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New accounting rules for public pension plans in the United States are set to take effect beginning in 2014. Successful implementation of the new rules will require an understanding of a variety of technical concepts regarding the various newly required calculations. This article is the seventh in a multi-part PERiScope *series that will explore these technical topics in detail. Please see the sidebar for more information on upcoming technical articles in this series.*

GASB 67/68 – Pension Expense, Balance Sheet Items, and Projections From Valuation Date to Measurement Date

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In 2012, the Governmental Accounting Standards Board (GASB) released new accounting standards for public pension plans and participating employers. These standards, GASB Statements No. 67 and 68, substantially revised the accounting requirements previously mandated under GASB Statements No. 25 and 27. Required implementation is imminent, with GASB 67 effective for plan fiscal years beginning after June 15, 2013, and GASB 68 effective for employer fiscal years beginning after June 15, 2014.

As part of Milliman's GASB 67/68 miniseries, this *PERiScope* article examines the impact these new accounting standards have on the pension expense and balance sheets of both pension plans and participating employers. In addition, this article will explore roll-forward procedures that can be used to project plan liabilities from the valuation date to the measurement date.

PENSION EXPENSE

Under GASB 67 and GASB 68, a pension plan's *net pension liability* (NPL) is equal to the *total pension liability* (TPL) minus the *fiduciary net position* (i.e., the market value of assets). The NPL is similar to the unfunded actuarial liability (UAL) under GASB 25 and 27 with two exceptions. First, asset-smoothing techniques are no longer allowed under the accounting standards. Second, the TPL must be determined by the individual entry age cost method. GASB 67 and 68 require that changes in the NPL from one measurement date to the next must be recognized in pension expense. Certain changes in the NPL are recognized immediately, while others are recognized in expense over a period of years. Those amounts not recognized immediately are accounted for as *deferred inflows and outflows of resources.*

Pension Expense: Single and Agent Employers

In general, pension expense is calculated as follows:

	Service Cost
+	Interest on the TPL
+/−	Changes in the NPL arising from plan amendments
−	Employee contributions
−	Expected earnings on plan investments
+	Administrative expenses
−	Recognition of deferred inflows
+	Recognition of deferred outflows

Selected components of pension expense are discussed in more detail below, broken out between components that are recognized immediately and those that are recognized in expense over a period of years.

Did you know? Milliman's GASB 67/68 Task Force will release an upcoming miniseries on technical and implementation issues surrounding GASB 67 and 68. Each article will be released through *PERiScope*. Look for the following articles in coming months:

- **Proportionate Share Calculations**
- **Special Funding Situations**

Additionally, a Frequently Asked Questions document will be maintained, with links to relevant miniseries articles as they become available.

Visit www.milliman.com/GASB6768 for all the latest resources on the new statements.

Pension Expense Items Requiring Immediate Recognition

The plan's service cost (i.e., gross normal cost), measured at the beginning of the measurement period, is included in pension expense. The service cost must be determined using the individual entry age (level percentage of pay) actuarial cost method. Benefits should be attributed over a period that begins when the employee starts accruing benefits under the terms of the plan and ends when the employee separates service. In situations where a plan offers a Deferred Retirement Option Program (DROP) to participants, the date of entry into the DROP should be considered as the separation date.

One year's interest on the TPL is also included in pension expense. Interest on the service cost, offset by interest on benefit payments (including refunds of employee contributions) during the measurement period, should also be included. Interest should be calculated using the plan's discount rate assumption.

There are other sources of change in NPL that must be recognized immediately in pension expense. They include, but are not limited to, employee contributions, administrative expenses, and any change in NPL arising from plan amendments.

Pension Expense Items Requiring Deferred Recognition

Certain changes in a plan's NPL must be recognized in expense over a period of years. Changes in NPL that arise due to experience gains or losses fall into this category. These changes should be amortized using a "systematic and rational method" (e.g., straight line or level percentage of pay) over a closed period equal to the expected remaining service lives of all pension plan participants, both active and inactive.[1] The expected remaining service lives should be determined as of the beginning of the measurement period.

Changes in NPL that arise due to assumption changes must also be recognized in expense over a period of years using the same methodology as is used for experience gains/losses. However, a change in NPL associated with an assumption change that is a direct result of a plan change (for example, a change to the plan's retirement assumption due to a change in the normal retirement age) must be recognized immediately.

Changes in NPL that arise due to differences between projected and actual earnings on pension plan investments must be recognized in expense over a five-year period, beginning with the current reporting period. Projected earnings should be calculated using the plan's long-term rate of return assumption, net of investment expenses.

Q&A 83 of the GASB 68 implementation guide states that it is not permissible for employers to apply a method that would recognize the *entire* amount of changes in NPL attributable to experience gains/losses, assumption changes, or differences in projected and actual investment earnings in pension expense. That is, delayed recognition *must* be used in these situations.

1 Please see the July 2014 *PERiScope* article "Calculation specifics on individual entry age normal and recognition of deferred inflows/outflows" for more information on this amortization process.

Pension Expense: Cost-sharing Employers

While the general approach for calculating pension expense for a cost-sharing employer plan is similar to that used for single and agent employer plans, there are a few notable differences. First, changes in the collective deferred inflow and outflow of resources due to changes in the employer's proportion of the collective NPL since the last measurement date must be recognized in expense. Second, any difference between actual employer contributions and the employer's proportionate share of the total of all contributions from all employers must be recognized in expense. In both cases, these changes must be amortized over a closed period equal to the expected remaining service lives of all pension plan participants, not the expected remaining service lives for participants of a select group of individual employers.

Deferred Inflows and Outflows of Resources:—Single and Agent Employers

Under the new GASB standards, changes in the NPL arising from experience gains/losses, assumption changes, and differences between projected and actual earnings on investments must be recognized in expense over a period of years. Those amounts that are not recognized in expense during the current reporting period are accounted for as deferred inflows and outflows of resources.

Deferred inflows and outflows of resources that arise from experience gains/losses or assumptions changes in different years should **not** be expensed on a combined net basis. Rather, individual bases, or "layers," should be established with each new reporting period and tracked until each has been fully recognized in expense. However, in the notes to the financial statements, balances should be aggregated for the purpose of reporting balances of deferred inflows and outflows.

Balances of deferred inflows and outflows of resources arising from differences between projected and actual earnings on investments in different periods, on the other hand, should be reported on a net basis. If the net balance is a credit, it should be reported as a deferred inflow of resources. If the net balance is a debit, it should be reported as a deferred outflow of resources.

Finally, in addition to changes in NPL that have not been recognized in pension expense, the deferred outflow of resources should also include any employer contributions made after the measurement date and before the end of the employer's reporting period.

Deferred Inflows and Outflows of Resources:—Cost-sharing Employers

While the general approach for calculating the deferred inflows and outflows of resources for a cost-sharing employer plan is similar to that for single and agent employer plans, there are also a few differences. As with single and agent employers, changes in NPL attributable to experience gains/losses, assumption changes, and differences between projected and actual earnings on investments not recognized in expense during the current reporting period are accounted for as deferred inflows and outflows of resources.

However, cost-sharing employers have two additional sources of deferred inflows and outflows of resources that are not applicable to single or agent employer plans. First, if there are changes in the employer's proportion of the collective NPL since the last measurement date, then any effect on the employer's proportionate share of the collective NPL, collective deferred outflow of resources, or collective deferred inflow of resources not recognized in expense is reported as a deferred item. Second, any difference between actual employer contributions and the employer's proportionate share of the total of all contributions from all employers not recognized in expense must be reported as a deferred item.

Deferred amounts arising from these two sources in a given year may be reported on a net basis. However, deferred amounts resulting from these two sources may not be reported net of similar deferred amounts arising in other periods.

PROJECTIONS FROM VALUATION DATE TO MEASUREMENT DATE

An actuarial valuation is performed by taking a snapshot of the pension plan's membership and benefit provisions as of a valuation date. Decisions about actuarial assumptions are also determined as of the valuation date. Using this information, the actuary calculates the TPL and other related figures as of this date.

GASB 67 and 68 require that the TPL must be determined as of the measurement date. However, in some circumstances it may not be practical to perform a valuation as of the measurement date. In such situations the actuary can make use of update procedures to project or "roll forward" the TPL from the valuation date to the measurement date.

If update procedures are used, the valuation date may be no more than 24 months earlier than the fiscal year-end under GASB 67 and no more than 30 months and 1 day earlier than the fiscal year-end under GASB 68.[2] In addition, any significant changes that have occurred between the valuation date and the measurement date must be reflected in the TPL. A significant change in the TPL can result from either a single or combination of reasons. Examples of events that may have a significant effect on TPL are:

- Change in benefit terms
- Change in size or composition of covered group
- Change in municipal bond rate or index rate component of the discount rate
- Change in the pension plan's fiduciary net position that impacts the discount rate used to calculate the plan's TPL

GASB 67 and 68 do not establish specific procedures for applying update procedures, but direct the actuary to apply professional judgment in determining the necessary methods to estimate the TPL as of the measurement date. The accounting standards also state that among the factors to be considered is whether a new actuarial valuation is needed. If an event that triggers a significant change in the TPL is not reflected in the original valuation, the actuary may be required to rerun the valuation. For example, assume that a July 1, 2013 actuarial valuation is used for a June 30, 2014 measurement date and June 30, 2015 reporting date (fiscal year-end). If a plan adopts a material change in benefit terms on June 29, 2014, this change would need to be reflected in the TPL, and would require a new actuarial valuation. The impact of this change would need to be reflected even if the change is not effective until a later date, say, June 30, 2017. However, changes that occur subsequent to the measurement date are not reflected in the TPL. In the same example, if the change was adopted on July 1, 2014, it would not be reflected in the TPL until the next measurement date (i.e., during the employer's next fiscal year).

For plans that have actuarial valuations performed biennially, the TPL should be reported based on a new measurement date each year. This can generally be achieved through the use of update procedures as described above, or it may be accomplished by performing a new actuarial valuation. Whichever approach is taken should be agreed upon by the actuary, auditor, and trustees.

Finally, while the TPL as of the measurement date can be based on the results of an earlier actuarial valuation, the fiduciary net position must be the market value of assets as of the measurement date.

Careful consideration should be given to the choice of both the valuation date and measurement date. Once these dates have been established, discuss with your actuary whether a roll-forward calculation is necessary. This calculation is an important estimate, and changes between the valuation date and measurement date could have a material impact.

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2 For additional details, please see the March 2014 *PERiScope* article discussing the relationship between valuation date, measurement date, and reporting date.