State of Montana Department of Administration Accounting Update

May 6-7, 2014

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The Opinions expressed during this presentation are our own. They do not necessarily represent the views of the Comptroller, his representatives, or the Department of Audit.

GASB Standards

- Effective for FYE 6/30/14:
  - GASB 65, Items Previously Reported as Assets and Liabilities
  - GASB 66, Technical Corrections
  - GASB 67, Financial Reporting for Pension Plans
  - GASB 70, Accounting and Reporting for Nonexchange Financial Guarantees
- Effective for FYE 6/30/15:
  - GASB 68, Accounting and Financial Reporting for Pensions
  - GASB 69, Government Combinations and Disposals of Government Operations
  - GASB 71, Pension Transition for Contributions Made Subsequent to the Measurement Date

GASB Concept Statement # 4

- Test of Honesty
  - How many of you have <u>never</u> told a lie?
  - How many of you have <u>never</u> stolen anything?
  - How many of you know what GASB Concept Statement #4 says/does?

GASB Concept Statement # 4 and Beyond

GASB Concept Statement # 4

- Concepts Statements
  - GASB Currently has 6 Concept Statements
    - No. 1 Objectives of Financial Reporting
    - No. 2 Service Efforts and Accomplishments Reporting
    - No. 3 Communication Methods in General Purpose External Financial Reports That Contain Basic Financial Statements
    - No. 4 Elements of Financial Statements
    - No. 5 Service Efforts and Accomplishments Reporting (an amendment of Concept Statement No. 2)
    - No. 6 Measurement of Elements of Financial Statements

GASB Concept Statement # 4

- Concepts Statements
  - Provide GASB with a framework to evaluate existing standards and for establishing future standards.
  - Helpful to accountants and auditors to know how GASB thinks.
  - Existing practice and pronouncements may be inconsistent with Concept Statements (they are)
  - No changes are required by Concept Statements (i.e non-authoritative as they relate to financial reporting)

GASB Concept Statement # 4

- Concept Statement #4 identifies five elements of statements of **financial position**.
  - Assets
  - Liabilities
  - Deferred Outflows of Resources
  - Deferred Inflows of Resources
  - Net Position

GASB Concept Statement # 4

- Concept Statement #4 also identifies two elements of **resources flows statements**.
  - Outflows of resources (expenses/expenditures)
  - Inflows of resources (revenues)

- The names of these elements are neutral with respect of measurement focus and do not necessarily reflect account titles that must be used in financial statements.

GASB Concept Statement # 4

- Central to all the definitions is a “resource”.
  - Resource: An item that can be drawn on to provide services to the citizenry.

GASB Concept Statement # 4

- Definitions
  - Asset = resources with present service capacity that the government presently controls.
  - 1980 GAAFR Definition
    - Resources owned or held by a government which have monetary value.

GASB Concept Statement # 4

- Definitions
  - Liability = a present obligation to sacrifice resources that the government has little or no discretion to avoid
  - An Obligation is a social, legal, or moral requirement (i.e. duty, contract, promise that compels one to follow or avoid a particular course of action)
  - 1980 GAAFR Definition
    - Debt or other legal obligations arising out of transactions in the past which must be liquidated, renewed, or refunded at some future date.

GASB Concept Statement # 4

- Definitions
  - Outflow of resources = a consumption of net assets (i.e. assets netted with liabilities) by the government that is applicable to the reporting period)
  - Consumption means a decrease in assets or increase in liabilities such that net assets is decreased
  - 1980 GAAFR Definition
    - Expenditure – Decreases in net financial resources.

GASB Concept Statement # 4

- Definitions
  - Inflow of resources = an acquisition of net assets by the government that is applicable to the reporting period.
  - Applicable to the reporting period relates to the concept of Interperiod Equity
    - Interperiod Equity is the state in which current period inflows of resources equal current period costs of services (Paragraph 27)

GASB Concept Statement # 4

- Definitions
  - Deferred Outflows of Resources = a consumption of net assets by the government that is applicable to a future period.
  - Deferred Inflow of Resources = an acquisition of net assets by the government that is applicable to a future reporting period.
  - Recognition of Deferred Outflows and Inflows should be limited to those instances identified by GASB in authoritative pronouncements.

GASB Concept Statement # 4

- Definitions
  - Did you feel the ground shift just a little as we read the definitions of Deferred Outflows and Inflows?
  - Are Deferred Outflows (DR) and Inflows (CR) Assets or Liabilities???
  - Any balance that is not specifically defined by GASB as a Deferred Outflow or Inflow should be presented as we currently present deferred items. For example, prepaid rent (DR) or Grant Advances (CR)
  - **However, GASB suggests (Paragraph 59) that the caption "deferred revenue" would be best reserved for items that meet the definition of deferred inflows of resources.**

GASB Concept Statement # 4

- Instructions for the rest of this presentation:
  - If the ground does start shaking, get out of the building, or if you can't, get under a table, cover your head, and make sure you can reach your cell phone
  - Buy stock in any company that still prints accounting texts or materials
  - The new GFOA Governmental Accounting, Auditing, and Financial Reporting (GAAFR or Blue Book) Text was way overdue. See if you can begin to figure out why during the remainder of this presentation

GASB Concept Statement # 4

- GASB is, by Concept Statement #4 and other Proposed Concept Statements, – Changing the definitions of Assets, Liabilities, Inflows and Outflows, and the face of our Financial Statement Models, as well as our measurement focus for financial statements that are presented on the current financial resources measurement focus (Governmental Funds)

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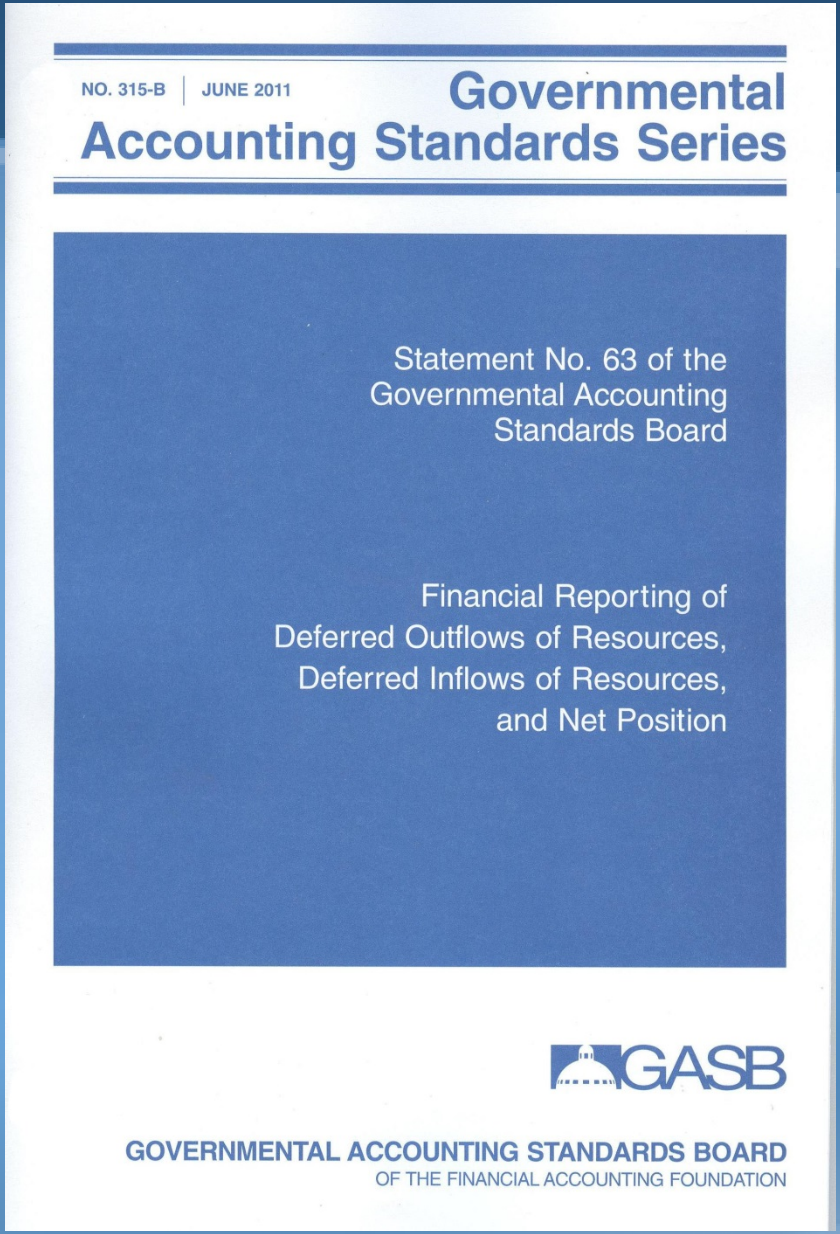
GASB Statement 63

Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position

Issued
June 2011

Effective for periods beginning after December 15, 2011


NO. 315-B | JUNE 2011

Governmental Accounting Standards Series

Statement No. 63 of the Governmental Accounting Standards Board

Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position

GASB

GOVERNMENTAL ACCOUNTING STANDARDS BOARD
OF THE FINANCIAL ACCOUNTING FOUNDATION

Statement of Net Position

Objectives of the project:

- To operationalize the introduction of the deferred inflows of resources and deferred outflows of resources financial statement elements through display guidance
- To consider the effects of these changes on other elements presented in the existing statement of net assets
- Will determine what amendments, if any, should be made to the requirements of Statement No.34

Background

- Concepts Statement 4 identifies 5 elements that make up a statement of financial position:
  - -Assets
  - -Liabilities
  - -Deferred outflows of resources
  - -Deferred inflows of resources
  - -Net position

- This differs from the composition currently required by Statement 34, which requires the presentation of assets, liabilities, and net assets in a statement of financial position

- Statements 53 and 60 identify deferrals of resources

Definitions

- **Deferred outflows of resources**

A consumption of net assets by the government that is applicable to a future reporting period.

- Has a natural debit balance and, therefore, a positive effect on net position, similar to assets

- **Deferred inflows of resources**

- -An acquisition of net assets by the government that is applicable to a future reporting period.

-Has a natural credit balance, and therefore, a negative effect on net position, similar to liabilities

- **Net position**

-The residual of all elements presented in a statement of financial position

Provisions

- Deferred outflows should be reported in a separate section following assets

- Similarly, deferred inflows should be reported in a separate section following liabilities

- Net position components resemble net asset components under Statement 34, but include the effects of deferred outflows and deferred inflows
  - -Net investment in capital assets
  - -Restricted
  - -Unrestricted

- Allowed to report subtotals for:
  - Combination of assets and deferred outflows of resources, and
  - Combination of liabilities and deferred inflows

Financial Statement Reporting Format

- Economic Resources Measurement Focus
  - Preferred reporting format is: assets + deferred outflows – liabilities – deferred inflows = net position
  - Traditional balance sheet format is permitted: assets + deferred outflows = liabilities + deferred inflows + net position

- Governmental Fund Financial Statements
  - Required reporting format is: assets + deferred outflows = liabilities + deferred inflows + fund balance

Statement of Net Position

	Primary Government			
	Governmental Activities	Business-type Activities	Total	Component Units
ASSETS				
Cash and cash equivalents	$ 11,712,829	$ 10,516,820	$ 22,229,649	$ 303,935
Investments	29,250,291	64,575	29,314,866	7,428,952
Derivative instrument--rate swap	1,040,482		1,040,482	
Receivables (net)	11,792,650	3,609,615	15,402,265	4,042,290
Internal balances	313,768	(313,768)		—
Inventories	322,149	126,674	448,823	83,697
Equity interest in joint venture	2,303,256	—	2,303,256	—
Capital assets:				
Land, improvements, and construction in progress	28,435,025	6,408,150	34,843,175	751,239
Other capital assets, net of depreciation	141,587,735	146,513,065	288,100,800	36,993,547
Total capital assets	170,022,760	152,921,215	322,943,975	37,744,786
Total assets	226,758,185	166,925,131	393,683,316	49,603,660
DEFERRED OUTFLOWS				
Accumulated decrease in fair value of hedging derivatives	—	127,520	127,520	—
LIABILITIES				
Accounts payable and accrued expenses	7,538,543	659,592	8,198,135	1,803,332
Advances from grantors	1,435,599		1,435,599	38,911
Forward contract		127,520	127,520	
Long-term liabilities:				
Due within one year	9,236,000	4,426,286	13,662,286	1,426,639
Due in more than one year	83,302,378	74,482,273	157,784,651	27,106,151
Total liabilities	101,512,520	79,695,671	181,208,191	30,375,033
DEFERRED INFLOWS				
Accumulated increase in fair value of hedging derivatives	1,040,482	—	1,040,482	—
NET POSITION				
Net investment in capital assets	103,711,386	79,088,574	182,799,960	15,906,392
Amounts Restricted for:				
Transportation and public works	10,655,737	—	10,655,737	—
Debt service	3,076,829	1,451,996	4,528,825	—
Housing and community redevelopment	6,845,629	—	6,845,629	—
Other purposes	1,483,387	—	1,483,387	492,445
Unrestricted Amounts (deficit)	(1,567,785)	6,816,410	5,248,625	2,829,790
Total net position	$ 124,205,183	$ 87,356,980	$211,562,163	$ 19,228,627

Financial Statement Items Renamed

Pre GASB 63	Post GASB 63
Statement of Net Assets	Statement of Net Position
Invested in Capital Assets, Net of Related Debt	Net Investment in Capital Assets
Statement of Revenues, Expenses, and Changes in Net Assets	Statement of Revenues, Expenses, and Changes in Net Position

Effective Date

- Effective for financial statements for periods beginning after December 15, 2011
- Earlier application is encouraged
- Accounting changes adopted to conform to the provisions of the Statement should be applied retroactively by reclassifying the statement of net position and balance sheet information, if practical, for all prior periods presented.
- In the period this statement is first applied, the financial statements should disclose the nature of any reclassification and its effect

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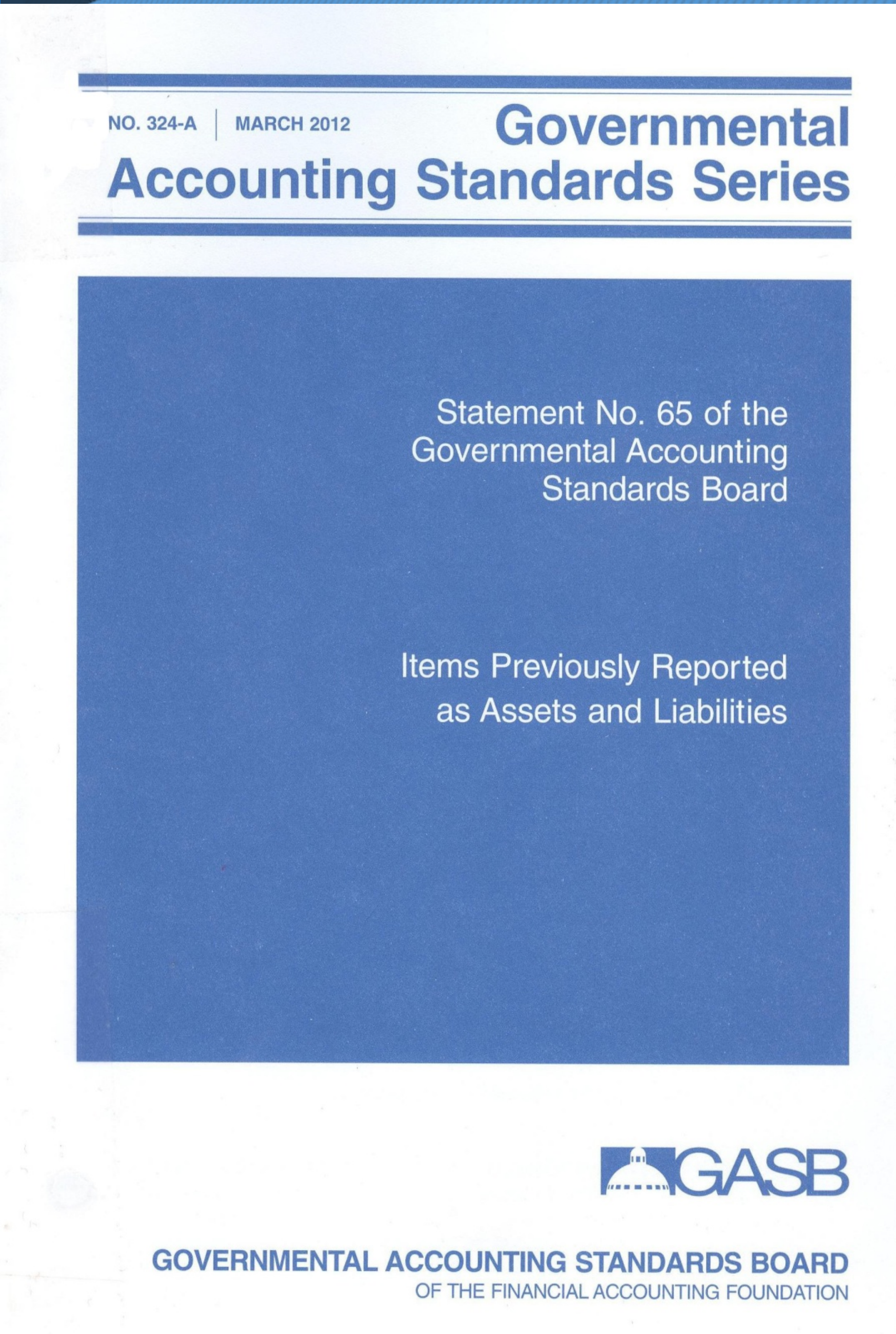

NO. 324-A | MARCH 2012

Governmental Accounting Standards Series

Statement No. 65 of the Governmental Accounting Standards Board

Items Previously Reported as Assets and Liabilities

GASB

GOVERNMENTAL ACCOUNTING STANDARDS BOARD
OF THE FINANCIAL ACCOUNTING FOUNDATION

Statement 65

Items Previously Reported as Assets and Liabilities

Changes Considered

- Effect on assets
  – Continue to report as assets
  – Reclassify as deferred outflows
  – Treat as current period expenditure/expense
- Effect on liabilities
  – Continue to report as liabilities
  – Reclassify as deferred inflows
  – Treat as inflow of current period

Reclassify as deferred inflows

- Advance of revenue from imposed nonexchange transaction
- Grants received in advance of meeting timing requirement
- Deferred amounts from refunding of debt (credits)
- Proceeds from sale of future revenues
- “Regulatory” credits

Reclassify as deferred inflows

[continued]

- Deferred gain from sale-leaseback
- “Unavailable” revenue related to the application of modified accrual accounting
- Loan origination fees (excluding points) for mortgage loans held for resale prior to sale

Reclassify as deferred inflows

[continued]

- Loan origination fees for points for lending activities and mortgage loans held for investment
- Resources generated by current rates intended to recover costs that are expected to be incurred in the future (regulated industries)
- Gains or other reductions of net allowable costs intended to reduce rates over future periods (regulated industries)

Deferred Outflows of Resources

- Grant paid in advance of meeting timing requirement
- Deferred amounts from refunding of debt (debits)
- Cost to acquire rights to future revenues (intra-entity)
- Loss from sale-leaseback

Outflows of Resources

- Debt issuance costs (other than insurance)
- Initial costs incurred by lessor in an operating lease
- Acquisition costs for risk pools
- Loan origination costs

Treat as current inflows

- Loan origination fees (excluding points) related to lending activities
- Commitment fees realized upon exercise or expiration of commitment
- Commitment fees charged (with obligation to make or acquire a loan or to satisfy an obligation when exercise is considered remote)

Treat as current inflows [continued]

- Fees received for purchased loans
- Loan origination fees (excluding points) for mortgage loans held as investments
- Loan origination fees (including points) for mortgage loans held for resale after sale

Treat as current inflows [continued]

- Fees realized after the funding of mortgage loans has occurred or after commitment to guarantee the funding of mortgage loans expires
- Fees realized when a commitment is arranged directly between a permanent investor and a borrower

Continue to report as assets

- Prepayments
- Capitalized incurred costs for regulated activities
- Net pension plan position in excess of employer's total liability
- Cable TV initial subscriber installation costs

Continue to report as liabilities

[continued]

- Commitment fees (with the obligation to make or acquire a loan)
- Fees to guarantee funding of mortgage loans
- Fees to arrange commitment directly between permanent investor and borrower
- Refunds imposed by a regulator

Other Items

- Criteria for determining major funds will include deferred items
- Use of the term “deferred” limited to deferred outflows and deferred inflows

- Which of the following could properly be
- described as deferred revenue ?
- A. Unearned rental income
- B. Advance related to an expenditure-driven grant
- C. Property taxes collected in advance of year being
- funded
- D. All of the above
- E. None of the above

- How should bond issuance costs be
- classified?
- A. Asset
- B. Outflow of resources
- C. Either A or B

- If a fund is legally designated as a special
- revenue fund, but must be reported as part of
- the general fund pursuant to GAAP, how
- should its budgetary comparison be
- presented?
- A. Integral part of general fund budget
- B. Treated as special revenue fund in combining
- and individual fund statements
- C. No budgetary comparison required

GASB Update Focusing on Pensions

GASB 67 and 68 and the new GASB 71

Some Basic Definitions of Defined Benefit Plans

- **Single Employer Plan**
  - A plan that is only open to one employer or multiple departments /functions within one employer
- **Agent Multiple – Employer Plan**
  - A plan that includes more than one employer
  - Assets pooled for investment purposes
  - Separate account exists for *each* employer
  - Employer's assets can *only be used to pay for that employer's benefits* (and no others)
- **Cost Sharing Multiple – Employer Plan**
  - A plan that includes more than one employer
  - Assets and liabilities are pooled
  - All assets are available to pay for all benefits

Some Basic Definitions of Defined Benefit Plans – Hybrids (only *occasionally found in government)*

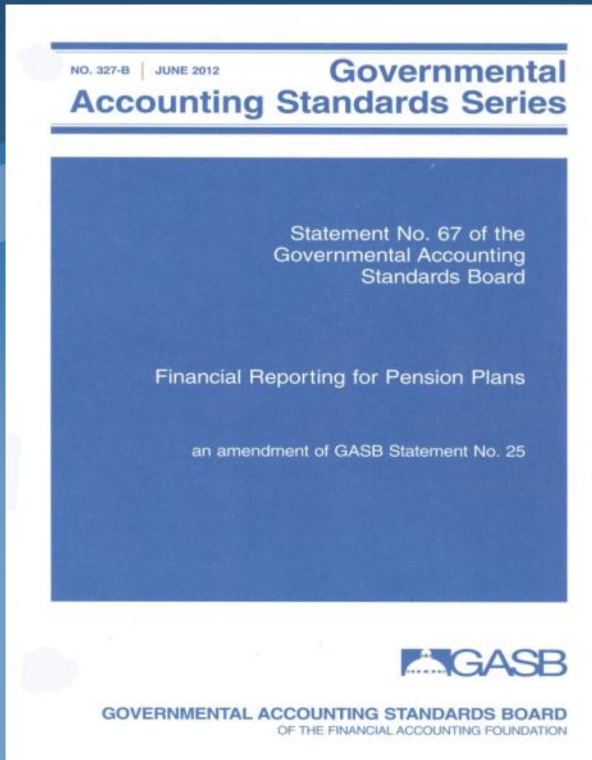
- **Cash Balance Plan**
  - Hypothetical accounts maintained for participants
  - Employer credits participants' accounts with funds annually and promises earnings at a specific rate
    - Rate may be different from actual earnings
    - Formula may be changed annually
    - Has defined contribution aspects as well as defined benefit
- **Money Purchase Plan**
  - Mostly like defined contribution plan
  - Employers contributions determined for and allocated for specific individuals as a percentage of compensation
  - Employer contributions based on formula
- **Target Benefit Plan**
  - Employees contribute on an actuarial basis knowing a certain date of retirement (e.g. Target 2025)
  - No guarantees of balance or return

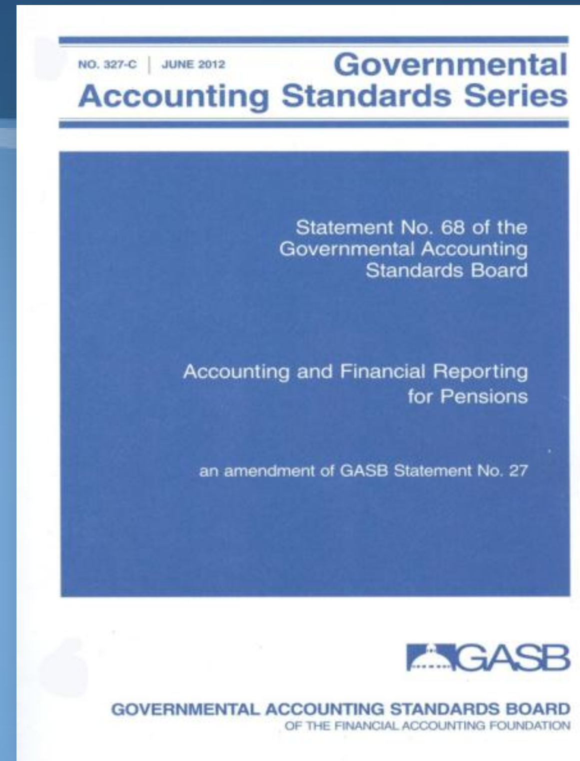
Types of Defined Contribution Plans

- IRC 401(k) plans
  - Optional percentage of compensation contributed
  - Employer may match
  - Tax deferred unless election to tax currently (Roth 401k)
- Thrift Savings Plans
  - Employees make after tax contributions matched by employer (whole or in part)
    - Federal government is the largest TSP
- IRC 403(b) Plans
  - Tax deferred annuities funded by salary reductions
  - Usually in non-profit /government higher ed and hospitals
  - Some governments may have a wrinkle in lump sum transfers to 403(b) plan
- IRC 457 Plans
  - Common in government
  - Plan administrator invests plan assets at direction of plan participants
  - Participant has risk due to potential loss of value

Tennessee's Hybrid Plan

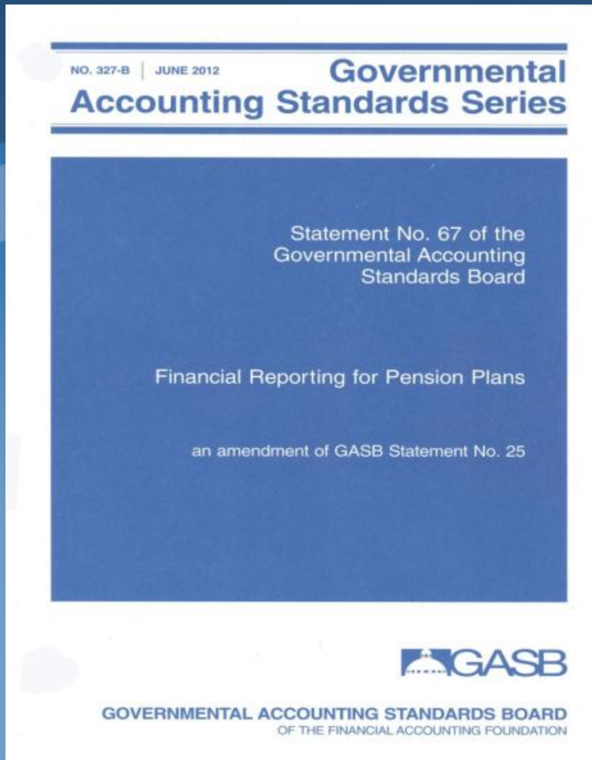
- State, Higher Education and K-12 employees hired on or after June 30, 2014 are eligible
- Combination of DB and DC plans
- Benefit formula is 1% of average final compensation over last 5 years (legacy is sliding percentage over last year)
- Rule of 90 instead of rule of 80 (age + service)
- 5 year vesting





Statement 67
Financial Reporting for Pension Plans

Statement 68
Accounting and Financial Reporting for Pensions



NO. 327-B | JUNE 2012

Governmental Accounting Standards Series

Statement No. 67 of the Governmental Accounting Standards Board

Financial Reporting for Pension Plans

an amendment of GASB Statement No. 25

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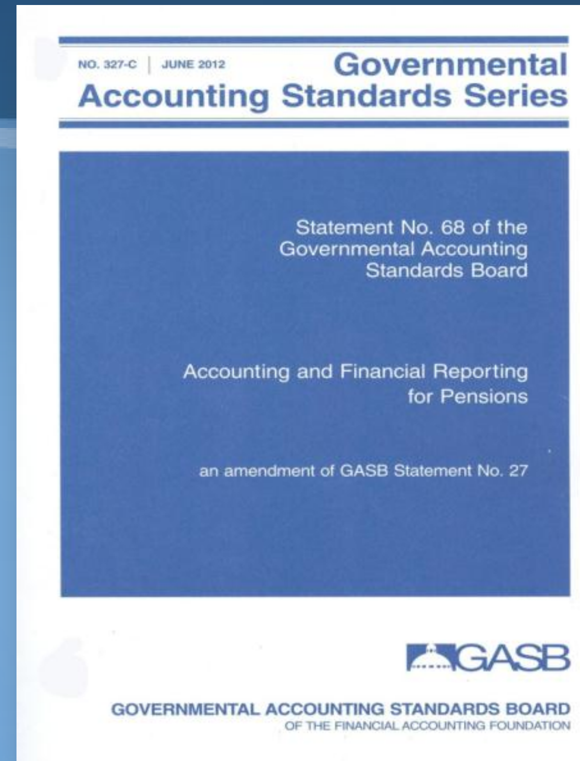
GOVERNMENTAL ACCOUNTING STANDARDS BOARD
OF THE FINANCIAL ACCOUNTING FOUNDATION



NO. 327-C | JUNE 2012

Governmental Accounting Standards Series

Statement No. 68 of the Governmental Accounting Standards Board

Accounting and Financial Reporting for Pensions

an amendment of GASB Statement No. 27

GASB

GOVERNMENTAL ACCOUNTING STANDARDS BOARD
OF THE FINANCIAL ACCOUNTING FOUNDATION

Statement 67
Financial Reporting for Pension Plans

Statement 68
Accounting and Financial Reporting for Pensions

Statement 71 (not pictured)
Pension transition for contributions made subsequent to the measurement date

The New GASB Revolution

- GASB's Postemployment Benefits Project
  - March 2009: GASB issues "Invitation to Comment"
  - June 2010: GASB issues "Preliminary Views" (PV)
  - July 2011: GASB issues two Exposure Drafts
  - Summer 2012: GASB Releases two final standards
- **Effective dates**
  - For plan reporting: plan years beginning after June 15, 2013
    (2013/2014 for fiscal year plans or 2014 for calendar year)
  - For employer reporting: fiscal years beginning after June 15, 2014 (2014/2015)

The GASB Revolution

- **FOUR Major Focus Areas** in the new standards

  1. Placing the Net Pension Liability on the Balance Sheet

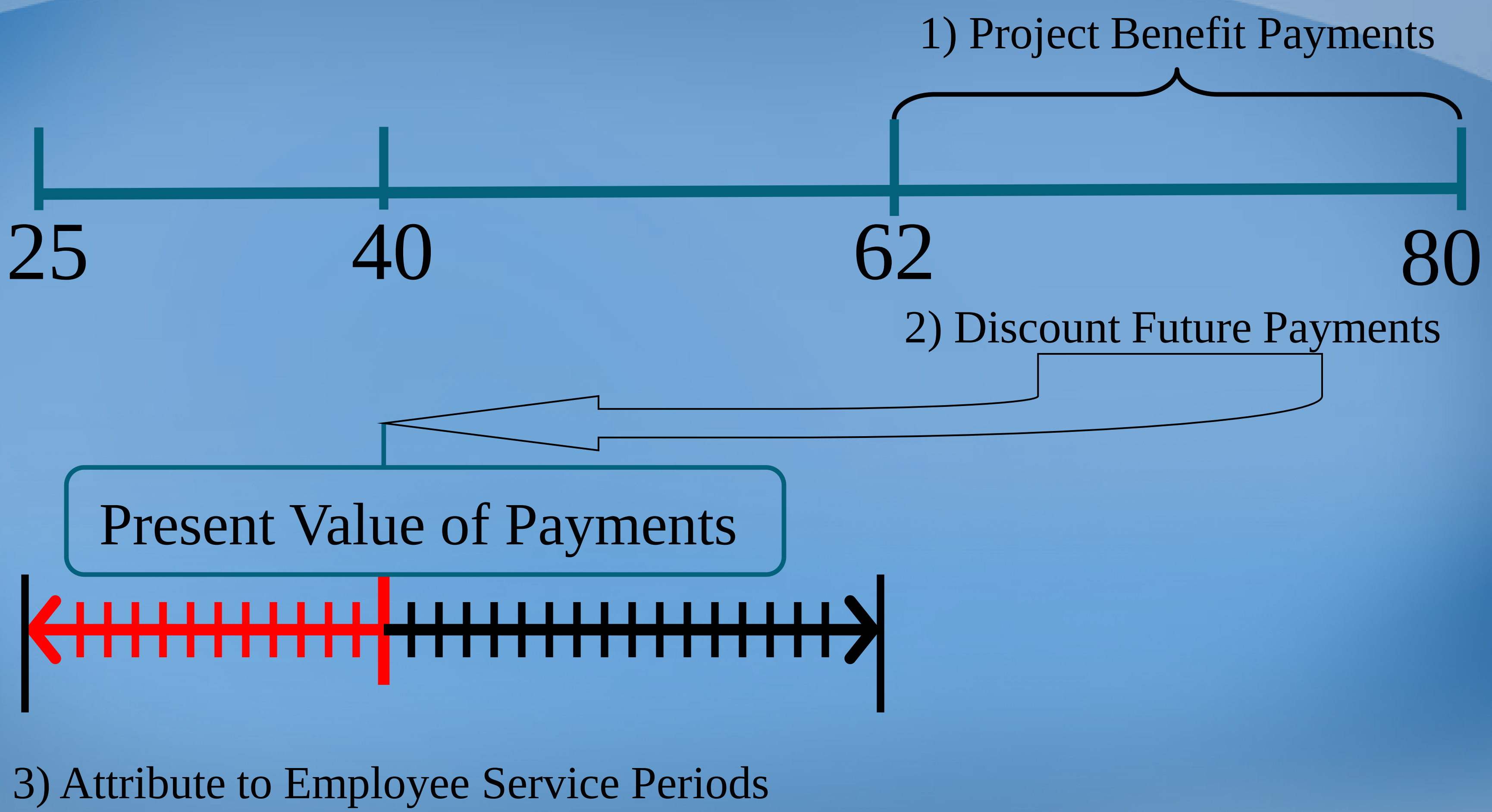
  2. Decoupling Expense from Funding

  3. Accounting for Cost-Sharing Plans (n/a for single employer)

  4. Expanding Disclosure Information (Notes & RSI)

- Timing of Measurements, Effective Dates
- Implementation Guides and Audit Guidelines

The Basic Three-Step Approach for Defined Benefit Pensions



GASB Objectives and Goals

Focus on FINANCIAL REPORTING not operations

- GASB establishes accounting and financial reporting standards, not funding policies
- Focus on pension obligation, changes in obligation, and attribution of expense

Assume Governments Last Longer than 1 year Unlike Businesses

- Cost of services to long-term operation
- “Interperiod equity” matches current period resources and costs

Use Federal Guidance (US DOL / SSA) on Who is an Employee and Who they Work For

- Employer incurs an obligation to its employees for pension benefits
- Transaction is in context of a career-long relationship

Change in Pension Expense Recognition

- Pension Expenses are now going to be recorded immediately when:
  - Pension benefits earned during the reporting period (service cost or normal cost)
  - Projected investment earnings on pension plan investments (long-term expected rate of return)
  - Interest cost on the total pension liability
  - Changes in benefit terms that affect the total pension liability

Change in Pension Expense Recognition

Pension Expense is Deferred and Amortized on Some Events:

- Deferred and recognized over a period equal to the average remaining service periods of active and inactive (including retirees) employees for:
  - Differences between expected and actual changes in economic and demographic factors
  - Changes in assumptions about economic and demographic factors
- Differences between actual and projected earnings on plan investments would be deferred and recognized as pension expense over a five-year, closed period

Cost-Sharing Employers – Huge Change

- A government participating in a cost-sharing plan would report a liability in its own financial statements that is equivalent to its proportionate share of the net pension liability of all the employers in the cost-sharing plan.
- Approach uses a basis for allocation of proportionate share based on the employer's contribution effort relative to that of all contributors

A Deeper Dive into the Four Issues

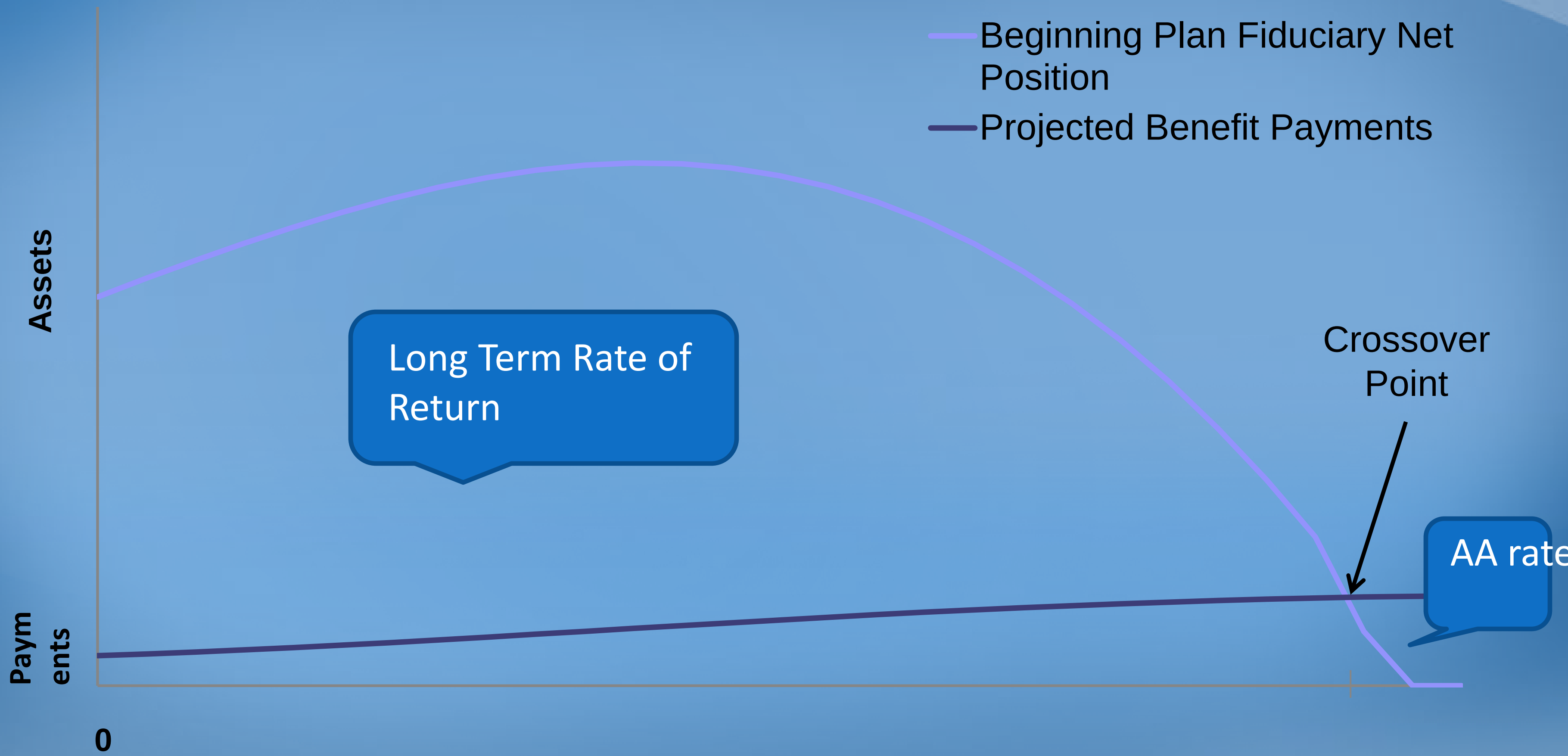
Major Focus Area #1
Net Pension Liability Reported on Balance Sheet

- Net Pension Liability (NPL)
  - Total pension liability (TPL) minus plan assets at market value ("plan net position")
    - TPL uses new "blended" discount rate and "Entry age" cost method **(change for TRS)**
  - Similar to Unfunded Actuarial Accrued Liability (UAAL) but using market assets, not "smoothed" assets
    - Note 5-year asset smoothing still allowed (in determining pension expense), but reported separately **(likely change in all plans)**
- NPL must be reported on the employer's balance sheet
  - Currently, UAAL is reported in the Required Supplementary Information (RSI)
  - Currently, only the Net Pension Obligation (NPO) is reported on the balance sheet
    - Cumulative difference between annual required contribution (ARC) and actual contributions

The New "Blended" Discount Rate

- Discount rate is based on projected benefits, current assets, and projected assets for current members
  - Projected assets include future contributions that fund benefits for current members
  - Projected assets do not include employer or employee contributions that fund service cost for future employees
  - For projected benefits that are covered by projected assets
    - Discount using long-term expected rate of return on assets
  - For projected benefits that are not covered by projected assets (i.e., after the "cross-over date")
    - Discount using yield on 20-year AA/Aa tax-exempt municipal bond index
  - Solve for a single rate that gives the same total present value
    - Use that single equivalent rate to calculate the total pension liability (TPL)

What is this thing called the Crossover Point?



Why Does it Matter?

- Simple- the lower the interest rate, the higher the liability
  - Private Sector uses "risk free rate of return" – **what's yours?**
    - It's what changed most private sector pensions to defined contribution (401k plans) by 1990
  - Equation is what took an extra year of GASB deliberation and meetings with public sector employer groups to hammer out
  - **In single employer plan like ERS –** will the current rate of 8% change??

Major Focus Area 2
Decoupling Expense from Funding

- Currently, pension expense is based explicitly on an actuarially determined funding requirement
  - The ARC, which is the "annual required contribution"
    - Even though is not required to be contributed!
  - Based on established practices for managing contribution volatility
    - Asset smoothing and UAAL amortization
  - The ARC served as a de facto funding standard
- New GASB pension expense is the change in NPL each year, with deferred recognition of only certain elements
  - ARC Specifically not intended to be a funding target or standard

New Pension Expense Components

- Changes in Total Pension Liability that are recognized (i.e., expensed) immediately—no deferrals allowed
  - Service cost – pensionable compensation x rate
  - \+ Annual interest on the TPL
  - \- Projected investment returns over the year
  - \+ / - All plan amendments
- Immediate recognition of all plan amendments, whether for actives or retirees
  - Probably different from funding

New Pension Expense Components

- Changes in Total Pension Liability where some deferrals are allowed (i.e., expensed over multiple periods)
  - Changes in actuarial assumptions
  - Actuarial gains and losses
- Changes are recognized in expense over average expected remaining service lives of active and inactive members (including retirees)
  - Resulting amortization periods will still be very short
    - 5 to 10 years
    - Shorter than for funding (currently ranges from 15 to 30 years)

New Pension Expense Components

- Changes in Assets where some deferrals are allowed (i.e., expensed over multiple periods)
  - Differences between actual and projected earnings over the year (i.e., investment gain/loss)
    - Recognized in expense over closed 5-year period
    - Most systems use either 5- or 7-year asset smoothing for funding
  - So the NPL on balance sheet will be "market volatile", but effect on expense and on employer net position will still reflect asset smoothing
    - Need to look at "Deferred Outflows and Inflows"
  - Effect on expense will be different from funding (and current ARC), where investment gain/loss is:
    - Smoothed over 5 or 7 years and
    - Also amortized as part of the UAAL

Summary of New Pensions Expense Components – a great cheat sheet

- Changes in the employer’s Net Pension Liability will be recognized in pension expense more quickly

<table>
<tr><th></th><th colspan="2">Current Standards</th><th colspan="2">New Standards</th></tr>
<tr><th>Source of Change in the Net Pension Liability</th><th>Expense</th><th>Deferral</th><th>Expense</th><th>Deferral</th></tr>
<tr><td>Service Cost</td><td>Immediate</td><td>None</td><td>Immediate</td><td>None</td></tr>
<tr><td>Interest on the TPL</td><td>Immediate</td><td>None</td><td>Immediate</td><td>None</td></tr>
<tr><td>Projected Investment Earnings</td><td>Immediate</td><td>None</td><td>Immediate</td><td>None</td></tr>
<tr><td>Changes in Benefit Terms</td><td rowspan="5">Initial period amount</td><td rowspan="5">Amortization over a period up to 30 years (closed or open)</td><td>Immediate</td><td>None</td></tr>
<tr><td>Changes in Assumptions</td><td rowspan="3">Initial period amount</td><td rowspan="2">Expense over average remaining service period of actives and inactives</td></tr>
<tr><td>Differences between Assumed and Actual Economic and Demographic Factors</td></tr>
<tr><td>Differences between Projected and Actual Earnings</td><td>Expense over 5-year closed period</td></tr>
<tr><td>Other Changes in the NPL</td><td>Immediate</td><td>None</td></tr>
</table>

Decoupling Expense from Funding

- The faster — often immediate — recognition of net pension liability changes will introduce much greater volatility in the reported pension expense.
  - This volatility will be reflected directly on the income statements of plan sponsors.
- This volatility is what disqualifies this new expense as a basis for determining a funding policy.
  - Two competing measures of plan cost
- Plans will want to review or adopt funding policies, now that GASB expense no longer provides funding guidance.
  - Funding policy also needed for discount rate calculation – and for disclosures

What Does it All Mean?

- Fiscal folk in the room will have some explaining to do to decision – makers
  - Decision – makers are used to "Noah's ARC" or the letter from the plan
  - Decision – makers are used to compensation x rate OR rate per employee
  - Budget and funding only a component of expense
  - **Suggestion – use the previous slide to insert a schedule in MD&As to translate from annual contributions to annual expense as follows…**

A *Possible* Way to Translate for Decision-makers

Annual Contributions as determined by Actuary	$x,xxx,xxx
Adjustments for annual amortizations of:	
Differences between actual and expected experience	
Changes in assumptions	
Differences between projected and actual earnings on plan investments	
(COST SHARING ONLY) Changes in proportion and differences between contributions and proportionate share of contributions	
Contributions subsequent to measurement date recognized as deferred outflows of resources (GASB-71)	
Other	
Pension Expense	**$x,xxx,xxx**

Major Focus Area 3
Accounting for Cost-Sharing

- Current standards are simple
  - Pension expense is equal to the contractually required contribution
    - No “ARC”
  - Balance sheet only presents the sum of the difference (if any) since 1988 between the contractually required contribution and the actual contribution
  - Unfunded actuarial accrued liability is not reported at all

Accounting for Cost-Sharing

- Under new standards cost sharing reporting same as a single - employer
  - Recognize <u>proportionate share</u> of *the plan's* total
    - Net Pension Liability
    - Pension Expense
    - Deferred Positions

NONE of these are to be reported on the plan financial statements

Example Schedule of Cost Sharing Proportion

Final Design might be 5 years and average to comply with GAS-67

EXAMPLE COST SHARING PENSION PLAN

Schedule of Employer Allocations

June 30, 2015

Employer/ Nonmployer (special funding situation)	2015 Actual Employer Contributions	Employer Allocation Percentage
State of Example	$ 2,143,842	38.9 %
Employer 1	268,425	4.9
Employer 2	322,142	5.8
Employer 3	483,255	8.8
Employer 4	633,125	11.5
Employer 5	144,288	2.6
Employer 6	95,365	1.7
Employer 7	94,238	1.7
Employer 8	795,365	14.4
Employer 9	267,468	4.9
Employer 10	267,128	4.8
Total	$ 5,514,641	100.0

STAY TUNED FOR AUDIT DETAILS OF THIS

Example

Example of Cost Sharing						
30-Jun-12	Source – A Statewide CAFR 2012, Statistical Section					
			Contributions			
Participating Government	2012		2003		Average	
Teachers	$ 470,263	50.81%	$ 203,847	49.38%	50.10%	
State Employees	311,349	33.64%	141,595	34.30%	33.97%	
Higher Education Employees	143,920	15.55%	67,371	16.32%	15.94%	
	$ 925,532	100.00%	$ 412,813	100.00%	100.00%	
				Floating Variance of .0001%		
Theoretical Net Pension Liability						
Total Present Assets	30,118,178,556					
Total Liability	36,723,638,901					
Theoretical NPL	(6,605,460,345)					
Teachers	(3,309,005,360)	50.10%	Further allocation needed			
State Employees	(2,243,874,879)	33.97%	Further allocation needed			
Higher Education Employees	(1,052,580,106)	15.94%	Further allocation needed			
	(6,605,460,345)	Floating Variance of .0001%				

Example

- Number will be different due to
  - Actuarial value vs. fair value of assets
  - Roll-forward of liabilities
- Other information needed to give to employers
  - Annual expense
  - Deferred Inflows of Resources
  - Deferred Outflows of Resources
- Further allocation in multiple levels necessary to
  - Proprietary Funds
  - Higher Education funds / campuses
  - School districts **(Special Funding Situations)**

Example Schedule of Employer Pension Amounts Allocated by Cost Sharing Plan

EXAMPLE COST SHARING PENSION PLAN
Schedule of Pension Amounts
June 30, 2015

		Deferred Outflow of Resources				Deferred Inflows of Resources				Pension Expense	
Employer/ Nonmployer (special funding situation)	Net Pension Liability	Differences Between Expected and Actual Economic Experience	Differences Between Projected and Actual Investment Earnings	Changes of Assumptions	Changes in Employer Proportion and Differences Between Contributions and Proportionate Share of Pension Expense	Differences Between Expected and Actual Economic Experience	Differences Between Actual and Projected Investment Earnings	Changes of Assumptions	Changes in Employer Proportion and Differences Between Contributions and Proportionate Share of Pension Expense	Proportionate Share of Plan Pension Expense	Net Amortization of Deferred Amounts from Changes in Propotion and Proportionate Share of Pension Expense
State of Example	$ 38,589,135	428,768	2,058,088	1,500,690	782,365	380,371	1,063,285	–	584,365	1,878,717	12,375
Employer 1	4,831,647	53,685	257,688	187,898	96,633	47,625	133,131	–	125,325	235,229	(1,793)
Employer 2	5,798,553	64,428	309,256	225,499	115,971	57,156	159,773	–	245,386	282,303	(8,088)
Employer 3	8,698,585	96,651	463,925	338,279	173,972	85,742	239,681	–	125,632	423,492	3,021
Employer 4	11,396,244	126,625	607,800	443,188	227,925	112,332	314,012	–	386,325	554,828	(9,900)
Employer 5	2,597,183	28,858	138,516	101,002	51,944	25,600	71,563	–	42,358	126,444	599
Employer 6	1,716,569	19,073	91,550	66,756	34,331	16,920	47,298	–	24,325	83,571	625
Employer 7	1,696,283	18,848	90,468	65,967	33,926	16,720	46,739	–	125,325	82,584	(5,712)
Employer 8	14,316,562	159,073	763,550	556,756	286,486	141,118	394,478	–	152,005	697,004	8,405
Employer 9	4,814,421	53,494	256,769	187,228	68,325	47,456	132,657	–	87,325	234,391	(1,188)
Employer 10	4,808,301	53,426	256,443	186,990	67,528	47,395	132,488	–	41,035	234,093	1,656
Total	$ 99,263,485	1,102,928	5,294,055	3,860,249	1,939,406	978,435	2,735,105	–	1,939,406	4,832,655	–

STAY TUNED FOR AUDIT DETAILS OF THIS

Major Focus Area 4
Expansion of Disclosure Information

- Includes both Notes and Required Supplementary Information (RSI)
- ***Greatly*** expanded plan and employer disclosures, including:
  - Description of the plan and assumptions
  - Policy for determining contributions
  - Sensitivity analysis of the impact on NPL of a one percentage point increase and decrease in the discount rate
  - Changes in the NPL for the past 10 years
  - Development of long-term earnings assumption
  - Annual rates of investment return for past 10 years (plan only)

Expansion of Disclosure Information

- More new disclosure information
  - "Actuarially determined (employer) contribution" (aka the ARC)
    - Basis and amount – if determined!
    - Comparison to amount actually contributed
    - May encourage review (or creation) of actuarial funding policy
- Expanded disclosures greatly increase the pension information needed for plan and employer's financial statements
  - New and challenging questions for employer's financials:
    - **Which actuary/auditor develops this information?**
    - **Who pays for it?**

Timing and Frequency

- Actuarial valuations must be at least biennial
- Recognition of significant changes between the actuarial valuation date and the measurement date:
  - Changes to benefit provisions
  - Size or composition of the membership
  - Change in municipal bond rate component of the discount rate
  - Other factors or assumptions that affect the valuation results

Timing and Frequency

- The new pension standards have **tremendous flexibility** in which plan financial statement / actuarial information to use
  - Liability is determined as of *either*
    - Actuarial valuation date
    - The plan's reporting date *or*
    - An actuarial valuation date *<u>no more than 24 months before</u> the plan's reporting date*, rolled forward
  - Assets are as of the *plan's* most recent fiscal year end

Timing and Frequency—GASB 68 (Employer)

Possible Approach

Each dot is one year

RD = reporting date
VD = actuarial valuation date
MD = measurement date

Possible Approach

More about this later

Possible Approach

GASB 68 Financial Statement Changes

GASB 25/27 Versus GASB 67/68 Treatment

OLD GASB 25/27 TREATMENT

Annual Pension Cost:

APC = ARC + one year's interest on the NPO +/- adjustment to the ARC to offset the effect of actuarial amortization of past (under or over) contributions.

Net Pension Obligation:

NPO = cumulative difference between <u>annual</u> pension cost and the employer's contributions to a plan, including the pension liability or asset at transition, if any.

GASB 67/68 NEW DEFINITIONS

- **Total Pension Liability (TPL)** = Actuarial present value of projected benefit payments attributed to past periods. Same as Actuarial Accrued Liability (AAL) calculated using Entry Age Normal and weighted discount rate.

- **Fiduciary Net Position (FNP)** = Market Value of Plan Assets

- **Net Pension Liability (NPL)**= Total Pension Liability minus Fiduciary Net Position

NET PENSION LIABILITY ON THE STATEMENT OF NET ASSETS (BALANCE SHEET)

GASB 25/27

Actuarially Accrued Liability (AAL)	$300,000,000
-	minus
Actuarial Value of Assets	$100,000,000
=	equals
Unfunded Actuarial Accrued Liability (UAAL)	$200,000,000

UAAL was not recorded, only disclosed

GASB 67/68

Total Pension Liability (TPL)	$300,000,000
(Using AAL per GASB 68)	minus
- Fiduciary Net Position (FNP) *(At FMV of Assets)*	$200,000,000
=	equals
Net Pension Liability (NPL)	$100,000,000

NPL recorded only by the employer

For GASB 67/68 - Net Pension Liability (NPL) = Unfunded Actuarial Accrued Liability (UAAL)

GASB 68 FOOTNOTE DISCLOSURES (ALL EMPLOYERS)

1. Plan Description and Related Information
2. Changes in Net Pension Liability (NPL)
3. Significant Assumptions
4. Discount Rate and Key Discount Rate Assumptions
5. Pension Plan's Fiduciary Net Position
6. Measurement and Actuarial Valuation Date
7. Changes/New Assumptions made related to Benefit Terms
8. Changes made subsequent to Measurement Date
9. Current Period Pension Expense
10. Schedule of Deferred Outflows/Inflows of Resources

GASB 68 Single or Agent Employers

Note Disclosures and Required Supplementary Information

SINGLE/AGENT EMPLOYERS FINANCIAL STATEMENTS

- Recognize full amount of NPL, Pension Expenses and Deferred Outflows and Inflows (100%).
- Recognition and Measurement using the economic resources measurement focus and accrual basis of accounting.
  - NPL recognized to the extent the liability is expected to be liquidated with **<u>expendable available financial resources.</u>
  - Calculated as: Amounts paid by the employer to the pension plan + the change between beginning and ending balances of amounts expected to be liquidated.

**** Means when benefits are due and payable, but the FNP is not sufficient to pay those benefits.**

SINGLE/AGENT EMPLOYERS FOOTNOTES TO THE FINANCIAL STATEMENTS

- Significant Assumptions/Inputs used to calculate Total Pension Liability (TPL)
- Date of the Actuarial Valuation used to determine TPL
- Details regarding changes in assumptions for benefit terms, basis for determining employer contributions to the pension plan, purchase of allocated insurance contracts
- Number of employees covered of Active and Inactive Members (receiving and not receiving benefits)
- Current Year Sources of Changes in Net Pension Liability

SINGLE AGENT EMPLOYERS REQUIRED SUPPLEMENTARY INFORMATION (RSI)

1. **10 Years** - Sources of changes in the Net Pension Liability (NPL)
2. **10 Years** - Components of TPL, FNP, NPL and Related Ratios
   - Plans Fiduciary Net Position (FNP) as a % of TPL
   - NPL as % of Covered-Employee Payroll
3. **10 Years (if applicable)** - If contributions are actuarially determined, schedule covering 10 most recent fiscal years including information on actuarially determined contributions, contributions to the pension plan, and related ratios.
4. **10 Years (if applicable)** - If contributions established by statute, 10 most recent years of statutorily required contributions, contributions to the pension plan and related ratios.

SINGLE AGENT EMPLOYERS REQUIRED SUPPLEMENTARY INFORMATION (RSI) - FOOTNOTES

– Notes to RSI – Significant assumptions used to calculate actuarially determined contributions (if applicable) – Single/Agent Employers Only

– Notes to RSI - Factors that affect the trends in the amounts reported in the schedules (i.e. changes in benefit terms, size and composition of the population, use of different assumptions) – All Employers

Required Supplementary Information

	20X9	20X8	20X7	20X6	20X5
Total pension liability					
Service cost	$ 101,695	$ 100,317	$ 103,471	$ 98,685	$ 81,657
Interest	231,141	219,193	200,491	185,434	171,179
Benefit changes	-	-	-	-	-
Differences between expected and actual experience	(69,638)	(41,374)	(9,387)	17,438	29,183
Changes of assumptions	-	-	63,375	-	-
Benefit payments	(124,083)	(118,311)	(109,281)	(99,654)	(91,558)
Refunds of contributions	(2,780)	(2,764)	(2,927)	(2,684)	(2,251)
Net change in total pension liability	136,335	157,061	245,742	199,219	188,210
Total pension liability—beginning	3,045,893	2,888,832	2,643,090	2,443,871	2,255,661
Total pension liability—ending (a)	$3,182,228	$3,045,893	$2,888,832	$2,643,090	$2,443,871
Plan net position					
Contributions—employer	$ 109,544	$ 107,028	$ 105,755	$ 103,089	$ 89,054
Contributions—member	51,119	50,344	54,949	51,926	41,411
Net investment income	199,273	83,235	(30,957)	131,629	236,486
Benefit payments	(124,083)	(118,311)	(109,281)	(99,654)	(91,558)
Administrative expense	(3,427)	(3,333)	(3,046)	(2,684)	(2,349)
Refunds of contributions	(2,780)	(2,764)	(2,927)	(2,684)	(2,251)
Other	8	(34)	37	9	(88)
Net change in plan net position	229,654	116,165	14,530	181,631	270,705
Plan net position—beginning	2,283,333	2,167,168	2,152,638	1,971,007	1,700,302
Plan net position—ending (b)	$2,512,987	$2,283,333	$2,167,168	$2,152,638	$1,971,007
Net pension liability—ending (a) – (b)	$ 669,241	$ 762,560	$ 721,664	$ 490,452	$ 472,864

Note: Only 5 years are presented here;
10 years of information would be required

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Required Supplementary Information

	20X9	20X8	20X7	20X6	20X5
Total pension liability	$ 3,182,228	$ 3,045,893	$ 2,888,832	$ 2,643,090	$ 2,443,871
Plan net position	(2,512,987)	(2,283,333)	(2,167,168)	(2,152,638)	(1,971,007)
Net pension liability	$ 669,241	$ 762,560	$ 721,664	$ 490,452	$ 472,864
Ratio of plan net position to total pension liability	78.97%	74.96%	75.02%	81.44%	80.65%
Covered-employee payroll	$ 435,373	$ 432,256	$ 426,939	$ 412,280	$ 387,055
Net pension liability as a percentage of covered-employee payroll	153.72%	176.41%	169.03%	118.96%	122.17%

Note: Only 5 years are presented here;
10 years of information would be required

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Required Supplementary Information

	20X9	20X8	20X7	20X6	20X5
Actuarially calculated employer contribution	$ 109,544	$ 107,028	$ 105,755	$ 103,089	$ 89,054
Actual employer contributions	(109,544)	(107,028)	(105,755)	(103,089)	(89,054)
Annual contribution deficiency (excess)	$ -	$ -	$ -	$ -	$ -
Covered-employee payroll	$ 435,373	$ 432,256	$ 426,939	$ 412,280	$ 387,055
Actual contributions as a percentage of covered-employee payroll	25.16%	24.76%	24.77%	25.00%	23.01%

Note: Only 5 years are presented here;
10 years of information would be required

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Plan Required Supplementary Information

SCHEDULE OF INVESTMENT RETURNS

Last 10 Fiscal Years

	20X8	20X7	20X6	20X5	20X4	20X3	20X2	20X1	20X0	20W9
Annual money-weighted rate of return, net of investment expense	8.19%	11.23%	9.28%	13.50%	4.09%	(4.28%)	(3.82%)	12.63%	11.01%	12.91%

This schedule is presented to illustrate the requirement to show information for 10 years. However, until a full 10-year trend is compiled, pension plans should present information for those years for which information is available.

GASB 68 Cost Sharing Employers

Note Disclosures and Required Supplementary Information

ATTRIBUTES OF A COST SHARING EMPLOYER

- Recognize only a proportionate share of the "Collective NPL", Pension Expenses and Deferred Outflows and Inflows.
- Based on annual assessed contributions by employer.
- Proportionate share could change from year to year.

COST SHARING EMPLOYERS FOOTNOTES TO THE FINANCIAL STATEMENTS

- Include all Single Agent Employer Information

+

- Descriptive information about the pension plan
- Identify the Discount Rate
- Assumptions made in measuring employer's proportionate shares of net pension liabilities, basis of proportion, and changes in proportion from year to year

COST SHARING EMPLOYERS FOOTNOTES TO THE FINANCIAL STATEMENTS

- Descriptive Plan Information
  - Name of the Pension Plan
  - Identification as Single Employer/Agent Plan/Cost Sharing Plan and the Plan Administrator
  - Benefit Terms (classes of employees covered, types of benefits, key elements of the pension formula, automatic COLAs, authority under which benefit terms are established
  - Number of employees covered allocated by inactive employees (receiving benefits), inactive members (entitled to but not receiving benefits, and active members)
  - Brief description of Contribution Requirements
  - Whether the pension plan issues a standalone financial report or included part of another government entity.

COST SHARING EMPLOYERS FOOTNOTES TO THE FINANCIAL STATEMENTS

- Discount Rate Disclosures
  - Discount Rate applied and change from last measurement date.
  - Assumptions about projected cash flows related to the pension plan including contributions from employers, non-employers and employees.
  - Long-term expected rate of return and how it was determined.
  - Municipal bond rate used and source of that rate.
  - Breakdown of how projected benefit payments are allocated between those applied to the long-term expected rate of return and municipal bond rate to arrive at the discount rate.
  - Assumed Asset Allocation and long-term expected rate of return applied to each asset class.
  - NPL calculated using a discount rate that is +/-1% than stated Discount Rate

COST SHARING EMPLOYERS FOOTNOTES TO THE FINANCIAL STATEMENTS

Significant Assumptions

- Inflation
- Salary Changes
- Ad Hoc post-employment benefit changes (COLA)
- Mortality Assumptions/Source of Assumptions (i.e. published mortality table/experience study)
- Dates of the Experience Study

REQUIRED SUPPLEMENTARY INFORMATION (RSI) FOR FINANCIAL STATEMENTS

- **10 Year** – Employer's Proportionate Share (%, Amount) of Collective NPL, Covered Employee Payroll, Net Pension Liability as a % of Employee Covered Payroll, Pension Plans Net Position as % of TPL
- **10 Year** – Schedule of Changes in NPL
- **10 Year** - FNP/TPL/Funded Status/Covered Payroll/NPL as % of Payroll
- **10 Year -** ADEC to Actual Contributions (If necessary)
- **10 Year -** Statutory/Contractual Contributions to Actual Contributions and Payroll (If necessary)

10 Year Schedules not required in year of implementation other than the ADEC schedule which is presented in full.

10 YEAR SCHEDULE OF CONTRIBUTIONS

If contributions to the plan are actuarially determined: the employers actual contributions, the difference between the actual and actuarially determined contributions, and a ratio of the actual contributions divided by covered-employee payroll.

Special Funding Situations (aka most school districts nationwide)

Note Disclosures and Required Supplementary Information

What is an SFS?

SPECIAL FUNDING SITUATIONS DEFINED

Where non-employer (example – a state) is **legally responsible** for making contributions to the pension plan.

Requirements:

1. The amount of contributions is not dependent on one or more events unrelated to the pension.
2. The non-employer is the only entity with a legal obligation to make a contribution directly to the plan.

THOUGHTS ANYONE???

SPECIAL FUNDING SITUATIONS

- Effect on Employer (example – School District):
  - Employer must recognize the pension liability plus an adjustment for the involvement of the non-employer entities (e.g. 100% *less* 100%)
  - Recognize ***proportionate share*** of Deferred Outflows and Inflows of resources
  - Employer is required to recognize the ***proportionate share*** of the collective pension expense/revenue of both employer <u>and non-employer contributions</u>.
    - **Proportionate share of expense *may not equal* proportionate share of revenue**

OTHER FOOTNOTE DISCLOSURES TO BE CONSIDERED WHEN NON-EMPLOYERS ARE INVOLVED

1. Government Non-Employer's Contributing Share of all accounting elements
2. Brief description of assumptions that affect pension liability (since last measurement date).
3. Amount of expense recognized by non - employer as a result of special funding.
4. Non-employer's balances of deferred positions

OTHER REQUIRED SUPPLEMENTARY INFORMATION TO BE CONSIDERED WHEN NON-EMPLOYERS ARE INVOLVED

- **10 Year -** Schedule of Non-Employer's Contribution Entity's proportion (% and Amount of Collective NPL; FNP/TPL)
- **10 Year -** Schedule if the Non-Employer is statutorily required to make contributions detailing required contribution, actual contributions (including pension plan receivables) and the difference
- **10 Year -** Schedule of Changes in Net Pension Liability used to determine the proportionate share of the Collective NPL belonging to the Employers versus Non-Employers.
- Other Footnotes/RSI may be required

SPECIAL FUNDING SITUATION

- Note that the Non-Employer Entity must also disclose in the their Financial Statement Footnotes:
  - If the Non-Employer recognizes a substantial part of the employers collective NPL, it should disclose description of the pensions, types of employees covered, discount rate, assumptions made in measurement of the NPL.
  - RSI same as Cost Sharing Employer
  - What is meant by "Substantial"? Unclear....wait for more guidance to clarify.

Effective Date and Transition Issues

- **Plans** – Fiscal years *beginning after* June 15, 2013
- **Employers –** Fiscal years *beginning after* June 15, 2014
- Prior period adjustments will likely take place for a number of years as deferred positions become clarified
- RSI
  - If data is unknown at transition – must include a text box on each schedule explaining why – similar to GASB-54

Prior Period Adjustments

- Example:
  - Employer – Net Pension Liability as of **June 30, 2015**
    - Measurement date – June 30, 2014 (annual valuation from 7/1/13 to 6/30/14)
    - No comparative financial statements
    - **Prior period adjustment would be as of 7/1/14** including
      - **Deferred outflows** *determined as of the beginning of the year*
        - » **Contributions from July 1, 2013 to June 30, 2014**
      - **NPL**
      - **Deferred inflows / outflows as of the measurement date**

Prior Period Adjustments

- How to PPA:
  1. Remove any Net Pension Obligation
  2. Remove any payables to the plan
  3. Add the balance of any NPL or proportion *as of the beginning of the period*
  4. Add deferred outflows of resources for contributions *after the measurement date* – **see next section**
  5. Add deferred outflows of resources / deferred inflows of resources *as of the beginning of the period*
  6. Add any payables to the plan as of the beginning of the period

Prior Period Adjustments

- If employer can determine deferred outflows / inflows of resources from investments, contributions **but cannot determine all other deferrals**
  - Don't record deferred positions of investments at implementation, only contributions.
    - Prior period adjustments when all others known
  - If can't determine all remaining deferred positions for all historical periods, report none except for contributions
    - Again – PPAs when known

The GASB Fix (aka GASB 71)

Again – the problem in Implementation

- GASB 68 requires employer to recognize NPL as of **the measurement date** no earlier than the prior fiscal year end
- Contributions made during the period *after measurement* date *but before reporting date* is required to be deferred
- Transition to new standards
  - If not practical to determine *all* deferred positions at transition, then start at zero.
  - BUT – contributions deferred!
  - Houston… we have a problem…

Updated transition guidance

- Recognize a deferred amount for pension contributions made after actuarial report but before fiscal year end
- Recognize no other beginning balance for deferred positions **unless known at transition**
- Effective date – same as GASB-68

Defined Contribution Plan Changes – GASB-67

New Pension Standards do apply to DC Plans if:

- Pensions are provided to employees or volunteers (ex: volunteer firefighters) that meet 3 requirements
  - Contributions from all sources and earnings remain in trust until benefits are paid (irrevocable)
  - Assets are solely to pay for benefits per terms and
  - Assets are legally protected from creditors of all entities (even administrator)
- If yes to all 3, then new GASB applies

New Pension Standards - DC Plans

- Reporting for the plan is similar to DB plans
  - Similar financial statements
    - Assets (cash, investments, receivables)
    - Liabilities (benefits payable, administrative)
    - Net Position
    - Inflows and outflows similar to today
  - Notes need to include descriptive information about
    - The plan
    - Classes of employees and retirees
    - Number of plan members and employers (if multiple)
    - Authority under which plan was established or may be amended

New Pension Standards DC Employers

- Financial statement amounts are dependent on <u>whether or not there is a special funding situation</u> (see previous)
- If no special funding situation
  - Pension expense is declared in funds and entity wide

New Pension Standards DC Employers – Pension Expense Calculation

NO SPECIAL FUNDING SITUATION	Entity Wide Statements	Proprietary Funds	Governmental Funds
Contributions or *credits* to employee's accounts attributable to current period service	Yes	Yes	No – Pension Expenditures = total amount paid adjusted to change in balances between beginning and ending amounts expected to use current resources
Less: Forfeited amounts that are removed from employees accounts and NOT given to other employees	Yes	Yes	
	= Pension Expense	=Pension Expense	See above
Difference in pension expense and amounts paid to plan	= Increase / Decrease in Liability or Asset		Liability = amounts expected to be paid out of current resources

Employer Reporting of DC Plans

- Liabilities associated with different DC plans may be aggregated as long as assets are not netted with them
- If Special Funding Situation
  - Non-employer contributor would effectively report a grant to the employer
  - Employer receiving the contribution reports a subsidy inflow

Employer Reporting of DC Plans

- Notes Required for each plan contributed to
  - Name, administration of the plan
  - Brief descriptions
    - Benefit terms, authority under which they are established and can be amended
    - Vesting
    - Forfeitures policies and amounts for the year
    - Contributions (or crediting) rates (dollars *or* percentage of salary) separately for employees, employer, nonemployer contributing entities
      - Also authority to establish or amend
    - Amount of pension expense recognized during period
    - Amount of forfeitures reflected in expense
    - Amount of liability outstanding at period end

Additional Note Disclosures for DC Employers with SFSs

- In addition to previous disclosures
  - Proportion of total pension expense for the employer as compared to <u>all</u> employers in plan
  - Amount of revenue recognized as the subsidy / support provided by nonemployer contributors

Other SFS Disclosures in DC Plans

Item	If NonEmployer contributes a "substantial" portion of total contributions	If less than a "substantial" portion of total contributions	Contributing Entity not in an SFS
Name of plan, basic descriptions	Yes	Yes	Yes
Benefit terms	Yes	NO	No
Contributions	Yes	Yes	No
Annual expense	Yes	Yes	Yes
End of year liability	Yes	Yes	No

Hybrid Plans

Hybrid Plans

- Hybrid plans do have to follow GASB-67 (plan) and 68 (employer)
- Example
  - Plan offers multiple tiers of graduating benefits based on age and years of service as established by contract.
  - The minimum retirement age is age 55 with anywhere from 8 to 10 years of service to vest
  - Compensation is multiplied by a percentage established in the contract that rises with years of service beyond vesting and may be adjusted
  - At retirement, a lump-sum payment is transferred from the government to a 403(b) defined contribution plan and becomes self-directed by the retiree

Hybrid Plans

- Accounting and Financial Reporting for Example
  - It *is* subject to GASB-68 (or if a mass-termination / ERIP – GASB-47 but similar provisions)
  - Government should accrue the earnings based on the plan provisions each year of service
  - Example –
    - 40 year old employee that is expected to retire at age 55 and has worked since age 30 (fully vested -10 years)
    - Pensionable salary X rate adjusted for the probability of retirement at age 40 = accrual for the year
    - Actuary may calculate the amounts expected to be earned until age 55
    - Discounting then occurs from age 55, back to current period
    - Funds reserved in an account to pay for the accumulated accruals would be matched against the accruals and a net pension asset / liability would result
    - Lump-sum payment at retirement still would occur

Example DB Plan Note Disclosures for a Special District

Sample District
Notes to the Financial Statements
for the Year Ended June 30, 20X9
(Dollar amounts in thousands)

Summary of Significant Accounting Policies

Pensions. For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the Political Subdivision Pension Plan (PSPP,) (part of the State Consolidated Retirement System (SCRS) and additions to/deductions from PSPP's fiduciary net position have been determined on the same basis as they are reported by PSPP. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

Note X

General Information about the Pension Plan
Plan description. The District's defined benefit pension plan, Political Subdivision Pension Plan (PSPP), provides pensions for all participating political subdivisions employees of the State. PSPP is a agent-employer defined benefit pension plan administered by the State Consolidated Retirement System (SCRS). Article 2 of the *Constitution of the State* grants the authority to establish and amend the benefit terms to the SCRS Board of Trustees (SCRS Board). SCRS issues a publicly available financial report that can be obtained at http://www.treasury.xx.gov/SCRS.pub.html.

Sample District
Notes to the Financial Statements
for the Year Ended June 30, 20X9
(Dollar amounts in thousands)

Benefits provided. PSPP provides retirement, disability, and death benefits. Retirement benefits are determined by a formula using the member's high five-year average salary and years of service. Members become eligible to retire at age 60 with 5 years of service or at any age with 30 years of service. A reduced retirement benefit is available to vested members who are at least 55 years of age or have 25 years of service. Disability benefits are available to active members with five years of service who become disabled and cannot engage in gainful employment. There is no service requirement for disability that is the result of an accident or injury occurring while the member was in performance of duty.   Members joining the plan prior to July 1, 1979, are vested upon completion of 10 years of service, unless five years vesting is authorized by resolution of the chief governing body.   Cost of living adjustments (COLA) are the same as provided by SCRS, except that the local government may elect (a) to provide no COLA benefits or (b) to provide COLA benefits under a noncompounding basis rather than the compounded basis applicable under SCRS.

Sample District
Notes to the Financial Statements
for the Year Ended June 30, 20X9
(Dollar amounts in thousands)

Employees covered by benefit terms. At June 30, 20X9, the following employees were covered by the benefit terms:

Inactive employees or beneficiaries currently receiving benefits	4,002
Inactive employees entitled to but not yet receiving benefits	1,207
Active employees	5,347
	10,556

Contributions. Political subdivisions may elect contributory or noncontributory retirement for their employees. The contribution rate for contributory employees of political subdivisions is 5% of gross salary. The employers contribute a set percentage of their payrolls, equal to at least, the percentage determined by an actuarial valuation. State statute provides that contribution rates be established and may be amended by the Board of Trustees of the SCRS. The administrative budget for the plan is approved through the State's annual budget process. Funding for the administrative budget is included in employer contributions.

Sample District
Notes to the Financial Statements
for the Year Ended June 30, 20X9
(Dollar amounts in thousands)

Net Pension Liability
The District's net pension liability was measured as of June 30, 20X9, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date.

Actuarial assumptions. The total pension liability in the June 30, 20X9 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	3.0 percent
Salary increases	4.75 percent, average, including inflation
Investment rate of return	7.5 percent, net of pension plan investment expense, Including inflation

Mortality rates were based on the RP-2000 Healthy Annuitant Mortality Table for Males or Females, as appropriate, with adjustments for mortality improvements based on Scale AA. The actuarial assumptions used in the June 30, 20X9 valuation were based on the results of an actuarial experience study for the period July 1, 20X5-April 30, 20X7.

Sample District
Notes to the Financial Statements
for the Year Ended June 30, 20X9
(Dollar amounts in thousands)

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

Asset Class	Target Allocation	Long Term Expected Rate of Return
Domestic Equity	42.4%	5.03%
International Equity	13.6	(10.79)
Fixed Income	38	10.68
Real Estate	3.9	10.01
Cash and Other	2.1	4.04
Total	**100%**	**5.61%**

Sample District
Notes to the Financial Statements
for the Year Ended June 30, 20X9
(Dollar amounts in thousands)

Discount rate. The discount rate used to measure the total pension liability was 7.5 percent. The projection of cash flows used to determine the discount rate assumed that employee contributions will be made at the current contribution rate and that District contributions will be made at rates equal to the difference between actuarially determined contribution rates and the employee rate. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, 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.

Table then inserted showing beginning balances, changes for year from expenses, contributions, net investment income, payments, administrative expense and ending balance

Sensitivity of the net pension liability to changes in the discount rate. The following presents the net pension liability of the District, calculated using the discount rate of 7.5 percent, as well as what the District's net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (6.5 percent) or 1-percentage-point higher (8.5 percent) than the current rate:

	1% Decrease (6.5%)	Current Discount Rate 7.5%	1% Increase (8.5%)
Net Pension Liability	$826,928	$751,753	$661,543

Sample District
Notes to the Financial Statements
for the Year Ended June 30, 20X9
(Dollar amounts in thousands)

Pension plan fiduciary net position. Detailed information about the pension plan's fiduciary net position is available in the separately issued SCRS financial report.

Pension Expense and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

For the year ended June 30, 20X9, the District recognized pension expense of $158,356. At June 30, 20X9, the District reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	$33,329	$53,995
Changes in assumptions	62,949	--
Net difference between projected and actual earnings on plan investments	133,976	--
Total	$230,254	$53,995

Sample District
Notes to the Financial Statements
for the Year Ended June 30, 20X9
(Dollar amounts in thousands)

Amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Year Ended June 30:	
20Y0	$57,966
20Y1	86,466
20Y2	43,069
20Y3	(1,778)
20Y4	1,465
Thereafter	(10,929)

Note – optional presentation of *this table – separate columns of positives and negatives and total column by year*

Payable to the Pension Plan
At June 30, 20X9, the District reported a payable of $6,988 for the outstanding amount of contributions to the pension plan required for the year ended June 30, 20X9.

Example DC Plan Note Disclosures for a City

Illustrative Disclosures for DC Plan (no SFS) at a City

Note X (*amounts in Thousands*)

The City contributes to the City Retirement Plan (CRP), a defined contribution pension plan, for its full-time general administrative employees. CRP is administered by the City Retirement System.

Benefit terms, including contribution requirements, for CRP are established and may be amended by the City Council. For each employee in the pension plan, the City is required to contribute 7 percent of annual salary, exclusive of overtime pay, to an individual employee account. Employees are permitted to make contributions to the pension plan, up to applicable Internal Revenue Code limits. For the year ended June 30, 20X9, employee contributions totaled $657, and the City recognized pension expense of $1,520.

Illustrative Disclosures for DC Plan (no SFS) for a City

Note X (Continued) (*amounts in Thousands*)

Employees are immediately vested in their own contributions and earnings on those contributions and become vested in City contributions and earnings on City contributions after completion of 23 months of creditable service with the City.

Nonvested City contributions are forfeited upon termination of employment. Such forfeitures are used to cover a portion of the pension plan's administrative expenses. For the year ended June 30, 20X9, forfeitures reduced the City's pension expense by $48.

As of the end of the year, the City had a liability to the plan of $27.

Coming Up for Air

Auditing and Best Practices for Implementation

Key Concerns & Decision Points - Plans

- GASB 67 adoption
- For all plans
  - Timing and content of information to employers
  - Should we engage auditors to provide assurance on employer information?
  - Investment valuation - precision v. timeliness
  - Employer selection of measurement date
  - Selection of actuarial valuation date
  - Employer involvement in establishing assumptions
  - Plan auditor understanding of actuarial information
  - Implementation concerns (timing, resources)
- Single-employer plans - **ERS**
  - Impact of stand-alone departmental or component unit reporting

Key Concerns & Decision Points - Plans

- **Special funding situations -** Identification
  - Handling differences of opinion
- **Cost-sharing multiple-employer plans**
  - Calculating allocation percentages
  - Employers and their auditors coming to visit
  - Who is going to pay for this?
- **Agent multiple-employer plans**
  - Who should calculate pension amounts for each employer?
  - Employers and their auditors coming to visit
  - Differences in actuarial assumptions by employer
  - Relationship between plan actuary and employers/employer auditors
  - Who is going to pay for this?

Key Concerns & Decision Points - Employers

- For all plans
  - Choosing measurement date
  - Relationship between measurement date and plan year-end
  - Actuarial valuation - precision v. timeliness
  - Involvement in establishing assumptions
  - Reliance on plan actuary as management specialist
  - Qualifications of plan auditor
  - Will plan engage auditors to provide assurance on employer information?
  - Implementation concerns (timing, resources)
- Single-employer plans
  - Impact of stand-alone departmental or component unit reporting

Key Concerns & Decision Points - Employers

- Special funding situations (do we have them?)
  - Identification
  - Handling differences of opinion
- Cost-sharing multiple-employer plans (big issue in Texas!)
  - Obtain amounts and disclosures for the financials
  - Evaluating accuracy of information
  - What work will my auditors need to do?
- Agent multiple-employer plans (Becoming not an issue??)
  - Where will amounts and disclosures for the financials come from?
  - Who is responsible for accuracy and verifiability of information?
  - What work will my auditors need to do?
  - Involvement in establishing actuarial assumptions

Key Concerns & Decision Points - Auditors

- For all plans
  - Timing of information needed for audit
  - Role in evaluating actuarial assumptions
  - Need to engage auditor's specialist?
  - Will plan engage auditors to provide assurance on employer information?
  - Did plan auditors engage a specialist?
  - Qualifications of plan auditor
  - Implementation concerns (timing, resources)
  - Sufficient appropriate audit evidence for unmodified opinion?
- Single-employer plans
  - Impact of stand-alone departmental or component unit reporting

Key Concerns & Decision Points - Auditors

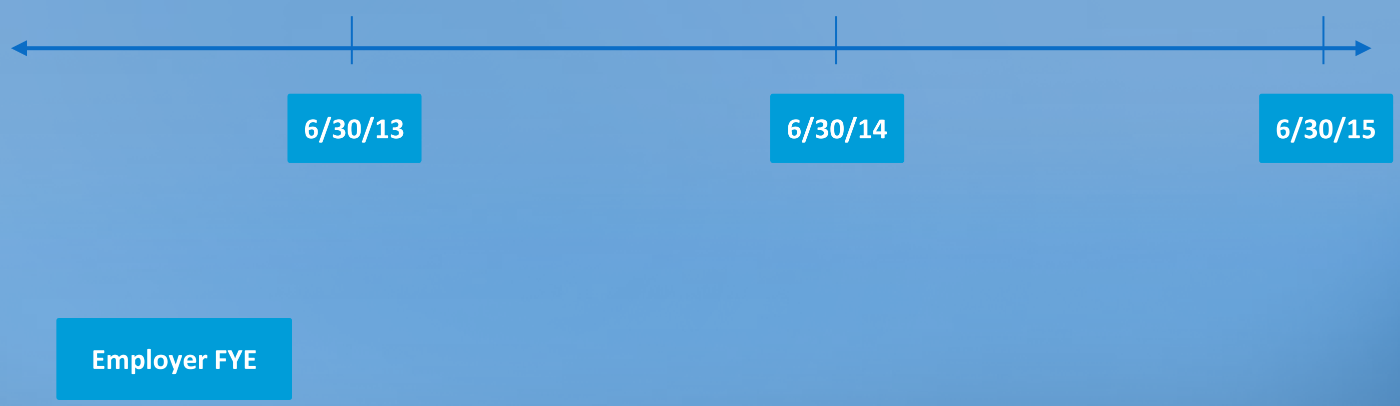
- Special funding situations
  - Identification
  - Handling differences of opinion
- Cost-sharing multiple-employer plans
  - Who will audit collective amounts and allocation of amounts to participating employers?
  - Obtaining sufficient audit evidence on actuarial information
  - Who will test census data at participating employers?
- Agent multiple-employer plans
  - Obtaining sufficient audit evidence on actuarial information
  - Who will test census data at participating employers?

AUDIT CONSIDERATIONS - KEY DATES

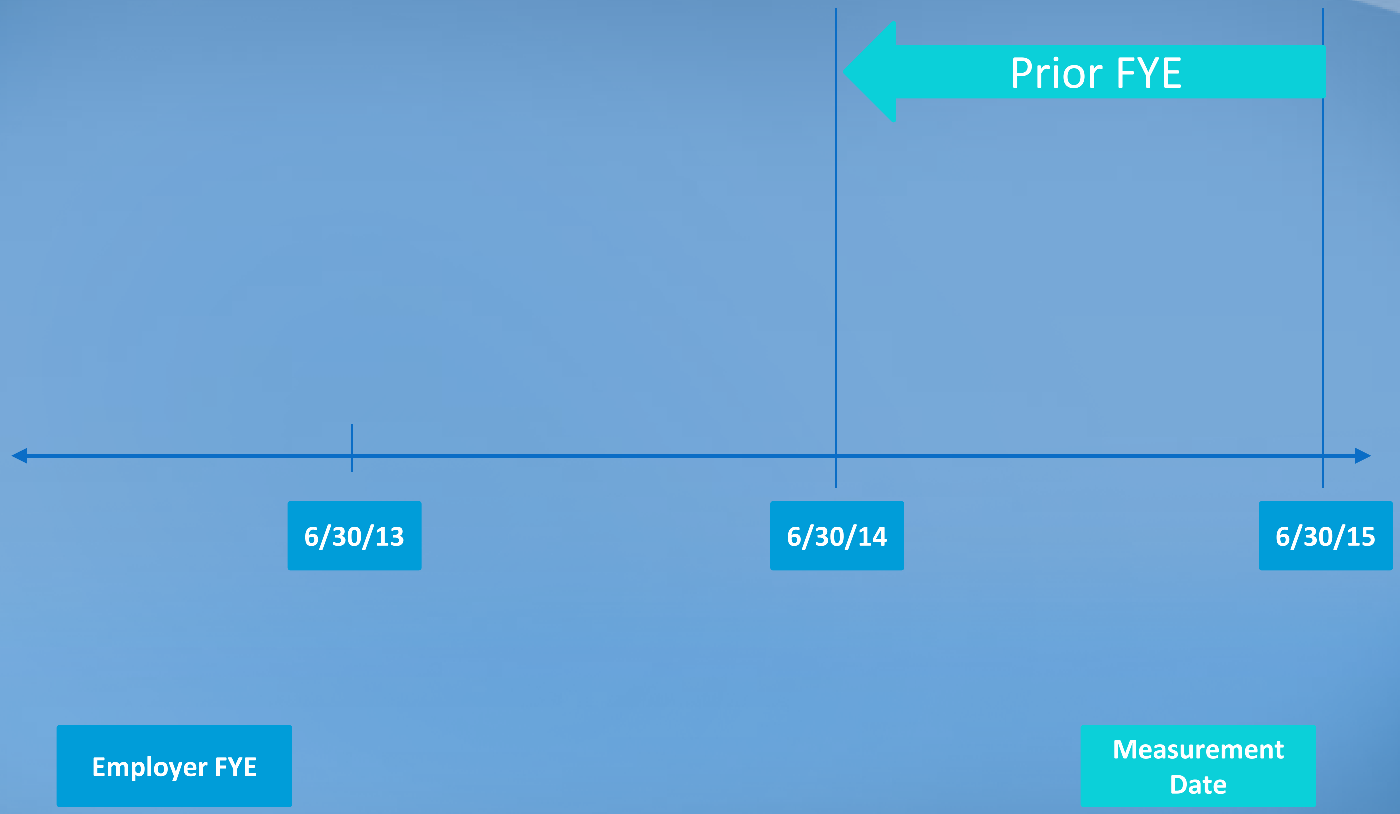
Key Dates

- Potentially 3 different dates we need to think about
  - Employer fiscal year-end
  - Measurement date (of NPL)
    - As of date no earlier than end of prior fiscal year
    - Both components (TPL/plan net position) as of the same date
  - Actuarial valuation date (of TPL)
    - If not measurement date, as of date no more than 30 months (+1 day) prior to FYE
    - Actuarial valuations at least every 2 years (more frequent valuations encouraged)
- Coordination with pension plan

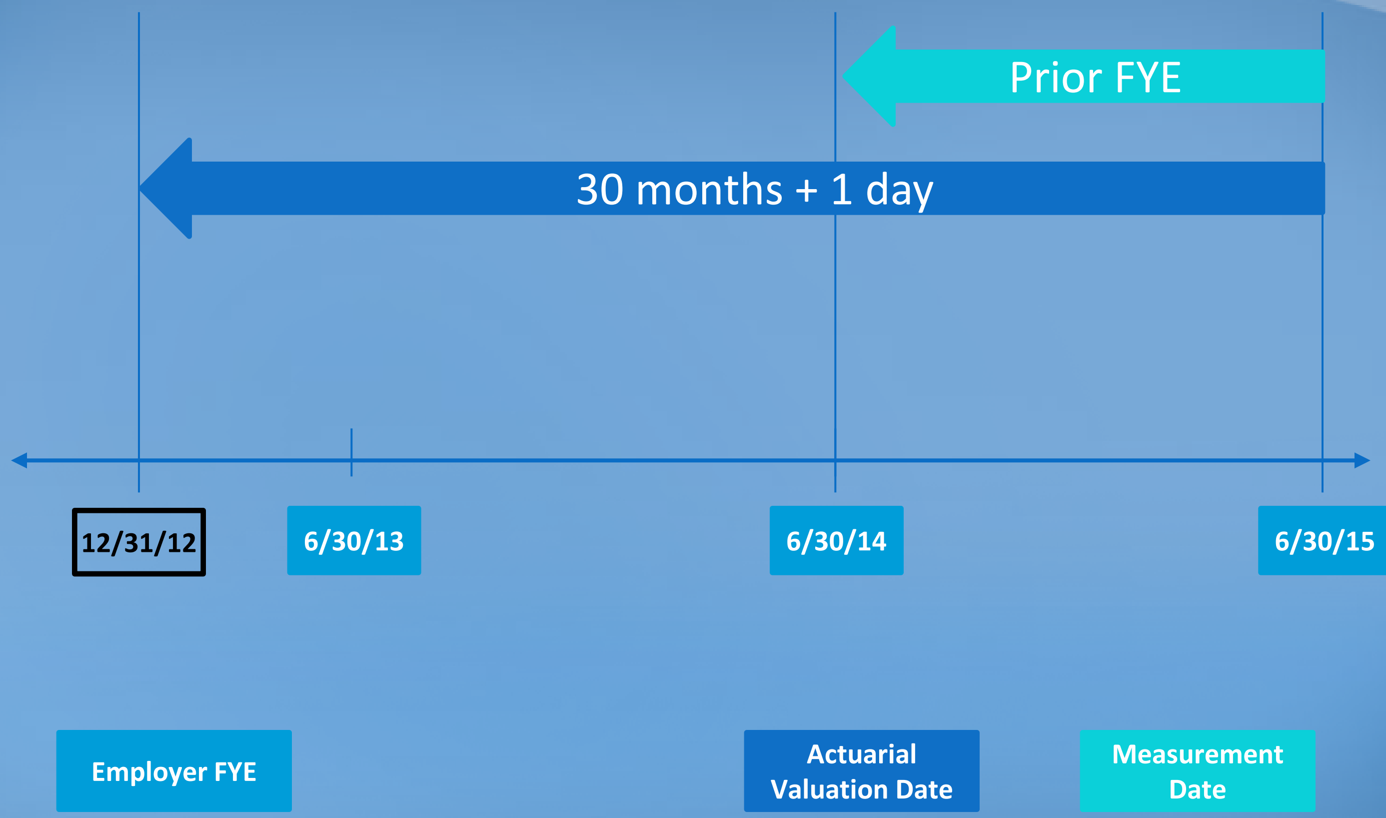
Timing - Example



Timing - Example

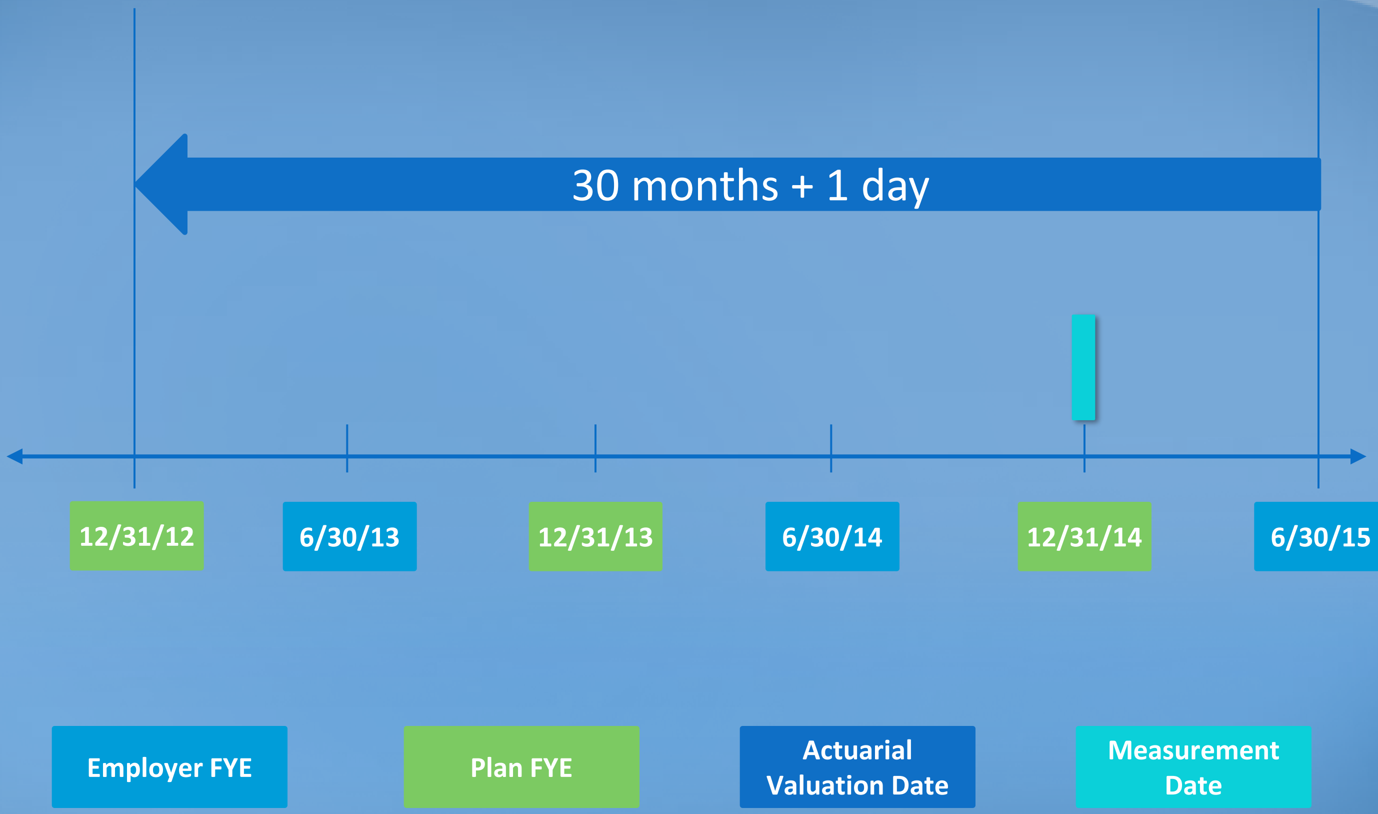


Timing - Example



Timing - Example

Timing - Example

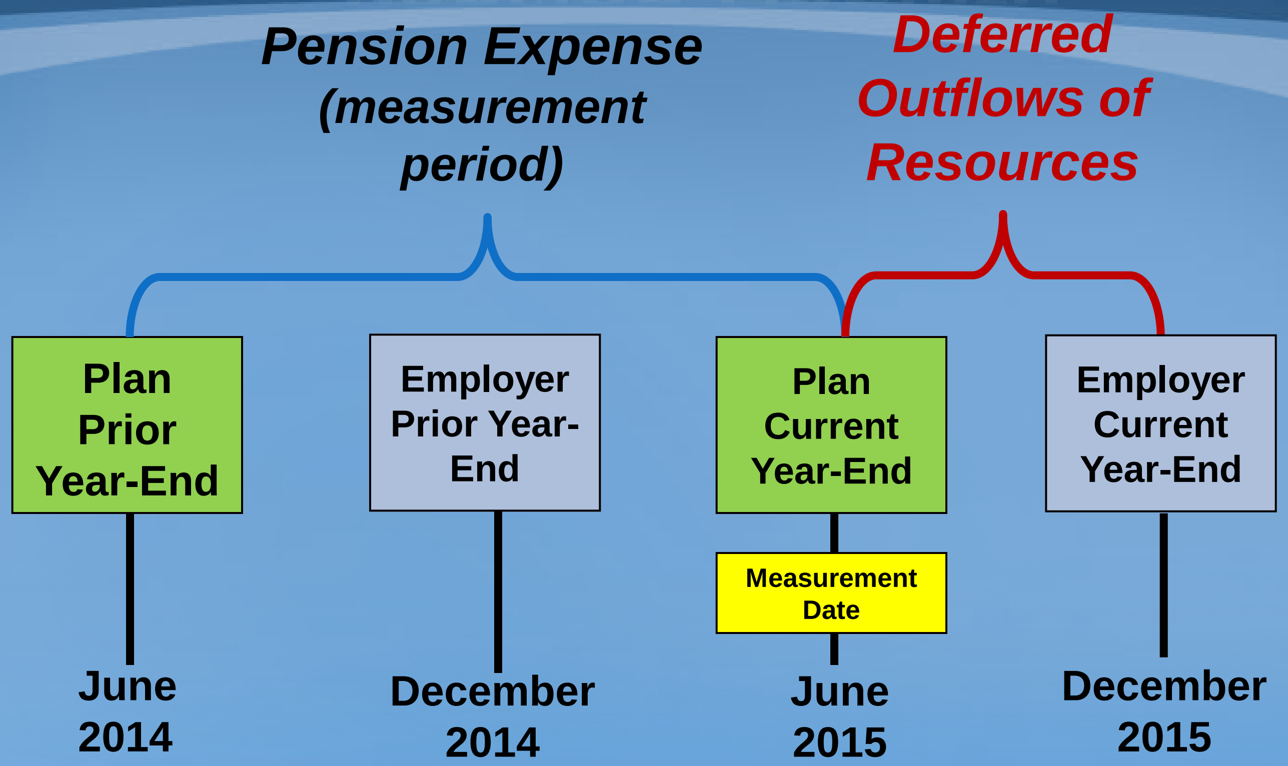


Timing - Example

Timing - Example

Timing - Example

Timing of Measurement of Total Pension Liability



Measurement date will most likely correspond to year-end of plan. Employer contributions made directly by the employer subsequent to the measurement date of the net pension liability and before the end of the employer's fiscal year should be recognized as a deferred outflow of resources.

AUDIT CONSIDERATIONS - ACTUARIAL INFORMATION

Where to Start?

- Read statutes/plan document
  - Gain understanding of key provisions
- Obtain actuarial valuation report
  - Measurement date
  - Key assumptions
  - Plan provisions
- Obtain and test census data from actuary and payroll
- Obtain confirmation from actuary
- Evaluation of management's specialist
- Consider need for auditor specialist

Actuarial Valuation Report

Table of Contents

Actuarial Assumptions

Investment Return Rate	7.25%
Wage Inflation Rate	4.0%
Pay Increase Assumptions	4.0%
Assumed Retirement	62
Rates of: Mortality, Disability, Retirement and Marriage	Actual Experience during 2008-2010 Period

The auditor must obtain an understanding of the actuarial methods and assumptions and assess their reasonableness and consistency of application.

Investment Return Rate

- Employer should be able to prove out based on investment mix and expected rates of return
- Auditor test for reasonableness
- Ex

Investment Type	Allocation (A)	Expected Return (B)	Total (A x B)
Equities	60%	10%	6.0%
Fixed Income	30%	6%	1.8%
Cash Equiv.	10%	2%	0.2%
			8.0%

Discount rate calculation

Year (a)	Projected Beginning Fiduciary Net Position (b)	Projected Benefit Payments (c)	Projected Benefit Payments: "Funded" Portion of Benefit Payments (d)	Projected Benefit Payments: "Unfunded" Portion of Benefit Payments (e)	Actuarial Present Values of Projected Benefit Payments: Present Value of "Funded" Benefit Payments (f) = (d) ÷ (1 + 7.5%)[a]	Actuarial Present Values of Projected Benefit Payments: Present Value of "Unfunded" Benefit Payments (g) = (e) ÷ (1 + 4%)[a]	Actuarial Present Values of Projected Benefit Payments: Present Value of Benefit Payments Using the Single Discount Rate (h) = (c) ÷ (1 + 5.29%)[a]
1	$ 1,431,956	$ 109,951	$ 109,951	$ -	$ 102,280	$ -	$ 104,427
2	1,500,197	116,500	116,500	-	100,811	-	105,088
3	1,565,686	123,749	123,749	-	99,613	-	106,019
4	1,628,547	131,690	131,690	-	98,610	-	107,154
5	1,687,890	140,229	140,229	-	97,678	-	108,370
6	1,742,722	149,168	149,168	-	96,655	-	109,487
7	1,792,194	158,466	158,466	-	95,516	-	110,468
8	1,835,463	168,332	168,332	-	94,384	-	111,450
9	1,871,402	178,591	178,591	-	93,150	-	112,302
10	1,898,930	189,069	189,069		[illegible]		112,918
26	547,880	322,779	322,779				84,503
27	316,985	326,326	-				81,140
28	64,800	328,997	-				77,694
29	-	330,678	-				74,168
30	-	331,266	-	331,266	-	102,135	70,567
96	-	1	-	1	-	-	-
97	-	-	-	-			
Total					$ 2,109,333 +	$ 1,724,534 =	$ 3,833,867

The sum of the present values of the two benefit payment streams is calculated.

Census Data

- Key census data
  - Date of birth
  - Gender (male or female)
  - Date of hire or years of service
  - Date of termination or retirement
  - Marital status
  - Spouse date of birth
  - *Eligible* compensation (may NOT equal W-2s, especially in higher education)
  - Employment status
- Auditing census data
  - Active employees
  - Inactive/retired
- Resolving exceptions

The auditor must test the reliability and completeness of the census data provided to the actuary.

Census Data - Multiple-Employer PERS

- When auditing participant data in a multiemployer benefit plan, the auditor is often unable to directly test payroll records
- AICPA EBP Guide (10.10) states census data for participating employers should be subject to test work on a cycle basis - with a four-year cycle being typical. Testing may be performed by
  - In-house compliance personnel,
  - Employer auditors, *i.e.*, agreed upon procedures, or
  - Auditor of plan

AUDIT CONSIDERATIONS -
YOU MAY HAVE TO USE A SPECIALIST

Specialists

Definitions

- **Auditor’s Specialist** - Individual or organization possessing expertise in a field other than accounting or auditing, whose work in that field is used by the auditor to assist the auditor in obtaining sufficient appropriate audit evidence. An auditor’s specialist may be either an auditor's internal specialist or an auditor’s external specialist
- **Management’s Specialist** - An individual or organization possessing expertise in a field other than accounting or auditing, whose work in that field is used by the entity to assist the entity in preparing the financial statements

Similarities Among & Differences Between Management & Auditor Specialists

Description	Management's Specialists	Auditor Internal Specialists & Resources	Specialists Engaged by Auditor
Specialists are a member of the engagement team	No	Yes	No - however, auditor directs their work
Auditor evaluates competence, capabilities and objectivity of specialists	Yes (AU-C-500.08(a), .A38-.A44)	Yes (AU-C-620.09, .A15-.A22)	Yes (AU-C-620.09, .A15-.A22)
Specialists may assist auditor in obtaining an understanding of the entity and its environment, including its internal control	No - however, they may provide relevant information	Yes (AU-C-620.A5)	Yes (AU-C-620.A5)

Similarities Among & Differences Between Management & Auditor Specialists

Description	Management's Specialists	Auditor Internal Specialists & Resources	Specialists Engaged by Auditor
Specialists may assist auditor in identifying and assessing risks of material misstatement	No - however, they may provide relevant information	Yes (AU-C-620.A5)	Yes (AU-C-620.A5)
Specialists may assist auditor in determining and implementing overall responses to financial statement-level risks	No	Yes (AU-C-620.A5)	Yes (AU-C-620.A5)
Specialists may assist auditor in designing and performing further audit procedures to respond to the assessed risks at the assertion level, comprising test of controls or substantive procedures	No	Yes (AU-C-620.07 and .A5)	Yes (AU-C-620.07 and .A5)

Similarities Among & Differences Between Management & Auditor Specialists

Description	Management's Specialists	Auditor Internal Specialists & Resources	Specialists Engaged by Auditor
Auditor obtains an understanding of the work of specialists	Yes (AU-C-500.08(b) and A.45-.A48)	Yes (AU-C-620.11 and .A25-A.29)	Yes (AU-C-620.11 and .A25-A.29)
Auditor evaluates the adequacy of the work of specialists	Yes (AU-C-500.08(c) and .A49)	Yes (AU-C-620.12 and .A35-.A42)	Yes (AU-C-620.12 and .A35-.A42)
Specialists may assist auditor in evaluating the sufficiency and appropriateness of audit evidence obtained in forming an opinion on the financial statements	No	Yes (AU-C-620.07 and .A5)	Yes (AU-C-620.07 and .A5)

Determining Whether to Use work of Management's specialist as Audit Evidence

- The nature, scope and objectives of the work of specialist
- Whether specialist is employed by entity or is party engaged to provide relevant services
- Extent to which management exercises control or influence or work of specialist
- Competence and capabilities of specialist
- Whether specialist is subject to technical performance standard or professional or industry requirements
- Auditor’s ability to evaluate work and findings of specialist without assistance of auditor’s specialist

ISSUES & AICPA RECOMMENDATIONS RELATED TO COST-SHARING MULTIPLE-EMPLOYER PLANS

Cost Sharing Employers

- 2 White Papers published by AICPA
  - Census data testing
  - Plan reporting to employers
- Census data testing would be **based on risk**
  - Testing coordinated by <u>plan auditor</u>
    - Employers > 20% of plan active employees tested annually
      - **Likely State only?**
    - Between 5% and 20% - tested every 5 years **Any?**
    - Less than 5% - tested every 10 years **but some tested annually to get comfort**
    - Very small employers may never get tested – immaterial
  - Report is an attestation report

Cost-Sharing Plan Issues

- Audited plan financial statements don't give participating employers everything they need
- Determining allocation percentages
  - Who will make the determination?
  - Do all employers have to use same allocation method?
- How will allocation percentages and other relevant information be audited?
- *Potential* solutions AICPA whitepapers at

  http://www.aicpa.org/INTERESTAREAS/GOVERNMENTALAUDITQUALITY/RESOURCES/GASBMATTERS/Pages/default.aspx

  Remember – these are "best practices" and NOT GAAS until / if auditing standards board approves

Cost-Sharing Plan Issues - Potential Solutions

- Plan provides supplemental "schedule of employer allocations" for which plan auditor is engaged to provide opinion
  - Use allocation method based on covered payroll or required (actual) contributions representative of future contributions and appropriate based on classes of benefits provided
  - Projected future contributions could be used if necessary (harder to audit)
  - **# of decimal places may become important for plans with large number of participating employers**

Note: Above not required by standard, but other alternatives create inconsistency and additional audit burden

Reminder - Example Schedule of Employer Allocations

EXAMPLE COST SHARING PENSION PLAN

Schedule of Employer Allocations

June 30, 2015

Employer/ Nonmployer (special funding situation)	2015 Actual Employer Contributions	Employer Allocation Percentage
State of Example	$ 2,143,842	38.9 %
Employer 1	268,425	4.9
Employer 2	322,142	5.8
Employer 3	483,255	8.8
Employer 4	633,125	11.5
Employer 5	144,288	2.6
Employer 6	95,365	1.7
Employer 7	94,238	1.7
Employer 8	795,365	14.4
Employer 9	267,468	4.9
Employer 10	267,128	4.8
Total	$ 5,514,641	100.0

Allocation may be historical or actuarial

Cost-Sharing Plan Issues - Potential Solutions

- Plan provides supplemental "schedule of plan pension amounts by employer" for which plan auditor engaged to provide opinion
  - Supplemental schedule showing the following amounts by employer
    - Net pension liability
    - Deferred outflows (by category)
    - Deferred inflows (by category)
    - Pension expense
- Alternative - "schedule of collective pension amounts"
  - Apply allocation percentages from other schedule
  - Would not reflect employer-specific deferrals

Reminder - Example Schedule of Employer Pension Amounts

EXAMPLE COST-SHARING PENSION PLAN

Schedule of Pension Amounts

June 30, 2015

		Deferred Outflow of Resources				Deferred Inflows of Resources				Pension Expense	
Employer/ Nonmployer (special funding situation)	Net Pension Liability	Differences Between Expected and Actual Economic Experience	Differences Between Projected and Actual Investment Earnings	Changes of Assumptions	Changes in Employer Proportion and Differences Between Contributions and Proportionate Share of Pension Expense	Differences Between Expected and Actual Economic Experience	Differences Between Actual and Projected Investment Earnings	Changes of Assumptions	Changes in Employer Proportion and Differences Between Contributions and Proportionate Share of Pension Expense	Proportionate Share of Plan Pension Expense	Net Amortization of Deferred Amounts from Changes in Propotion and Proportionate Share of Pension Expense
State of Example	$ 38,589,135	428,768	2,058,088	1,500,690	782,365	380,371	1,063,285	–	584,365	1,878,717	12,375
Employer 1	4,831,647	53,685	257,688	187,898	96,633	47,625	133,131	–	125,325	235,229	(1,793)
Employer 2	5,798,553	64,428	309,256	225,499	115,971	57,156	159,773	–	245,386	282,303	(8,088)
Employer 3	8,698,585	96,651	463,925	338,279	173,972	85,742	239,681	–	125,632	423,492	3,021
Employer 4	11,396,244	126,625	607,800	443,188	227,925	112,332	314,012	–	386,325	554,828	(9,900)
Employer 5	2,597,183	28,858	138,516	101,002	51,944	25,600	71,563	–	42,358	126,444	599
Employer 6	1,716,569	19,073	91,550	66,756	34,331	16,920	47,298	–	24,325	83,571	625
Employer 7	1,696,283	18,848	90,468	65,967	33,926	16,720	46,739	–	125,325	82,584	(5,712)
Employer 8	14,316,562	159,073	763,550	556,756	286,486	141,118	394,478	–	152,005	697,004	8,405
Employer 9	4,814,421	53,494	256,769	187,228	68,325	47,456	132,657	–	87,325	234,391	(1,188)
Employer 10	4,808,301	53,426	256,443	186,990	67,528	47,395	132,488	–	41,035	234,093	1,656
Total	$ 99,263,485	1,102,928	5,294,055	3,860,249	1,939,406	978,435	2,735,105	–	1,939,406	4,832,655	–

Cost-Sharing Plan - Employer Auditor Considerations

- Evaluate plan auditor's report on supplemental schedules (AU-C 805)
  - If plan auditor doesn't report on, evaluate necessary audit procedures
- Test amounts in schedules relating to employer
- Test census data
- Additional procedures as considered necessary
- Objective - sufficient appropriate audit evidence

Allocation Methodology May Also Be For Single / Agent Employers

- Further allocation in multiple levels necessary to
  - Proprietary Funds
  - Component Units
    - Presumes entities contribute through primary government to a plan
    - Required for full accrual financial statements and full cost of services

ISSUES & AICPA RECOMMENDATIONS RELATED TO SINGLE / AGENT MULTIPLE-EMPLOYER PLANS

Single / Agent Plan Issues

- Audited plan financial statements don't give participating employers everything they need
- Allocation of fiduciary net position by employer is unaudited
- AICPA whitepapers in progress - will be posted at
  - http://www.aicpa.org/INTERESTAREAS/GOVERNMENTALAUDITQUALITY/RESOURCES/GASBMATTERS/Pages/default.aspx

Single / Agent Plan Issues - Potential Solutions

- Plan provides supplemental "combining schedule of changes in fiduciary position by employer" for which plan auditor is engaged to provide opinion
- Plan auditor engaged to issue SOC 1 (type 2) report on allocation of inflows, *i.e.*, contributions, investment income, etc., and outflows, *i.e.*, benefit payments, administrative expenses, etc., of plan to individual employer accounts
  - Alternative - plan auditor issue opinion on each column of schedule or issue opinions on employer elements that cannot be tested by employer auditor

Single Agent Plan Issues - Potential Solutions

- Plan actuary issues separate actuarial report for each participating employer which includes all relevant information
  - Employer management and employer auditor rely on actuary as management specialist for total pension liability for individual employer
- Plan auditor engaged to issue SOC 1 (type 2) report on census data controlled by plan, *i.e.*, retired employees
  - User controls at the plan level - plan controls most of the information needed by the actuary (inactives/retirees)
  - User controls at the employer level - employer controls the active employee information
  - (Solution is complex and is still in development - watch for AICPA whitepaper)

Single / Agent Plan Issues - Potential Solutions

- Employer auditor tests census data of active employees and confirms actuarial information used by actuary
- Employer and employer auditor responsible for validating deferred outflows/inflows and pension expense related to individual employer
  - Deferred outflows/inflows resulting from current year can be recalculated from condensed statement of changes in fiduciary position (by employer) included as supplemental information in plan financial statements
  - Rely on actuarial report for deferred outflows/inflows related to actuarial experience

Single / Agent Multiple-Employer Plans - Other Issues

- Different actuarial assumptions for each participating employer
- Involvement of employer in establishing actuarial assumptions
- Ability of auditors of employers to evaluate appropriateness of actuarial assumptions
- Communication of auditors with plan actuary
- Ability of plan actuary to provide actuarial report directly to each employer

SAS-128 – *Using Work of Internal Auditors*

- Key Changes
  - Harmonization with ISA-610 (International)
  - Effective for periods ending on or after 12/15/14
  - Clarification of the risk assessment process
    - More ability to inquire of internal auditors
    - Stresses the importance of 2 way communication between internal and external auditors and 2 way communication between auditors and those charged with governance
    - Inquiries may include
      - information about operational and regulatory risks that may affect financial reporting.
      - information about system changes, system or control failures, or other information system-related risks.
  - The term "engagement team" now includes internal audit function, if independent

Key Worries for ALL Employers

- Who is going to provide me this information?
- What is it going to consist of?
- Where do I present this information?
- When am I going to get the information to put into my financial statements?
  - In other words – when do *I need* the information to put into my financial statements?
  - Which plan year is the information from?
- Why am I doing this?
- How much is it going to cost?

Who is Going to Provide Me This Information?

- Plan will likely provide the bulk of the information needed for financials
  - Different Plan Sponsors will need different information
  - Care must be taken to
    - Understand what is needed
    - Understand when it will be generated
    - Understand how it will effect my financials
  - Cost sharing employers largely allocations
  - Prime Implementation Strategy is communication with your Plan Sponsor
    - Task forces / working groups being set up
    - Controllers, Auditor(s), Actuary(ies) of Plan and Sponsors in group

Single and Agent Plan Sponsors Financial Information

- Will need a schedule of balances and inflows / outflows schedule
- Same questions apply –
  - When generated?
  - What will it contain?
  - Who is preparing it?
  - How much will it cost?
- Added question – **is it auditable?**

When Will Information Be Generated?

- Key Question but flexibility in use
  - **Pension Liability** determined by
    - Actuarial valuation as of the measurement date or
    - The use of update procedures to roll forward to the measurement date amounts from an actuarial valuation as of a **date no more than 30 months and 1 day earlier than the employer's most recent fiscal year-end**
  - **Pension Liability *can be*** measured as of a date (measurement date) ***no earlier* than the end of the employer's prior fiscal year**, consistently applied from period to period
  - In multiple employer plans, likely determined by the plan with input likely needed from the Sponsors

How Will It Effect My Financial Position?

- Net Pension Liability recorded which is the net of liability and assets
- Annual expense on an accrual basis
- Allocation of expense needed to proprietary / enterprise funds and discretely presented component units that pay through a general purpose government
- Rating agencies have already taken this into consideration (see City of Chicago, Detroit etc.)
- Key question – does management understand what is needed and is serious about managing this liability?
  - If answer is no, could be negative effect
- 2nd Key question – who is making decisions based on the information and what changes will be made?

How Will It Effect My Financial Position

- Plans (and bondholders) are very closely watching the bankruptcies of
  - Stockton, California
  - San Bernardino, California
  - Jefferson County, Alabama
  - Central Falls, Rhode Island
  - Detroit
  - Chicago???
  - State of Illinois???
  - Commonwealth of Puerto Rico???
  - Pension Plan of Northern Marianas
  - Harrisburg & Boise County Idaho dismissed
  - Many others under receivership / oversight

Maybe Best Answered by S&P

"Pension liabilities and the annual funding costs are important credit factors in our review. We view pension obligations as long-term liabilities that must be funded over time, and while the funding schedule can be more flexible than that for a fixed-debt repayment, it can also be more volatile and may cause fiscal stress if not managed. Our focus is primarily on the pension's affordability and management's ability and record in managing this liability. Key considerations in evaluating pensions include the size of the liability, the current funding status, and funding progress over time."

Standard & Poors Position – July 16, 2013

S&P Rating Framework

Government Framework	Financial Management	Economy	Budgetary Performance	Debt and Liability Profile
• Fiscal Policy • System Support • Intergovernmental Funding	• FMA • Budget management	• Demographics • Economic Structure • Wealth and Income • Economic Development	• Reserves • Liquidity • Tax / Revenue structure • Revenue forecasting • Service Levels • Structural Performance	• Debt • **Pension Liabilities** • OPEB Risk Management

= Indicative Credit Level

Overriding factors =

- **System support,**
- **Willingness to support debt,**
- **Capital market access constrained,**
- **High level of expected future debt liabilities,**
- **Weak financial management,**
- **High risk relating to derivatives or variable rate debts**.

Key Strategy for Implementation Success

- Working Group / Task Force led by Plan (usually making administrative decisions)
  - Plan key personnel (controller / CFO, internal audit, actuary, plan external auditor, legal counsel as needed)
  - Sponsor similar personnel
  - Regularly scheduled meetings with agendas, minutes, documented decisions
- Goal is documented timeline of events, key handoff points, agreement on communication strategy with decision-makers, (media if necessary)

Other Best Practices in Implementation

- Key Worries to be Addressed as part of Implementation per GASB Letter to the Profession
  - Pension funding policy
  - Selection of assumptions
  - Timing of measurements
  - Timing of actuarial valuations
  - Development of information for employer reporting

Best Practices in Implementation

- Funding Policy
  - Statements remove the direct link between measurements for funding purposes and measurement of pension expense for accounting and financial reporting purposes. For governments that have actuarially based funding policies, the measurement requirements of the new Statements for financial reporting purposes will include an actuarial valuation likely different from (and in addition to) the actuarial valuation that is used for funding purposes.
  - **Address through Consistent Communication**

Best Practices in Implementation

- Selection of Assumptions
  - Coordination will be necessary between pension plans and employers when measurements of the net pension liability of the employers are made. Assumptions integral to the measurement of an employer's pension liability include the long-term expected rate of return on pension plan investments, which plays a potentially significant role in the determination of the discount rate.
  - **Address through Communication, alignment of all actuarial assumptions to expectations of employers**

Best Practices in Implementation

- Timing of Measurements
  - Issue will be requirement to present information about the liabilities of the employers, the net pension liability is required to be measured as of the end of Plan's fiscal year.
  - Employers are provided with additional flexibility with regard to the "as of" (or "measurement") date of the net pension liability reported in its financial statements each period.
    - Employer may report a pension liability measured between the end of the employer's prior fiscal year and its current fiscal year-end (for example, as of the pension plan's fiscal year-end). Because information about pension plan net position is needed to measure the employer's net pension liability, in pension plans in which the same fiscal year-end is not shared among the employers and the plan itself, coordination of the employers' measurement date will be necessary.
  - **Address through coordination and timely transmittal of information to members**

Best Practices in Implementation

- Timing of Actuarial Valuations
  - Should not be an issue with as long as annual valuations are performed
    - If Plan and employer fiscal year-ends are different, attention to the timing of the actuarial valuation date relative to those fiscal year-ends will be necessary to ensure that the actuarial valuation date, in conjunction with the measurement date (discussed above), will fall within the timing requirements of the new Statements.
  - If not annual valuations – planning needed as valuation performed and received timely

Best Practices in Implementation

- Development of Information for Employer Reporting
  - **Key concern**
    - RSI schedule information (up to 10 years prior *or aged in*)
    - Additional information on cost sharing employer information expense
  - Key Questions
    - Who prepares it?
    - When is it released?
    - **Is it auditable?**

Best Practices in Implementation

- Development of Information for Employer Reporting
  - Questions *may* be answered by some / all of the following:
    - Implementation Guides
    - AICPA Update to State & Local Audit Guide (new pensions chapter coming **but when in 2014?)**
    - Task force coordination at each plan
  - But – who pays for it?

Again - Why Does This Matter?

- Defined Benefit Pensions represent a huge unfunded liability nationwide
  – Cities of Chicago, Detroit, State of Illinois
  – Very exposed to average voter
- Current disclosure is largely cash – basis and incomplete – not part of rates & charges
- Rating agencies have been starting to include management of pension liability as part of bond rating analysis

Some Q&As

Some Q&As received already

- A government reports an IRC 457 deferred compensation plan. The plan provides several payout options to participants. One of these options is the purchase of an annuity contract in the individual's name through an insurance company. Should the pension plan report these contracts?
- A government includes cash payments to retiring employees for unused compensated absences (vacation and sick) as part of the employees' compensation for the final year of service for the purpose of determining employees' defined benefit pension benefits and the employer's contractually required contributions to the cost sharing plan. Does GASB-16 apply or GASB-68?

Some Q&As received already

- A state department of education makes on-behalf payments for individual school districts' health and life insurance premiums and retirement contributions. The state payments are made directly to the insurance carriers and the pension plan. Are the school districts required to recognize those payments in their governmental funds, or can they recognize them only in the government-wide statement of net position?
- An employer provides an early retirement incentive in the form of an enhanced benefit formula for defined benefit pension benefits. What effect does this have on amounts reported by the employer with regard to its defined benefit pension arrangements?

Questions?

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Postemployment Benefits—Three Things

- Three Exposure Drafts
  - Other Postemployment Benefits (OPEB)—Plans
  - OPEB—Employers
  - Pensions—Plans that are not qualifying trusts
- OPEB proposals based on new pension standards
- Certain modifications made, including provision for healthcare trend rates

Timeline

- Exposure drafts of plan, employer and non-irrevocable trusts reporting by late April 2014
- Comment periods through July 2014
- Public hearings likely August 2014
- Redeliberation into 2015
- Final standards – June 2015
- Implementation – likely by July 1, 2016 for plans, July 1, 2017 for employers?

Questions?

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GASB 70
Accounting and Financial Reporting for Nonexchange Financial Guarantees

Effective Date

July 1, 2013 to June 30, 2014

Earlier Application is Encouraged

70

GASB 70, Nonexchange Financial Guarantees

- “Nonexchange” Transaction
  - A transaction where one party to the transaction does not receive equal or approximately equal value in exchange.
- Financial Guarantee
  - A government guarantees the obligations of another government. The Guarantor government commits to indemnify the holder of the obligation if the Debtor government does not fulfill its payment requirements. No cash at origination.

GASB 70, Nonexchange Financial Guarantees

- Guarantee for Legally Separate Entity
- Includes:
  - Discretely Presented Component Units
  - Blended Component Units
  - And Individuals

GASB 70, Nonexchange Financial Guarantees

- Liability
  - Record a liability when the Guarantor Government determines that **"more likely than not"** a payment under the Financial Guarantee Contract will be made.
  - **"More likely than not" = greater than 50% (i.e. 51%).**
  - "More likely than not" is more than **probable** which is defined as "likely to occur". **Significantly greater than 50%**. (GASB 62)

GASB 70,
Nonexchange Financial Guarantees

- Qualitative Liability Recognition Factors:
  - Initiation of Bankruptcy or Financial Reorganization Proceedings
  - Breach of debt contract - default or delinquency in making debt payments, failure to meet covenants, etc.
  - Indicators of significant financial difficulty (cont'd)

GASB 70,
Nonexchange Financial Guarantees

- Qualitative Liability Recognition Factors:
  - Significant Financial Difficulty (cont'd)
    - Failure to make payments to paying agents or trustees on a timely basis
    - Drawing on a reserve fund to make payments
    - Intercepting receipts to make payments
    - Debt holder concessions
    - Significant investment losses
    - Loss of a major revenue source
    - Increase in operating expenidtures
    - Supervision by another government

GASB 70,
Nonexchange Financial Guarantees

- Economic Resources Measurement Focus:
  - Record Expense and Fund Liability
  - Discounted present value of the best estimate of the future outflows expected to be incurred as a result of the guarantee, **or**
  - If that estimate is not possible, and a range of future outflows can be established, use the best estimate within the range **or** the minimum amount in that range.

GASB 70,
Nonexchange Financial Guarantees

- Current Financial Resources Measurement Focus:
  - Record Expenditure and Liability
  - To the extent the liability is normally expected to be liquidated with expendable available financial resources.
  - Payments are due and payable.

GASB 70,
Nonexchange Financial Guarantees

- The Debtor government may be required by contract to repay the Guarantor government for payments under the guarantee.
  - Reclassify the debt payments made by the guarantor as a liability due to the Guarantor.
  - The liability should continue to be recognized until legally released such as in bankruptcy court, then the Debtor government should recognize a **revenue** when the liability is written-off.

GASB 70,
Nonexchange Financial Guarantees

- A **receivable** should be recognized by the Debtor government when a liability has been recognized by the Guarantor government if the Guarantor government is one of the following:
  - A Blended component unit of the government.

GASB 70,
Nonexchange Financial Guarantees

- A **receivable** should be recognized if (continued):
  - A primary government that includes the government that extended the guarantee as a blended component unit within its reporting entity.
  - Within the same reporting entity and both parties are blended component units of the same primary government.

GASB 70, Nonexchange Financial Guarantees

- A **receivable** should be recognized if (continued):
  - **Otherwise a decrease in Net Position would occur because two liabilities would be presented for the same (i.e. related) obligation.**

GASB 70, Nonexchange Financial Guarantees

- Disclosures:
  - Disclosures for the government that extends nonexchange financial guarantees.
  - Disclosures for the government that has recognized a nonexchange financial guarantee liability or made payments.
  - Disclosures for the government that has received the nonexchange financial guarantees.
  - Disclosures for the government that has received payments under a financial guarantee and the guaranteed obligation is no longer outstanding.

GASB 70,
Nonexchange Financial Guarantees

- Transactions that <u>do not</u> constitute a financial guarantee:
  - Pledges of Revenue (GASB 48)
  - Joint-and-Several Obligations
  - Obligations that are not legal obligations
  - Exchange or Exchange-like transactions

GASB 70,
Nonexchange Financial Guarantees

- Jerry's believe it or not!
  - Assume the Guarantor government has made payments under a financial guarantee?
  - Assume the Guarantor government expects to receive repayment of some or all of the payments made under the guarantee.
  - Should the Guarantor government record a receivable. (Guidance is included in GASB 62, paragraph 112 for gain contingencies.)
    - No. Note disclosure only. Conservative approach.

GASB 70, Nonexchange Financial Guarantees

- Jerry’s believe it or not!
  - Assume the Guarantor government and has groups of similar guarantees?
  - Student loan guarantees, or perhaps housing loans.
  - The Guarantor has determined a historical rate of failure for these types of loan guarantees. In other words, the historical rate is “more likely than not” to remain accurate and occur.
  - Should a liability should be recorded.
    - Yes.

GASB 70,
Nonexchange Financial Guarantees

- Jerry's believe it or not!
  - There was one dissenting GASB Board member.
  - She believed that "Probable" (i.e. more than likely) was adequate for this standard.
  - She disagreed with adding another level or probability under the "more likely than not" category.

- At a minimum, a financial guarantee involves
- how many parties?
- A. Two
- B. Three
- C. Four

- Guarantors should recognize a liability when
- the likelihood of making payments is
- A. Reasonably possible
- B. More likely than not
- C. Probable

- When should an issuer cease to report a
- guaranteed obligation?
- A. When it is probable that payments will be made
- by the guarantor
- B. When it is more likely than not that payments will
- be made by the guarantor
- C. When the issuer is legally released as an obligor
- by the guarantor
- D. None of the above

- When should a guarantor report an expenditure
- for a guarantee in a governmental fund?
- A. When it is probable that payments will be made
- by the guarantor
- B. When it is more likely than not that payments will
- be made by the guarantor
- C. When the issuer is legally released as an obligor
- by the guarantor
- D. None of the above

- If a guarantor reports a liability because
- payment is considered to be more likely than
- not, the issuer should
- A. Always recognize a receivable
- B. Sometimes recognize a receivable
- C. Never recognize a receivable

- How should an issuer report its legal release
- as an obligor on guaranteed debt?
- A. Reclassification
- B. Revenue
- C. Either A or B

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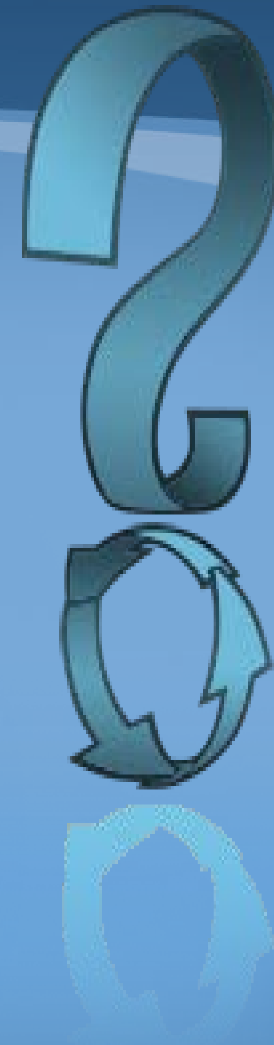
The Opinions expressed during this presentation were my own. They do not necessarily represent the views of the Comptroller, his representatives, or the Department of Audit.



69

GASB 69
Government Combinations and Disposals of Government Operations

Effective Date

July 1, 2014 to June 30, 2015

Earlier Application is Encouraged

GASB Statement 69

Government Combinations and Disposals of Government Operations

Project Objectives

- Consider the financial reporting requirements for government combinations that are accomplished through mergers, acquisitions, and transfers of operations
  - Addresses government's unique conditions and circumstances
- Analysis of government combinations that have taken place in both the general government area (ex. city/county consolidations), and the business type activities area (ex. healthcare organizations)
- Address certain spin-off issues (ex. A library district that was formerly a department in a primary government) – a transfer of operations

Existing Guidance

- Accounting Principles Board (APB) Opinion No. 16, *Business Combinations*
  - This guidance was never intended for the public sector and its application to the public sector has proven to often be problematic.
  - Addresses conditions and circumstances that are not normally encountered in government combinations
- Because this separate project was on the Board's agenda, did not incorporate into Statement 62

Scope

- Combinations in which NO consideration is provided
  - Government mergers
  - Transfers of operations
- Combinations in which consideration is provided
  - Government acquisitions
- Disposals of government operations

Government Combinations

- To be considered a government combination, the arrangement should result in the **continuation of a substantial portion of the services provided** by the previously separate entities or their operations after the transaction has occurred.
  - Terms of arrangement usually establish whether service continuation was intended
  - If not, professional judgment should be used
- This distinguishes a combination from a contribution or purchase of assets and related liabilities

Overall Approach

- The requirements distinguish between government combinations that involve significant (or lack) of financial consideration
  - **Government merger—**combinations of legally separate entities *without* the exchange of significant consideration
  - **Government acquisitions**—transactions in which a government acquires another entity, or its operations, in exchange for the payment of significant consideration
- Combinations not involving entire legally separate entities and in which no significant consideration is exchanged (shared service arrangements, reorganizations, redistricting, annexations, arrangements where an operation is transferred to a new government created to provide those services) – **transfer of operations**

Government Mergers

- Government combination of legally separate entities in which insignificant or no financial consideration is exchanged and which includes one of the following:
- An entirely new government is formed (A+B=C) OR
  - 2 or more governments (or one or more governments and one or more nongovernmental entities) cease to exist as legally separate entities and are combined to form one or more new governments
    - Merger date is the date the combination becomes effective
    - Initial reporting period of the new government begins on the merger date
    - The assets, deferred outflows of resources, liabilities, and deferred inflows of resources of the merging entities would be recognized and measured in the statement of net position at their "carrying value" as of the merger date

Government Mergers

- If the merging entities decide before the merger date to dispose of capital assets and the new government will use those capital assets until the disposal occurs
  - Capital assets should be measured and reported at their carrying values by the new government
- If the new government will not use the capital assets that have been identified for disposal or if the merging entities decide before the merger date that the manner or duration of use of capital assets will change
  - Capital assets should be evaluated for impairment in accordance with provisions of Statement 42, as amended to determine if the carrying values should be adjusted

Government Mergers

- A single continuing government remains (A+B=B+)
  - 1 or more legally separate governments or nongovernmental entities cease to exist and their operations are absorbed into, and provided by, one or more continuing governments
    - Merger date is the beginning of the reporting period in which the combination occurs, (as though the entities were already combined as of that date) regardless of the actual date of the merger
    - The assets, deferred outflows of resources, liabilities, and deferred inflows of resources of the merging entities would be measured in the statement of net position at their "carrying value" as of the merger date

Government Mergers

- If the merging entities decide before the actual date of the merger to dispose of capital assets of the dissolving government but the continuing government will use those capital assets until the disposal occurs
  - Capital assets should be measured and reported at their carrying values by the continuing government
- If the continuing government plans to dispose of the capital assets that it will not use or if decisions are made before the actual date of the merger that the manner or duration of use of specific capital assets of the dissolving government will change
  - Capital assets should be evaluated for impairment in accordance with provisions of Statement 42, as amended

Government Acquisitions

- Acquisition date is the date the acquiring government obtains control of the acquired entity's assets or becomes obligated for its liabilities or its operations (typically when consideration is paid)
- Assets and liabilities normally would be recorded at their acquisition value as of the acquisition date – price that would be paid for acquiring similar assets, having similar service capacity, or discharging the liabilities assumed as of the acquisition date
- Deferred outflows of resources and deferred inflows of resources should be brought forward at their carrying values

Government Acquisitions

- Consideration Given:
  - If exceeds the net position acquired, the difference would be treated as a deferred outflow of resources
    - Attributed to future periods in a systematic and rational manner, based on professional judgment
  - If net position exceeds the consideration given
    - Considered a contribution – if the seller accepted the lower amount for the purpose of providing an economic benefit to the acquiring government
      - If not – the difference would be eliminated by reducing the acquisition values assigned to noncurrent assets (other than investments reported at fair value).
      - If the difference exceeded the acquisition value of all noncurrent assets (other than investments reported at fair value), the remainder would be treated as a special item in the flows statement.

Transfers of Operation

- Government combination involving the operations of a government or nongovernmental entity, rather than a combination of legally separate entities, and in which no significant consideration is exchanged.
  - Operation-an integrated set of activities with associated assets and liabilities that is conducted and managed for the purpose of providing identifiable services.

Transfers of Operations

- Entered into for similar reasons as government mergers
- Transfer date is the date the transferee government obtains control of the acquired operation's assets or becomes obligated for its liabilities.
  - If the transfer of operations results in the formation of a new government – the new government's initial reporting period begins at the effective transfer date
  - If the transfer of operations results in a continuing government – the continuing government should report the transfer as a transaction in the financial statements for the reporting period in which it occurs

Transfers of Operations

- Assets, deferred outflows of resources, liabilities, and deferred inflows of resources of the transferred operation would be incorporated at their carrying value as of the effective transfer date

Disposals of Government Operations

- The disposing government would report a special item for any gain or loss on the disposal of operations in the period in which the disposal occurs, based on either
  - Effective transfer date of the transfer of operations, or
  - The date of sale for operations that are sold

Disclosures

- The following disclosures are required for all government combinations:
  - Brief description of the combination that
    - Identifies the entities involved and the primary reasons for the combination
    - Mentions whether the entities combined were part of the same financial reporting entity
    - Discloses the date of the combination
- Additional disclosures for
    - Mergers and transfers of operations
    - Acquisitions
    - Disposals of Operations

Effective Date and Transition

- Effective for financial statements for periods beginning after December 15, 2013
- Applied prospectively
- Earlier application is encouraged

- Which of the following would qualify as a
- government combination ?
- A. Merger
- B. Acquisition
- C. Transfer of operations
- D. All of the above
- E. Both A and B

- A government combination always involves
- A. At least one entity losing its separate legal
- identity
- B. The creation of a new legal entity
- C. Both A and B
- D. None of the above

- Which of the following always involves the
- exchange of significant consideration?
- A. Merger
- B. Acquisition
- C. Transfer of operations
- D. All of the above
- E. Both A and B

- Which of the following is a precondition for a
- transfer of operations?
- A. The operation must provide identifiable services
- with associated assets or liabilities
- B. The transferred operation must continue to provide
- the same services
- C. There must be a significant exchange of
- consideration
- D. All of the above
- E. Both A and B

- If a merged entity is absorbed into a continuing
- government, when does reporting begin?
- A. As of the merger date
- B. As of the start of the merging government's fiscal
- period
- C. Either A or B

- An entity obtains a capital asset through a
- merger. It intends to dispose of the asset
- eventually, but meanwhile plans to use it.
- When would the entity need to assess whether
- a capital asset impairment had occurred?
- A. When the capital asset is first obtained
- B. At the time of disposal

- In an acquisition, how should financial statement
- elements be measured?
- A. Fair value
- B. Acquisition value
- C. Disposal value
- D. Either A or B

- Acquisition value is based on
- A. Historical entry price
- B. Historical exit price
- C. Market-based entry price
- D. Market-based exit price

- Deferred outflows/inflows of resources in a
- merger are
- A. Always reported at carrying value
- B. Normally reported at carrying value
- C. Sometimes reported at carrying value
- D. Never reported at carrying value

- Consideration includes
- A. Assets remitted
- B. Liabilities incurred
- C. Both A and B

- In an acquisition, how should a disparity
- between the amount of consideration given and
- the net position acquired be treated?
- A. Deferred outflow of resources
- B. Contribution
- C. Reduction in amount reported for noncurrent
- assets
- D. Special item
- E. All of the above

- In an acquisition, how should a disparity
- between the amount of consideration given and
- the net position acquired be treated?
- A. Deferred outflow of resources
- B. Contribution
- C. Reduction in amount reported for noncurrent
- assets
- D. Special item
- E. All of the above

- Acquisitions within the financial reporting entity
- may involve some assets being reported at
- carrying value rather than at acquisition value.
- A. True
- B. False

Government dissolution (Z.69.1)

- Situation
- ◦ Government dissolves
- ◦ Operations form basis for new government
- ◦ No significant consideration
- □Question
- ◦ Treatment?
- □Answer
- ◦ Transfer of operations
- □Not a merger because only one existing entity is
- involved
- □Transferor government does not have to continue to
- exist

Merger impairment (Z.69.2)

- Situation
- ◦ Township merges into village
- ◦ Some capital assets of township will not be used by
- village
- Question
- ◦ How to report impairment?
- Answer
- ◦ Disclosure only
- Carrying value prior to merger
- Impairment adjustment
- Explanation

66

GASB 66, *Technical Corrections – 2012—an amendment of GASB Statements No. 10 and No. 62*

Objective of this project

- Resolve conflicting accounting and financial reporting guidance that resulted from the issuance of GASB 54 and GASB 62 impacting:
- GASBs 10, 13, and 48.
- Effective for periods beginning after December 15, 2012.
- Early application is encouraged.

GASB 10 Amendments

- Removes the provision that limits fund-based reporting of an entity's risk financing activities to the general fund and the internal service fund type.
- As a result, governments should base their decisions about fund type classification on the nature of the activity to be reported, as required in GASB 54 and GASB 34.

Provisions of GASB 62

- Deletes requirement in GASB 10 that requires an entity’s risk-financing activities be accounted for in either the general fund or an internal service fund.
- With new fund definitions in GASB 54, it is possible that such activities would meet the definition of a special revenue fund.

Provisions of GASB 62 (cont.)

- Deletes language in GASB 62 regarding the following:
  - A provision that does not permit the fair value method for recording expenses associated with an operating lease that varies from a straight-line basis as provided for in GASB 13,
  - The reporting of the purchase of loans that could be perceived as in conflict with GASB 48, and
  - Guidance for adjustments to a sales price of a mortgage loan when the stated service fee rate differs from the current (normal) servicing fee rate. The deleted language conflicts with provisions in GASB 48.

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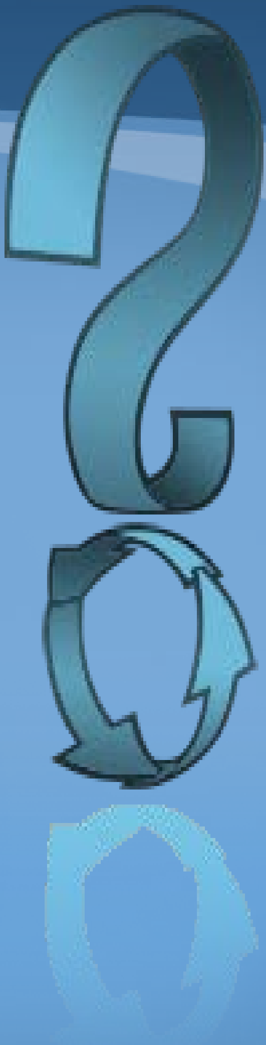
The Opinions expressed during this presentation were our own. They do not necessarily represent the views of the Comptroller, his representatives, or the Department of Audit.



Sources of Guidance & Standards

AICPA Governmental Audit and Accounting Publications

- Audit and Accounting Guides and Related Audit Risk Alerts
  - Government Auditing Standards and Circular A-133 Audits.
  - State and Local Governments.
  - Not-for-Profit Entities
  - Healthcare Entities
  - Gaming (no risk alert).

AICPA Governmental Audit and Accounting Publications (cont.)

- Other Publication
  - Not-for-Profit Entities: Checklists and Illustrative Financial Statements
  - State and Local Governments: Checklists and Illustrative Financial Statements
  - Accounting and Reporting Practices of Not for Profit Organizations.
  - The Audit Committee Toolkit: Government Organizations; Audit Committee Toolkit: Not-for-Profit Organizations; and AICPA Audit Committee Effectiveness Center
  - Applying OCBOA in State and Local Governmental Financial Statements.

AICPA Governmental Audit and Accounting Publications (cont.)

- Other Publication (cont.)
  - Accounting and Financial Reporting Guidelines for Cash and Tax Basis Financial Statements.
  - Compliance and Internal Control over Compliance Practice Aids.

AICPA Governmental Audit and Accounting Publications (cont.)

- **Audit Practice Tools and Aids**
  - Government Auditing Standards (Yellow Book) Tools and Aids.
  - Single Audit Practice Aids .
  - Other Compliance Audit Information Relating to For-Profits
  - Governmental Audit Quality Article Collection
  - Flowcharts and Illustrations

AICPA Governmental Audit and Accounting Publications (cont.)

- **Government Auditing Standards (Yellow Book) Practice Aids and Tools**
- **2011 Yellow Book Independence—Nonaudit Services Documentation Practice Aid**
- **NEW AICPA – Government Auditing Standards Independence Rules Comparison**
- **Archived Web Event on the GAQC 2011 Yellow Book Independence Practice Aid**
- **Archived Web Event on the 2011 Yellow Book**
- **Archived Web Event on the 2007 Yellow Book**
- ***Government Auditing Standards Peer Review Checklists***
- **Illustrative Yellow Book Audit Reports**

AICPA Governmental Audit and Accounting Publications (cont.)

- **Single Audit Practice Aids**
  - Schedule of Expenditures of Federal Awards
  - Internal Controls and Compliance Practice Aids
  - SAS No. 117, *Compliance Audits*
  - Sampling in a Single Audit Environment

AICPA Governmental Audit and Accounting Publications (cont.)

- **Financial Statement Tools, Practice Aids, and Other Resources for Auditees**
  - ***The New AICPA OCBOA Publications: What They Are and How They Apply to Governments and Not-for-Profits Using Cash, Modified Cash, and Regulatory Frameworks Web Event***
  - ***Article on Implementation Considerations of GASB 61***.
  - ***GASB's New and Upcoming Standards Web Event***

AICPA Governmental Audit and Accounting Publications (cont.)

- **Financial Statement Tools, Practice Aids, and Other Resources for Auditees**
  - NEW ***Not-for-Profit Entities: 2012/2013 Audit and Accounting Considerations Web Event***
  - ***Practice Aid on Alternative Investments***.
  - ***Challenges with Fair Value Measurements for Not-for-Profits Web Event***.

AICPA Governmental Audit and Accounting Publications (cont.)

- **Quality Control**
  - *Tips for Getting Through a Quality Control Review*
  - *Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice*
  - *Guide for Quality Control Reviews of OMB Circular A-133 Audits*, and *Guide for Desk Reviews of OMB Circular A-133 Audit Reports*
  - Peer Review Checklists

GAO

- High risk alert (http://www.gao.gov/highrisk)
- Yellow Book (*GAS*)
- Green Book (Standard for Internal Controls)
- Financial Audit Manual

OMB

- Circulars
- Bulletins
- Memoranda
- Reports and Other Documents (e.g., budget execution reports and reports to Congress)
- Federal Register
- Federal agencies' websites

COSO

- Committee of Sponsoring Organizations of the Treadway Commission
- http://coso.org/guidance.htm
- Enterprise Risk Management
- Internal Controls
- Fraud Deterrence

FASB

- Accounting Standards Codification (ASC) – online
- Concept Statements – online
- Financial Accounting Research System (FARS) – online
- Pre-Codification Statements
- 2013 US GAAP Financial Reporting Taxonomy (i.e., XBRL)

GFOA

- **Committee on Accounting, Auditing and Financial Reporting (CAAFR) best practices and advisories**
  - Audit committees
  - Audit procurement
  - Establishment of internal audit function
  - Auditor Association with Financial Statements Included in Offering Statements or Posted on Web Sites
  - 28 additional best practices and advisories

GFOA

- **Best practices and advisories related to other committees**
  - Budgeting and fiscal policy
  - Debt management
  - Economic development and capital planning
  - Retirement and benefits
  - Treasury and investment management
- Budget best practices

GFOA

- **Certificate of Achievement for Excellence in Financial Reporting Program (CAFR Program)**
  - **Checklists**
    - **General-purpose governments**
    - **School districts**
    - **Stand-alone business type activity**
    - **Pension and other postemployment benefit systems**
    - **Cash and investment pools**

NASACT and NACUBO

- NSAA peer review checklists
- NACUBO
  - UPMIFA
  - Risk Assessment Toolkit
  - Liquidity and Fair Value Resources
  - Operating Measure for Independent Institutions
  - Accounting Tutorials

PPC/Thomson Reuters Checkpoint

- Audits of Local Governments
- Audits of Nonprofit Organizations
- Single Audits
- Government Accounting and Auditing Update
- Government Documents Library
- Governmental Financial Statement Illustrations and Trends
- Preparing Governmental Financial Statements
- Checkpoint tools for PPC

AGA

- Fraud Prevention ToolKit
  - AGA's Fraud Prevention ToolKit provides current, state-of-the-art tools for federal, state, local and tribal government financial managers to use in preventing and detecting fraud. It furthers AGA's mission of "Advancing Government Accountability."
- AGA convened a special work group of government officials to develop this ToolKit because:
  - The typical organization loses 5 percent of its annual revenue to fraud.
  - Governments are the second most frequent victims of fraud (after banking).
  - The median duration of those fraud schemes that are discovered is 18 months.
  - Nearly half of victim organizations do not recover any losses that they suffer due to fraud.

Source: Association of Certified Fraud Examiners' 2012 Report to the Nations

AGA

- "There is no kind of dishonesty into which otherwise good people more easily and more frequently fall than that of defrauding the government."

- Ben Franklin

GASB Website—www.gasb.org

- Downloads and ordering information (Exposure documents, Statements, Q&As)
- Summaries of standards
- Project pages
- Technical inquiry form
- Staff contacts
- http://www.gasb.org/tech/index.html (GASB 20 paragraph 7 guidance – superseded by effective date of GASB 62)

GASB

- Statements (71) – also online
- Interpretations (6) – also online
- Technical Bulletins (14) – also online
- Concept Statements (6) – also online
- Implementation Guides (13 including Comprehensive Implementation Guide)
- Governmental Accounting Research System (GARS) – basic view free (no search capability)
- SEA Performance Information

Questions?

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