The total pension liability must be determined using an actuarial valuation as of either: Option 1. the measurement date, or Option 2. Not more than 30 months and one day before the employer's most recent fiscal year end.

The TRS and ERS pension plans have set June 30, 2014 as the measurement date. Using Option 2 above, the measurement date (June 30, 2014) is 12 months before the most recent fiscal year end (June 30, 2015).

Now that the measurement date is set, it is important to note that the school districts are not only going to be required to post the liability as of June 30, 2014, but the school districts will post all of the activity during the measurement period (July 1, 2013 through June 30, 2014). GASB 68, Paragraph 33 states that the measurement period includes all changes after the prior-year measurement date and through the current year measurement date. For our purposes during the initial implementation year, the measurement period is July 1, 2013 through June 30, 2014. Therefore, the school districts will have to record a **restatement to beginning net position** (based on the liability at June 30, 2013), the current year pension plan activity (July 1, 2013 through June 30, 2014), and the ending pension liability (June 30, 2014).

Why restate beginning net position?

In the first year of implementing the new standards, the net position of the school districts will decrease because the school districts did not report a pension liability of any type in the financial statements. Because the liability has existed since the school district began participation in the retirement plan, the restatement serves to record the liability that existed at that point in time, instead of booking the entire previous history as current year activity in the initial year the liability is recorded.



Contributions after the measurement date

Based on GASB Statement No. 71, the pension liability at June 30, 2015 that will be recorded in the financial statements is the liability as of June 30, 2014. Therefore, any contributions made to the pension plan after the measurement date (June 30, 2014) are considered Deferred Outflows of Resources (expenditures related to a future period) and should not be recorded as an expense at the district-wide level. The expenditures will remain at the fund level with no changes to current practice.

One thing to consider is that the school districts record the contributions for employees on the accrual basis. Therefore, the expenditures reported on the general ledger for the school districts are, in some cases, for the months of September through August. The contributions reported for the pension plan measurement period are expenditures recorded July-June. The question becomes, should the Deferred

Outflows of Resources be adjusted to the actual amount of expenditures recorded on the general ledger?

The answer to the question above is NO. The GASB 68 Implementation Guide, question 147 states: What should be included in the amounts reported as Deferred Outflows of Resources for a cost-sharing employer's contributions made subsequent to the measurement date? Answer: For purposes of paragraph 57 of Statement 68, the Deferred Outflow of Resources reported by an employer should include contributions made by the employer during its fiscal year that will be reflected in the net pension liability in the next measurement period - that is, the amount of contributions through the end of the employer's fiscal year to be recognized by the pension plan on the accrual basis of accounting in the next measurement period.

The pension plan's accrual method for recognizing contributions in the next measurement period is to recognize contributions from July 1, 2014 through June 30, 2015. While there are differences between the amounts recognized in the prior year (For July and August 2014) and the current year (For July and August 2015), the difference is reasonably believed to be immaterial, therefore the reclassification of contribution expenses paid (cash basis) to Deferred Outflows of Resources should be for the measurement period of July through June of each fiscal year.

Special funding situations

Additionally, most school districts participate in a special funding situation with TRS. Pursuant to OCGA §47-3-63, the employer contributions for certain full-time public school support personnel are funded on behalf of the employers by the State of Georgia. Those contributions paid by GaDOE to TRS on-behalf of those employees eligible per §47-3-63 are considered on-behalf payments for the school district, and a special funding situation by the pension plan.

Special funding situations exist when a nonemployer entity (the State of Georgia) pays the contributions on behalf of employees of another entity (the school districts). The liability associated with the special funding situation is reported by the nonemployer entity. The entity that employs the qualifying employees only records the expenses and associated revenues related to the on behalf activity.

For the TRS special funding situation, even though GaDOE is paying for the benefits of certain employees, the cost of those benefits is nonetheless the school district's cost of providing services, it is a part of the cost of the compensation of employees. As a result the school district will report pension expense as if GaDOE did not assume a portion of the liability. The school district will also report the revenue equal to the pension expense.

The treatment of the on-behalf payments to TRS will differ between what the school district records on the fund statements versus what the school district records on the district-wide statements. For fund reporting, the school district should continue to record the expenditures and related revenue that is equal to the dollar amount paid by GaDOE on behalf of the school district for the employer contributions of specific employees. Actual contributions are treated in same manner as how the school districts have recorded the activity in previous fiscal years. However, at the district-wide level, only the proportionate share of the employer's pension expense related to the special funding situation of the pension plan should be recorded as revenue and expense. This will create an annual adjusting entry that the school districts will need to post to the district-wide financial statements to adjust the amount of revenue and expenditures posted at the fund level to the amount per the plan information provided by TRS. Please note: For the special funding situation, the pension liability for that portion belongs to the State of Georgia and will be recorded at that level. The school districts are only recording the pension expense and related revenue, as actuarially determined. **See below for the difference between activity recorded at the fund level versus the district-wide level.**

<u>Why the difference between what is recorded on the Governmental Fund Statements and the District-wide Statements?</u>

The governmental fund statements and the district-wide statements report the pension related activities from two different perspectives.

The governmental fund statements report the annual contributions to the pension plan that are needed to fund future benefit payments. The Required Supplementary Information will report the 10 year trend information of the annual contributions. This reports the compliance of the school district with the funding statute.

The district-wide statements report the amount of liabilities that represent the benefits that employees have earned and, therefore, that the government has a present obligation to pay in the future. The total pension liability is the school district's promise of benefits for work already performed. The net pension liability is the amount of the total pension liability in excess of the pension plan's net position (fund balance).

<u>What will be provided to record the journal entries and prepare the note disclosures?</u>

TRS and ERS have agreed to provide the detailed actuarial plan information. The information that TRS and ERS will provide is as follows:

- Required Disclosures and Supplementary Information – this packet will include all of the journal entries and actuarial information required for the note disclosures and the supplementary information specific to each district. The following are examples of items provided:
    - Beginning Proportionate Share of Collective Net Pension Liability as of June 30, 2013
    - Difference between expected and actual experience
    - Net difference between projected and actual investment earnings on pension plan investments
    - Changes in assumptions
    - Changes in proportion and differences between employer contributions and proportionate share of contributions
    - Net amortization of deferred amounts from changes in proportion and differences between employer contributions and proportionate share of contributions
    - Total Employer Pension Expense
    - Schedule of Deferred Outflows of Resources and Deferred Inflows of Resources related to the pensions.
    - Actuarial assumptions that were applied to the pension liability during the measurement period.

- Schedule of the long-term expected rate of return on investments, determined by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation.
- The district's proportionate share of the net pension liability to changes in the discount rate.

The items related to the actuarial assumptions are either Deferred Outflows of Resources (if the activity increases the liability) or Deferred Inflows of Resources (if the activity decreases the liability). It becomes confusing, but basically Deferred Outflows and Inflows are used because the changes in the pension plan are actuarially determined and represent a consumption of resources (Deferred Outflow) or an acquisition of resources (Deferred Inflow) that applies to a future period(s) and therefore will not be recognized as an expenditure or revenue until the future period in which it applies.

The items related to the actuarial determination of total employer pension expense represent the amount of expense that was actuarially determined. It is important to note that at the district-wide level, the actuarially determined expense is the expense that is required to be posted. The school districts currently record the contributions to the pension plan as an expense. In considering the pension liability at a specific measurement date, the plan is calculating the expense that is required by the school districts to fund their portion of the plan. The cash contributions to the plan are just that, cash contributions.

- Also provided is the TRS GASB 68 Sample Note Disclosures – this packet will include all of the general plan information that will be needed for each district's note disclosure. The school districts will have to complete using the information in the school district's packet described above.

What items will the school district provide?

- The total amount of contributions provided to the pension plan for covered payroll, July 1, 2014 through June 30, 2015.
- The total amount of covered payroll for the period, July 1, 2013-June 30, 2014.
- The total amount of covered payroll for the period, July 1, 2014-June 30, 2015.

What items will GaDOE provide?

- The on-behalf totals for TRS that will be posted as revenue and expenditures on the fund level financial statements.
- An allocation worksheet that provides the percentage of benefit contributions by functional category for both TRS and ERS for each school district.

It will be the responsibility of the school districts to properly record the pension activity in the financial statements, the notes to the financial statements, and the required supplementary information. Please see the following instructions.

What is the result of the change in accounting principles? Two sets of numbers

Both sets of numbers serve an important role in the financial statement representation.

- District-wide Statements – follows GASB 68 to establish the standards for reporting the pension obligation. The numbers are intended to provide information about a government's financial status as of the end of the fiscal year (including pension liabilities) and the financial results of the current period's activities (including pension expense).
- Governmental Fund Statements – follows the funding of the plan. Intended to address the approach for pension plan funding – the policy or statue regarding how much money the government will contribute to the pension plan each year (annual contributions)

How does this liability affect net position?

The net position of a school district indicates whether the school district currently has sufficient resources to satisfy its liabilities. It does not provide information about the amount of resources available to meet the school district's immediate operational needs. Net position is affected by capital assets and the balance of long term debt obligations that are not recorded at the fund level. In the year of implementation, the pension liability will significantly reduce the net position of many governments, including school districts.

A negative balance in net position essentially means that the school district does not currently have all of the resources needed to satisfy its liabilities. However, it is not necessarily an indication that the school district is in dire financial difficulties. This negative balance is only on the district-wide financial statements. The General Fund fund balance is not affected by the implementation of GASB 68.

Additional General Information Related to the Actuarially Determined Proportionate Share of the Collective Pension Liability (for information specific to the TRS and ERS plans, see those audit reports)

What are the components of the Net Pension Liability?

The net pension liability equals the total pension liability (a measure of the total cost of future pension benefit payments already earned, stated in current dollars) minus the net position of the pension plan (the value of the assets in the pension trust that can be used to make benefits payments).

How is the proportionate share determined?

A school district's proportionate share of the net pension liability will equal its proportion multiplied by the collective net pension liability for the plan as a whole. The new accounting standards encourage that the proportion be calculated as follows: (1) a government's projected long-term contributions to the plan divided by (2) the projected long-term contributions to the plan by all the participating entities.

How is the annual pension expense measured?

The new standards base annual pension expense on the amount by which the reported net pension liability increased or decreased during the year. The net pension liability is a measure of the portion of a government's obligation for pension benefits that is not covered by assets contributed to and invested by a pension trust fund. The net pension liability is calculated by subtracting the value of those assets in the plan from the total pension liability. The net pension liability changes from year to year as a result of factors that cause either the value of the plan assets or the total pension liability to increase or decrease. The amount by which those factors cause the net pension liability to increase or decrease generally is reported as pension expense in the year in which they occur.

What types of changes in the Net Pension Liability are reported in pension expense in the period in which they occur?

- Benefits earned each year
- Interest on the total pension liability
- The effect of changes in the benefit terms
- Projected earnings on plan investments
- Changes in plan net position from events other than contributions and investment earnings

What types of changes in the Net Pension Liability are not reported in pension expense in the period in which they occur?

Increases or decreased in the net pension liability resulting from certain types of events are introduced into annual pension expense over a period of several years.

- Changes in the assumptions the government uses when measuring its pension liability
- Differences between the assumptions the government made about demographic and economic factors and what those factors actually were (often called experience gains and losses)
- The effects of other changes associated with an individual government that provides benefits through a cost sharing plan or a special funding situation.

The changes above are introduced in the pension expense as deferred outflows and inflows of resources, as those changes affect future measurement periods.

What is a discount rate and how does it relate to pension accounting?

A discount rate is an interest rate used to calculate the present value (the value in today's dollars) of projected future benefit payments.

Under the new pension standards, a government can continue to use a discount rate that is based on the long-term expected rate of return as long as the pension plan's net position that has been accumulated for the benefits of current employees and retirees is projected to be sufficient to make those projected benefit payments.

If at some future point the benefit payments for current employees and retirees are projected to exceed the amount of plan net position, those projected benefit payments ("unfunded" projected benefit payments) are required to be discounted using an index rate for 20-year general obligation municipal bonds rated AA (or its equivalent) or higher.

What is included in the pension plan's projected net position?

The pension plan's projected net position should include all assets that are expected to be accumulated in the pension plan in the future to pay the benefits of current employees and retirees. The plan's projected net position is increased by projected future contributions to the plan that are intended to finance the benefits of current employees and retirees and projected earnings on the plan's investments. It is reduced by projected future benefit payments and administrative expenses.

What is meant by the "long-term expected rate of return"?

Under the new accounting standards, long-term is intended to reflect a period roughly equal to the number of years between an employee's date of hire and the date when the last pension payment for that employee or the employee's beneficiaries is expected to be made. It does not necessarily mean that the pension plan invests in long-term investments, though that is often the case. Governments will be required to disclose information in the notes to the financial statements about how their long-term rate of return was developed.

Resources for preparation of guidance

- Governmental Accounting Standards Board Statement No. 68
- Governmental Accounting Standards Board Statement No. 71
- Governmental Accounting Standards Board Statement No. 68 Implementation Guide Q&A
- Pension Communication Resource Group (PCRG), a group comprised of the GASB and several other state and local government organizations, which was organized to develop resources to communicate the impact of the new pension accounting standards that go into effect this year.