GASB 67/68 School District Implementation Impacts

Minnesota School Boards Association
Roundtable

January 16, 2015

Presented by:
Jay Stoffel, Deputy Executive Director
John Wicklund, Assistant Executive Director/Administration
On the doorstep of implementation

GASB 67: Pension Plan Reporting

- PERA and TRA will implement for their CAFRs for the period ending June 30, 2014.

GASB 68: Accounting and Financial Reporting for Pensions

- School districts will implement for CAFRs for the period ending June 30, 2015.
Major reporting changes: Statement of net position (GASB 68)

- Adds net pension liability (NPL) – similar to the unfunded liability PERA and TRA report today (government-wide financial statements).

- Pension expense for school district is the difference between beginning NPL and ending NPL.
There will be a one-year lag in school district reporting of GASB 68 results. Example: School districts, in their FY2015 reporting, will use FY2014 actuarial valuation results from PERA and TRA.
## GASB 68 calculation:
### Net pension liability (NPL) (in thousands)

**June 30, 2014**

<table>
<thead>
<tr>
<th>(Dollars in thousands)</th>
<th>PERA</th>
<th>TRA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total pension liability</td>
<td>$22,102,321</td>
<td>$24,901,612</td>
</tr>
<tr>
<td>Fiduciary net position</td>
<td>17,404,822</td>
<td>20,293,684</td>
</tr>
<tr>
<td>Net pension liability</td>
<td>$4,697,499</td>
<td>$4,607,928</td>
</tr>
</tbody>
</table>
Calculation of employer proportionate share

<table>
<thead>
<tr>
<th>PERA</th>
<th>TRA</th>
</tr>
</thead>
<tbody>
<tr>
<td>ER unit ER contributions</td>
<td>ER unit ER contributions</td>
</tr>
<tr>
<td>Total PERA ER contributions</td>
<td>Total TRA ER contributions</td>
</tr>
</tbody>
</table>

\[
\begin{align*}
\text{X} & \times \\
$4,697,499,000 & = \text{Each employer unit’s share of the PERA NPL} \\
\end{align*}
\]

\[
\begin{align*}
\text{X} & \times \\
$4,607,928,000 & = \text{Each employer unit’s share of the TRA NPL} \\
\end{align*}
\]
### GASB 68: Example of likely allocations (unaudited)

<table>
<thead>
<tr>
<th>Example:</th>
<th>PERA FY14 NPL</th>
<th>TRA FY14 NPL</th>
<th>Total FY14 (PERA + TRA)</th>
<th>School’s latest net financial position reported</th>
</tr>
</thead>
<tbody>
<tr>
<td>Suburban district</td>
<td>$22.1 million</td>
<td>$66.5 million</td>
<td>$88.6 million</td>
<td>$126.8 million</td>
</tr>
<tr>
<td>Regional outstate school district</td>
<td>$6.9 million</td>
<td>$20.4 million</td>
<td>$27.3 million</td>
<td>$48.7 million</td>
</tr>
<tr>
<td>Small town Greater MN</td>
<td>$1.8 million</td>
<td>$4.6 million</td>
<td>$6.4 million</td>
<td>$4.1 million</td>
</tr>
</tbody>
</table>
Key points: How to talk about GASB

- The information disclosed under the new GASB rules is not new. Pension debt has always been disclosed by the pension plans. What’s new is the allocation of that debt to each local government unit, moving that number from the pension system’s books to the employer unit’s books.

- The new rules affect accounting and reporting, not TRA’s funded status.

- The reported pension liabilities have no impact on funding, employer contribution rates or local tax levies.

- Pension expenses are not crowding out essential services. Local government employers and school districts have always budgeted pension payments.

- Pension costs are not bankrupting the school district/city/county. Pension debt will continue to be paid down by employees and employers through annual contributions to the pension funds over many years, much like the amortizing of a home mortgage.
After 2010 and 2013 reforms that reduced Minnesota pension benefit liabilities by $6.44 billion, credit ratings agencies (Moody’s, Fitch, Standard & Poor’s) have positive things to say about the state’s handling of pension obligations.

Minnesota exercises financial discipline, correcting problems as they occur and proactively proposing benefit reforms. Employer pension contributions in Minnesota are only 2 percent of state and local government spending, compared to 3.7 percent in other states. Teachers and other public employees are required to contribute half the cost of their pensions.

Minnesota has a highly successful investment program: The State Board of Investment has averaged 10.3 percent annual returns over the last 30 years, consistently outperforming its peers.
News reporters in every community cover school board meetings. **Anyone who might field questions from the press, general public, or taxpayer groups about GASB should be able to answer the questions accurately.**

Fact sheets should be included in your organization’s newsletters and materials going to school boards timed for when GASB changes first hit the books and discussion of district statements first appears on school board agendas. We have fact sheets ready for immediate distribution.

- What is the best way to get GASB talking points and fact sheets into the hands of your organization’s members, including superintendents and school board members statewide?
- Employer stakeholders: Can you facilitate TRA communications to your members to distribute talking points and fact sheets?
- MSBA has accepted an article for its newsletter about GASB. This article is available to other stakeholders to use in their newsletters. Contact Susan Barbieri, sbarbieri@minnesotatra.org or 651-205-4247 to get a copy.
Resources

Welcome to the Teachers Retirement Association

Members  Retirees and Beneficiaries  Employers

Administration
Members
Retirees and Beneficiaries
Employers
Legislation

Study: Public pensions give boost to Minnesota’s economy

JULY 30 — Benefits paid by state and local pension plans support a significant amount of economic activity in Minnesota, according to the new study, "Pensionomics 2014" from the National Institute on Retirement Security. Pension benefits received by
PERA/TRA resources

Visit the “Employer” tab on PERA’s and TRA’s websites.
www.mnpera.org
www.minnesotatra.org/employerinfo/gasb

You’ll find:

- Links to GASB publications.
- Links to AICPA audit guidance.
- Toolkit of informational guides/articles.
- Frequently asked questions.
- News and developments on implementation

Questions: E-mail Dave Dejonge (PERA), dave.dejonge@mnpera.org, or John Wicklund (TRA), jwicklund@minnesotatra.org.
GASB IN BRIEF

- The information disclosed under the new GASB rules is not new. Pension liabilities have always been disclosed by the pension plans. What’s new is:
  - the allocation of pension costs to local governments, and
  - moving those costs from the pension system’s books to the employer’s books.

- The new rules affect accounting and reporting, not the funded status of PERA or TRA.

- New GASB rules have no impact on funding, employer contributions or local tax levies.

- Pension expenses are not crowding out essential services. Local government employers and school districts have always budgeted pension payments. Employer pension contributions in Minnesota are only 2 percent of state and local government spending, compared to an average of 3.7 percent in other states. (Census Bureau)

- Pension costs are not bankrupting the school district/city/county. Employers’ pension liabilities will continue to be paid down through annual contributions to the pension funds over many years, much like the amortized portion of a home mortgage.

- After 2010 and 2013 reforms that reduced Minnesota pension benefit liabilities by $6.44 billion, credit ratings agencies (Moody’s, Fitch, Standard & Poor’s) have had positive things to say about the state’s handling of pension obligations:
  - Moody’s: Minnesota’s “relatively well funded pension system” is a “credit strength.”
  - Fitch: “On a combined basis, the burden of debt and unfunded pension liabilities is well below the median for U.S. states rated by Fitch.”
  - S&P: “Minnesota’s pension plans are reasonably well funded relative to those of other states and there have been significant reform measures. … We would expect these changes to improve funded ratios over time.”

- Minnesota exercises financial discipline, correcting problems as they occur and proactively proposing benefit reforms when needed. Public employees contribute half the cost of their pensions. Minnesota has a highly successful investment program: The State Board of Investment has averaged 10.3 percent annual returns over the past 30 years, consistently outperforming its peers. Investment returns produce 70 percent of the revenue to finance pensions.
GASB OVERVIEW

New accounting changes for reporting public pension costs from the Governmental Accounting Standards Board (GASB) will be implemented in 2014-15. There is concern that the new accounting rules will cause confusion and raise false alarm regarding the financial well-being of public pension plans, including Minnesota's. The new GASB numbers can be misleading and create a distorted picture of the systems' long-term financial soundness. Beginning in 2014, the GASB changes will require that school districts and other local governments such as cities and counties show their share of the Public Employees Retirement Association (PERA) and Teachers Retirement Association (TRA) pension costs prominently on their balance sheets. Previously, the costs and financial status of Minnesota’s pension plans were reported only in the systems’ annual reports and in regular reports to the Legislature.

Here are answers to some frequently asked questions about GASB.

Q. What’s new in the GASB rules?

A. Previously, pension liabilities were annually disclosed by the retirement systems on their financial statements and to legislative oversight bodies such as the Legislative Commission on Pensions and Retirement. Now state and local governments and school districts will each have to report their proportionate share of pension debt as a liability on financial balance sheets. Under the old accounting rules, those government units only disclosed the annual contribution to the pension systems needed to fund the retirement systems and pay off the unfunded liability.

The underlying economics and health of the plans are not affected, but the new standards will require school districts and local governments to report liabilities that had previously not been reported in financial statements. These liabilities have always existed and are not new. Furthermore, the new rules do not change what school districts and local governments owe in annual contributions to the retirement systems. The new disclosures should have no impact on budgeting practices.

Q. Why is GASB requiring employers to show this information?

A. Transparency and disclosure are good, but it’s important to provide context for the numbers. The presence on local government or school district balance sheets of a large number representing pension debt could give the incorrect impression that employers/taxpayers have an immense debt that must be paid immediately. This is not the case. Pension costs are amortized or paid off over long periods. The retirement systems plan for this and work to make sure annual contributions are sufficient to pay off any pension debt on a schedule. This works much like a homeowner’s mortgage. Even though a homeowner might have a $100,000 unpaid mortgage, there is no expectation that this be paid off in one year. The owner makes manageable monthly payments and pays down the mortgage debt over a scheduled time period. This is what governments and school districts do when they make regular contributions to the retirement system.
Q. Will governments and school districts have to pay more for pensions because of GASB?
A. No. GASB statements will not affect what governments and school districts pay to fund the plans.

Q. How will local governments and school districts get the pension liability information?
A. TRA and PERA will annually calculate and report to each employer unit that unit’s proportionate share of unfunded pension liabilities. These unfunded pension liabilities will be reported to the government unit or school district so that they can be shown as liabilities on balance sheets. Employers currently have no comparable reporting requirements in statements, footnotes or schedules. Instead, they report only their annual pension contributions.

Q. Do the new standards establish rules for how government units should fund pensions?
A. No. GASB said it is not within its scope to set standards establishing a specific method of funding pensions or to regulate a government unit’s compliance with the funding policy or method it adopts. Funding pensions is a policy decision for government officials or other responsible authorities. In 2013 legislature enacted into law the funding standards the retirement systems have historically used.

Q. Won’t people be alarmed if pension costs loom large on employer balance sheets?
A. They shouldn’t be. The GASB numbers will be somewhat confusing. The liability amount reported on the employer balance sheet will represent the employer’s proportionate share of liabilities and will be paid down by employers’ annual contributions to the pension funds over many years. A June 2012 report from the Center for Retirement Research stated: “It would be unfortunate if the press and politicians characterized these new numbers as evidence of a worsening of the (pension) crisis when, in fact, states and localities have already taken numerous steps to put their plans on a more secure footing.”

Q. Will new GASB standards affect municipal bond ratings?
A. According to Pensions & Investments (April 14, 2014): The new GASB standards “will not materially affect the credit ratings of most public plan sponsors. This is because the rating agencies themselves have signaled their understanding that the new GASB reporting rules might be mere window dressing that, ultimately, does not change the already apparent realities of the marketplace. … The ratings agencies themselves fully recognize that GASB’s changes in financial reporting merely disclose in a different manner liabilities that frankly, were already known through different channels.”

Q. What do the major bond rating agencies have to say about Minnesota pension obligations and local government units’ health?
A. Fitch: “On a combined basis, the burden of debt and unfunded pension liabilities is well below the median for U.S. states rated by Fitch.” Moody’s: Cited Minnesota’s “relatively well funded pension system” as a “credit strength.” Standard &Poor’s: “Minnesota’s pension plans are reasonably well funded relative to those of other states and there have been significant reform measures implemented in the past couple of years aimed at lowering the liabilities. … “We would expect these changes to improve funded ratios over time.”
The Governmental Accounting Standards Board (GASB) is the independent organization that establishes standards of accounting and financial reporting for state and local governments and school districts. Recently, GASB fundamentally changed those standards as they apply to employers that offer pension benefits, including employers participating in TRA and PERA that must produce GAAP-compliant financial statements. Here are some frequently asked questions about the new requirements:

**Q. What are the main GASB 68 requirements for me as an employer?**

**A.** GASB 68 significantly changes pension accounting and financial reporting for state and local governments and school districts that prepare a separate summary set of financial statements on the accrual basis called “government-wide” financial statements by separating pension accounting methodology from pension funding methodology. GASB 68:

- Requires employers to include a portion of TRA’s and PERA’s unfunded liability, called the “net pension liability” or “NPL” on the face of their government-wide financial statements.
- Changes the amount employers report as pension expense and defers some expenses to future years by using accounts called “deferred inflows and outflows of resources.”
- Requires pension costs to be calculated by an actuary. In the past, pension costs were equal to the amount of employer contributions that were sent to TRA and PERA during the year.
- Replaces most of the current footnote disclosures and required supplementary information with information based on new accounting measures.
- Changes the amortization periods that can be used for the different components that affect the pension plan’s total pension liability.

**Q. How are the new pension costs determined?**

**A.** Pension plan actuaries will calculate the pension costs (NPL, pension expense, deferred inflows and outflows of resources) collectively. TRA and PERA accountants will determine each employer’s proportionate share of those costs and develop schedules that supply employers with the information they need to complete their financial statements. Each employer’s proportionate share is determined based on the employer’s contributions for the year as a percentage of total contributions.

**Q. What is the difference between “accounting” costs and “funding” costs?**

**A.** Pension funding and pension accounting have two different objectives. The retirement systems’ funding objective is to maintain reasonably stable contribution rates and to achieve an ultimate funded status of 100 percent over time. To achieve stable contribution rates, our actuarial funding methodology “smooths” out the effects of market fluctuations and amortizes the resulting unfunded pension liability over a longer time horizon. The objective of pension accounting is to record the financial events that affect the total pension liability when they occur. Thus pension accounting calculates the total pension liability using the fair value of investments at a point in time and uses a short-term amortization period.
for components of the total pension liability.

Q. Will the implementation of GASB 68 cause contribution rates to increase?
A. No. GASB 68 amounts recorded in your financial statements are “paper” entries used for accounting purposes only. Employer contribution requirements will continue to be based on TRA's and PERA's actuarial funding methodology, the objective of which is to maintain reasonably stable contribution rates and to achieve an ultimate funded status of 100 percent over time.

Q. Am I really liable for the net pension liability that will be on my books under GASB 68?
A. No. The net pension liability that will be recorded in your financial statements is an accounting estimate of your proportionate share of TRA's and PERA's pension liability at a specific point in time. That number will change from year to year, and is based on assumptions about the probability of the occurrence of events far into the future. Those assumptions include how long people will live, how long they will continue to work, projected salary raises, and how well pension trust investments will do. Actuarially-determined amounts are subject to continual revision. In addition, pension plan boards and the legislature historically have worked together to lower liabilities by “sharing the pain” among employers, active members and retirees.

Q. Will GASB 68 change the amount of contributions I make?
A. No. While your pension expense amount will change on your financial statements, it will no longer be the same amount as the actual contributions you pay, as it has been in the past. You will continue to be responsible to pay only your required contribution amount, which is set in statute.

Q. Will this new GASB standard affect our bond ratings?
A. While we cannot speak for rating agencies, rating agencies 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. Standard and Poor's has stated that it doesn't anticipate significant revisions to states' ratings solely based on the GASB changes. Moody's new approach to analyzing pension liabilities does not include liabilities calculated using the GASB 67 and 68 methodology. Please see the agency websites for more information: Standard and Poor’s (http://www.standardandpoors.com/spf/upload/Events_US/US_PF_Event_Webcast72913Article2.pdf) and Fitch Ratings (http://www.fitchratings.com/web/en/dynamic/articles/GASB-Rules-Generally-Positive-for-U.S.-States-and-Locals.jsp) discuss their approach to pension liabilities in light of GASB 67 and 68. Moody’s (https://www.moodys.com/research/Moodys-announces-new-approach-to-analyzing-state-local-government-pensions--PR_271186) discusses its new approach to analyzing state and local government pensions. Moody’s approach does not take GASB 67 or 68 into account.

Q. Why are some people concerned about the new accounting costs?
A. There are two concerns. The first is that employers will soon be including their proportional share of TRA's and PERA's unfunded liabilities on their balance sheets, even though it's not a liability that they are solely responsible for paying off, and that may be difficult to explain to the public. The second concern is that we will now have two sets of numbers, which may be confusing to those who set policies. The true health of a pension plan is determined by the funding costs and funding policy (which will not change), not by the new accounting costs, but seeing two sets of numbers will be confusing.