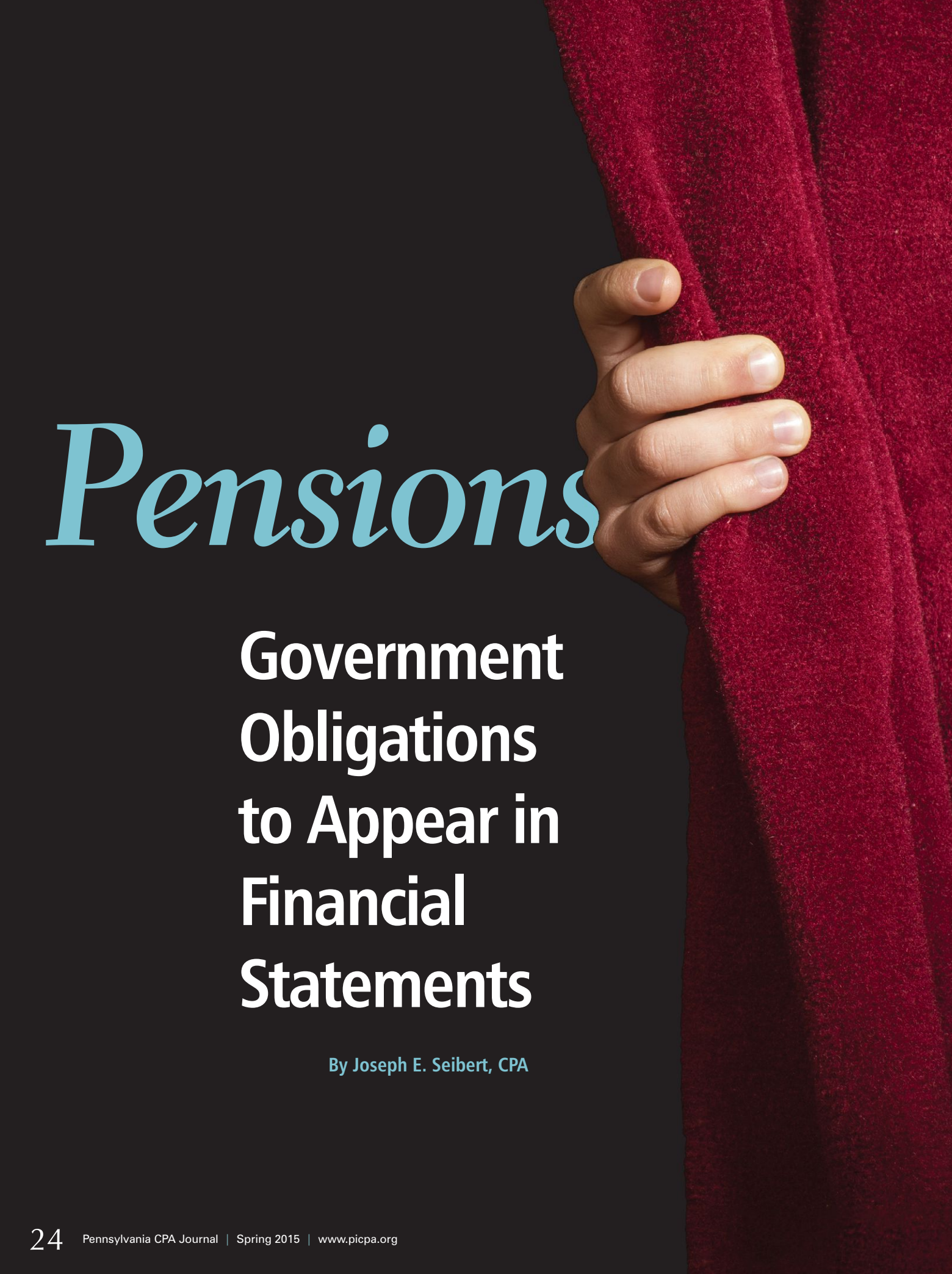


A hand is visible on the right side of the image, holding a thick, red velvet curtain. The background is a solid dark grey or black. The word "Pensions" is written in a large, light blue, cursive font across the middle of the image.

Pensions

Government Obligations to Appear in Financial Statements

By Joseph E. Seibert, CPA

The Governmental Accounting Standards Board's (GASB) Statement No. 68, *Accounting and Financial Reporting for Pensions*, becomes effective for years ended June 30, 2015, and beyond. This standard transforms the way governments report their pension obligations in their financial statements, which will present challenges for employer governments and their auditors during implementation. This feature discusses some of the key considerations for Pennsylvania local governments and their auditors to consider.

Pension Plans

To pinpoint the appropriate accounting under Statement No. 68 and the related information that will need to be obtained, the type of defined benefit pension plan first must be determined. Defined benefit pension plans are classified according to the number of employers whose employees are provided with pensions through the pension plan and whether pension obligations and pension plan assets are shared. For purposes of this classification, a primary government and its component units are considered to be one employer. Accordingly, plans are classified in one of the following categories:

- Single employer plans – Pension benefits are provided to the employees of only one employer. In Pennsylvania, these include the plans of counties, many cities, and other municipalities.
- Cost-sharing multiple-employer (cost-sharing) plans – Pension obligations to the employees of more than one employer are pooled and plan assets can be used to pay the benefits of the employees of any employer that provides pensions through the pension plan. The Public School Employees Retirement System (PSERS) is a cost-sharing plan in which local school districts participate.
- Agent multiple-employer (agent) plans – Plan assets are pooled for investment purposes, but separate accounts are maintained for each individual employer so that each employer's share of the pooled assets is legally available to pay the benefits of only its employees. The Pennsylvania Municipal Retirement System (PMRS) is an agent plan in which many local governments participate.

Pension Amounts in Accrual Basis Statements

When Statement No. 68 is implemented, employers will be required to recognize a liability as employees earn their pension benefits – that is, as they provide services to the government. For the first time, employers participating in single and agent plans will recognize their specific pension amounts, which include net pension liability, deferred outflows of resources, deferred inflows of resources, and pension expense (that is, specific pension amounts). Employers participating in cost-sharing plans will recognize their proportionate share of the collective pension amounts for the plan.

In many cases, the net pension liability will be material to the financial statements, resulting in a significant increase in reported liabilities with a corresponding decrease in net position (equity). It is recommended that employer governments include appropriate discussion of the impact of these changes in the management's discussion and analysis section of the comprehensive annual financial report. Employer governments may also consider developing a communications plan to educate elected officials and those charged with governance about the new reporting requirements.

Selecting Measurement Date

In accrual basis financial statements, the net pension liability is required to be measured as of a date no earlier than the end of the employer's prior fiscal year (the measurement date) and consistently applied each year. As a practical matter, based on the need for information from the plan, the measurement date for the net pension liability will almost always coincide with ►

the year-end of the plan. In these circumstances, the employer will need to use the plan year-end that falls within the preceding 12 months of the employer's year-end. When the employer and the plan have the same year-end, the employer may choose to use either the current or prior year-end of the plan as the measurement date. However, once selected, the employer must follow the measurement date consistently. For example, assume an employer with a June 30 year-end is implementing Statement No. 68 for the year ended June 30, 2015. Assume further that the employer participates in a cost-sharing plan that also has a June 30 year-end. In this case, the employer can select either June 30, 2014, or June 30, 2015, as the measurement date to report the net pension liability in the employer's financial statements for the year ended June 30, 2015. Employers should carefully consider the timeliness of the information being provided by the plan in selecting the measurement date to avoid unnecessary delay in the issuance of the employer's financial statements.

Governmental Fund Financial Statements

In governmental fund financial statements, a net pension liability should only be recognized to the extent the liability is normally expected to be liquidated with expendable available financial resources. Pension expenditures are the total of amounts paid by the employer to the pension plan and the change between the beginning and ending balances of the liability to be liquidated with expendable available financial resources. Statement No. 68 clarifies that pension liabilities are normally expected to be liquidated with expendable available financial resources to the extent that benefit payments have matured – that is, benefit payments are due and payable and the pension plan's fiduciary net position is not sufficient for payment of those benefits. In most circumstances, this means pension expenditures will be recognized when

Council on Governmental Accounting (NCGA) Statement 1, Governmental Accounting and Financial Reporting Principles, paragraph 42, as amended, which requires that long-term liabilities that are directly related to, and expected to be paid from, those funds be reported in the statement of net position or statement of fiduciary net position, respectively." Most governments likely will allocate a portion of the net pension liability, deferred outflows of resources, deferred inflows of resources, and pension expense using the allocation methodology for employers participating in cost-sharing plans. This allocation will likely result in the recognition of additional deferred outflows of resources or deferred inflows of resource related to changes in proportion from year to year.

Cost-Sharing Employers

For the first time, employers participating in cost-sharing plans (such as those schools participating in PSERS) will recognize their proportionate share of the collective pension amounts for the plan. A major challenge faced by each employer is how they will obtain all the necessary information to support their proportionate share of these collective pension amounts. Similarly, employer auditors will be challenged in obtaining sufficient appropriate evidence to opine on the pension amounts included in employer financial statements.

The AICPA State and Local Government Expert Panel issued a white paper in February 2014 (*Governmental Employer Participation in Cost-Sharing Multiple-Employer Plans: Issues Related to Information for Employer Reporting*). This cost-sharing plan white paper addresses these issues and recommends that cost-sharing plans calculate each employer's allocation percentage and collective pension amounts. The following are the schedules the AICPA recommends that cost-sharing plans prepare:

- Schedule of employer allocations and allocation method to be used – This displays the proportionate relationship of each employer to all employers and each allocation percentage. The plan will engage its auditor to opine on the schedule of employer allocations and related notes to the schedule.
- Schedule of pension amounts by employer – This will calculate amounts to be recorded in the financial statements of the employer, including net pension liability, deferred inflows and outflows, pension expense, and changes in proportion share. The plan should engage its auditor to opine separately on the four following elements: total net pension liability, total deferred outflows of resources, total deferred inflows of resources, and total pension expense for the sum of all participating entities included in this schedule.

The white paper discusses a number of employer auditor responsibilities when relying on the information and related audit assurance provided by the plan. Specifically, the employer auditor should review the plan auditor's report and any related opinion modifications and assess other matters discussed in the report. Additionally, the employer auditor should evaluate whether the plan auditor has the necessary competence and independence for the school auditor's purposes. Further, the school and its auditor have a responsibility to verify and recalculate amounts specific to the applicable employer, including the employer amount used in the allocation percentage (the numerator of the calculation), recalculate the allocation percentage for the employer, and recalculate the pension amounts allocated to the employer based on the allocation percentage.



When Statement No. 68 is implemented, employers will be required to recognize a liability as employees earn their pension benefits.

paid, similar to the cash basis of accounting. This may be a change for some governments that previously recognized pension expenditures for contributions made to the plan shortly after year-end.

Allocation of Pension Amounts

Statement No. 68 does not establish specific requirements for allocation of the net pension liability or other pension-related measures to individual funds. However, question 37 of the implementation guide for Statement No. 68 states "For proprietary and fiduciary funds, consideration should be given to National

The AICPA issued a census data white paper that addresses the plan auditor's responsibility to obtain sufficient appropriate evidence regarding the completeness and accuracy of census data underlying certain financial statement elements of the cost-sharing plan financial statements. The suggested audit procedures performed by the plan auditor include selecting a risk-based representative group of participating employers each year on a rotating basis for testing underlying payroll records of active employees for completeness and accuracy of the significant elements of census data reported to the plan. As a result, employer auditors may receive requests to perform procedures to assist the plan auditor in obtaining sufficient appropriate evidence over the completeness and accuracy of census data or the plan auditor may reach out to employers to complete these procedures themselves. If the participating employer's auditor does the procedures, an AT Section 101 attestation examination would be conducted.

Agent Employers

For the first time, employers participating in agent plans (such as local governments participating in PMRS) will recognize their specific pension amounts, including net pension liability, deferred outflows of resources, deferred inflows of resources, and pension expense. A challenge faced by each employer (and its auditor) participating in an agent plan is how the employer will obtain all necessary information to support the specific pension amounts, including net pension liability, deferred outflows of resources, deferred inflows of resources, and pension expense. This is because specific pension amounts are dependent on certain accounting records maintained by the plan, the controls and processes of the plan, and calculations by the plan's actuary. The AICPA white paper on agent plans recommends addressing total pension liability, deferred outflows of resources, deferred inflows of resources, and pension expense as a best practice solution. Another best practice solution is to address the employer's specific interest in the agent plan's fiduciary net position as follows:

- Total pension liability, deferred outflows of resources, deferred inflows of resources, and pension expense – The plan actuary issues a separate actuarial valuation report specific to each employer that includes a certification letter addressed to employer management. Also, the plan engages its auditor to issue either a service organization controls (SOC 1) Type 2 report on controls over census data maintained by the plan, or an examination engagement over selected management's assertions related to census data maintained by the plan.
- Fiduciary net position – The plan prepares a schedule of changes in fiduciary net position by the employer and related notes to the schedule. Also, the plan engages its auditor to opine on the schedule of fiduciary net position by employer either through an opinion on the schedule as a whole combined with a SOC 1 Type 2 report on the controls over the calculation and allocation of additions and deductions to employer accounts, or an opinion on each employer column in the schedule.

The agent plan white paper discusses a number of employer auditor responsibilities when relying on the information and related audit assurance provided by the plan. Specifically, the employer auditor retains the responsibility of evaluating whether the underlying census data is complete and accurate, and should consider the following: confirm census information with the

actuary, review roll forward of census data, compare census to prior-year values and employee base, sample participants and review personnel file for accuracy of census data, sample from payroll system to verify completeness of census file, and evaluate plan auditor and its reports.

Additionally, the employer auditor will need to perform procedures related to the employer-specific amounts in the schedule of changes in fiduciary net position, including verifying the completeness and accuracy of the employer and employee contributions attributed to the individual employer, and analytical procedures on investment income and administrative expenses and benefit payments by developing an expectation and validation of the expectations. Additionally, the employer auditor should evaluate whether the auditor's report and accompanying schedule are adequate and appropriate for the employer auditor's purposes.

Communication

Communication between pension plans, government employers, and their auditors is essential in implementing Statement No. 68. This communication may be challenging because of the complexity of the standards and the potential lack of awareness about some of the more difficult provisions. Nonetheless, timely communication is essential in the employer government's implementation. Employers and their auditors need to understand what information and associated audit assurance the plan will provide and the expected timing. Employers should not take for granted that the plan will provide the necessary information and associated audit assurance as discussed in the applicable AICPA white papers.

Key Planning Actions

As a result of the complexity of the pension environment in governments and the new requirements of the GASB standards and resulting AICPA white papers, the following are key steps that governmental entities should be taking in conjunction with their actuary and auditor to be ready for a successful implementation:

All Employers

- Review financial reporting timing and select measurement date.
- Educate board/elected officials.

Single Employers

- Review investment policies to validate that they are in sync with rate of return assumptions in the valuation.
- Review or create policies for employer contributions.
- Review policies for post-retirement benefit increases.

Cost-Sharing Employers

- Coordinate with auditor on incremental census testing.
- Coordinate with PSERS on required testing of active employee census testing requirements and AICPA schedules.

Agent Employers

- Coordinate with auditor on incremental census testing and review of PMRS data.
- Coordinate with PMRS on timing of AICPA recommended reporting. 



Joseph E. Seibert,
CPA

Joseph E. Seibert, CPA, is a partner with KPMG LLP in Harrisburg. He can be reached at jseibert@kpmg.com.

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