Dave Yost · Auditor of State

Bulletin 2015-006

Auditor of State Bulletin

Updated October 2023.

DATE ISSUED: **September 22, 2015**

TO: **All Fiscal Officers and Independent Public Accountants (IPAs)**

FROM: **Dave Yost, Auditor of State**

SUBJECT: **Governmental Accounting Standards Board Statement No. 68 – Accounting and Financial Reporting for Pensions**

Background Information

The Governmental Accounting Standards Board (GASB) Statement No. 68, "Accounting and Financial Reporting for Pensions," includes guidance for reporting pension liabilities. GASB 68 addresses accounting for defined benefit and defined contribution pension plans.

The five major pension plans in Ohio include Ohio Public Employees Retirement System (OPERS), Ohio Police & Fire Pension Fund (OP&F), State Teachers Retirement System of Ohio (STRS), School Employees Retirement System of Ohio (SERS) and the Ohio Highway Patrol Retirement System (HPRS). HPRS is a single-employer retirement plan while the remaining plans are multiple-employer plans. Local government employers contribute to OPERS, OP&F, STRS and SERS. The major plans that are offered by these four pension systems are defined benefit, cost-sharing plans. The focus of this bulletin will be on defined benefit, cost-sharing plans. Guidance related to defined contribution plans will be discussed later in this bulletin.

The GASB issued an implementation guide to supplement the guidance found in GASB 68. The Implementation Guide is organized in a question and answer format. This bulletin references specific questions from the GASB 68 Implementation Guide (IG).

The requirements of this Statement apply to all Ohio State and local governments with a Generally Accepted Accounting Principles (GAAP) reporting requirement per OAC 117-02-03(B). Some other governments may be subject to GAAP, such as through a debt covenant. GASB 68 is effective for financial statements for periods beginning after June 15, 2014. Meaning, school districts and other governments with a June 30 fiscal year end must apply GASB 68 to their June 30, 2015, GAAP financial statements; governments with a December 31 fiscal year end must apply it to their 2015 GAAP financial statements.

Comparison to GASB 27

GASB 68 is an amendment to GASB Statement No. 27, "Accounting for Pensions by State and Local Governmental Employers." GASB 27 focused on a funding approach and recognized a liability on both the accrual basis and modified accrual basis for any unpaid contractually required contributions.

GASB 68 focuses on an earnings approach for recognizing a liability on an accrual basis as pensions are earned by employees. GASB 68 also recognizes a liability for payables to a defined benefit pension plan on both the accrual basis and modified accrual basis.

Under GASB 68, an intergovernmental payable will continue to be reported for any unpaid contractually required contributions at year end on both the accrual basis and modified accrual basis of accounting. On the "full-accrual" basis, governments will also report a net pension liability. A net pension liability will be recognized on the modified accrual basis of accounting to the extent 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 these benefits. Currently, no Ohio pension plans have net pension liabilities requiring recognition on the modified accrual basis.

Calculating the Net Pension Liability (NPL)

The NPL reported on the statement of net position represents a liability to employees for pensions. Pensions are a component of exchange transactions-–between an employer and its employees—of salaries and benefits for employee services. Pensions are provided to an employee—on a deferred-payment basis—as part of the total compensation package offered by an employer for employee services each financial period. The obligation to sacrifice resources for pensions is a present obligation because it was created as a result of employment exchanges that already have occurred.

The NPL represents the government's *proportionate share* of the actuarial present value of projected benefit payments attributable to past periods of service, net of the pension plan's fiduciary net position. The NPL calculation is dependent on critical long-term variables, including estimated average life expectancies, earnings on investments, cost of living adjustments and others. While these estimates use the best information available, unknowable future events require adjusting this estimate annually.

Selecting a measurement date The NPL is to 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. This determination is made by the employer.

Typically, a local government's fiscal year end is the same as the fiscal year end of the pension system. In this case, the local government can report their NPL as of their current year end or as of the prior fiscal year end. (IG 123, codified as 5.162.1) Once the measurement date is determined, it is to be consistently applied.

If a government participates in two separate pension systems, the employer is not required to use the same measurement date for each net pension liability. (IG 124 / 5.162.2)

Example: Assume a city contributes to OPERS. The city's and OPERS' fiscal years end December 31. For its 2015 financial statements, the city can elect to use OPERS' NPL measured as of December 31, 2015 or 2014.

Because OPERS' 2015 audited financial statements and schedules of pension amounts might not be available in time to meet the city's 150-day filing requirement (ORC 117.38), the city may use the NPL from OPERS' 2014 financial statements and schedules of pension amounts.

Proportionate share The proportionate share is a measure of the proportionate relationship of the employer to all employers within the pension plan. This percentage is typically based on employer contributions and will be calculated by the pension system.

Collective net pension liability The collective net pension liability is the NPL for benefits provided through a cost-sharing plan. This amount is measured as the portion of the actuarial present value of projected benefit payments that is attributed to past periods of employee service, net of the pension plan's fiduciary net positon. The net pension liability represents the liability of employers to employees for benefits provided through a defined benefit pension plan. This amount will be provided by the pension systems.

GASB 68 has specific requirements the pension systems follow related to determining the pension liability, including the actuarial valuation. These requirements address the timing and frequency of the actuarial valuation, the selection of assumptions, the projection of benefit payments, the discount rate, and the attribution of the actuarial present value of projected benefit payments to periods. Certain data maintained by the pension system is used in this calculation process. This data includes, birth date, hire date, gender and marital status and is collectively referred to as census data. This census data is subject to the pension plan's audit.

A local government's NPL is calculated by multiplying the pension plan's collective net pension liability by the local government's proportionate share percentage. If the local government reports proprietary or fiduciary funds, consideration should be given to NCGA Statement 1, paragraph 42, 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. (IG 122 / 5.161.2)

To allocate the NPL between governmental activities and proprietary or fiduciary funds, a method similar to the allocation made by the pension system (based on contributions) can be used or any other reasonable method.

Pension expense and deferred inflows/outflows Pension expense and/or deferred inflows/outflows are affected by changes in the collective net pension liability, items related to the calculation of the proportionate share and contributions made subsequent to the measurement date.

Changes in the collective net pension liability should be included in collective pension expense, except for the following which are components of deferred inflows/outflows:

1. Difference between expected and actual experience in the measurement of the total pension liability. *
2. Changes of assumptions *
3. Net difference between projected and actual earning on pension plan investments. **

*Amortized beginning in the current period over the average of the expected remaining service life of all employees that are provided with pensions determined as of the beginning of the measurement period. The expected remaining service life will be provided by the pension system.

**Amortized over a five year period

Information to calculate items 1 through 3 will be provided by the pension system.

Contributions to the pension plan from employers should not be included in collective pension expense.

Changes related to the calculation of the proportionate share include:

1. Change in the employer's proportion percentage*
2. Difference between the employer's contribution and the employer's proportional share of contributions. *

*Amortized beginning in the current period over the average of the expected remaining service life of all employees that are provided with pensions determined as of the beginning of the measurement period. The expected remaining service life will be provided by the pension system.

Items 1 and 2 can be reported net.

Contributions to a plan from the employer subsequent to the NPL measurement date and before the end of the employer's reporting period should be reported as a deferred outflow. For example, if an employer selects a measurement date one year *prior* to its current year end, it should report all contributions during the *current* year as deferred outflows. The contributions should be calculated on a GAAP basis, not a cash basis. (IG 147 / 5.169.1)

Other than employer contributions subsequent to the measurement date, there is no restatement required for deferred inflows/outflows (GASB 71). However, the restatement note should indicate if it includes deferred inflows of resources or deferred outflows of resources. Also, the reason for not restating prior periods should be explained.

Special Funding Situations

Special funding situations are circumstances in which a nonemployer entity is legally responsible for making contributions directly to a pension plan that is used to provide pensions to the employees of another entity or entities.

This should not be a common situation for Ohio local governments. Payments to STRS and SERS through a deduction from school foundation do not qualify as a special funding situation. Additional information related to special funding situations can be found in GASB 68 paragraphs 92 through 96.

Financial Statements

The employer's proportionate share of the collective net pension liability is not required to be displayed separately on the face of the financial statements; i.e. it is acceptable to include it with *liabilities due in more than one year*. However, for some governments, it will be a significant balance, and governments may prefer to display it separately on the face of the financial statements. Liabilities for net pension liabilities associated with different plans may be aggregated for display, and assets for net pension assets associated with different plans may be aggregated for display. However, aggregated pension assets and aggregated pension liabilities should be separately displayed. (IG 136 / 5.164.2)

Note Disclosure

The note disclosure requirements for cost sharing employers are identified in GASB 68 paragraphs 74 through 80. The total of the employer's pension liabilities, pension assets, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense/expenditure for the period associated with net pension liabilities should be disclosed if the total amounts are not otherwise identifiable from information presented in the financial statements. The notes should also include a description of the pension plan (GASB 68 ¶76), information about the employer's proportionate share of the collective net pension liability (GASB 68 ¶77 - ¶79) as well as other information (GASB 68 ¶80). These disclosure requirements are quite lengthy; refer to the referenced GASB 68 paragraphs for the specific requirements.

In addition, the amount of payables to a defined benefit pension plan outstanding at the end of the reporting period, significant terms related to the payables, and a description of what gave rise to the payable should be included in the notes to the financial statements.

The information needed to update the GASB 68 note each year is available in the pensions systems' audited schedules and the pension systems' ACFR.

~~Note disclosure shells are available on the Auditor of State's website at http://www.ohioauditor.gov/references/gasb68.html. We believe these examples meet the requirements of Statement 68. However, each governmental employer is responsible for comparing their disclosure with the aforementioned paragraphs in 68 to determine if their disclosure is complete and accurate.~~

Required Supplementary Information (RSI)

All cost-sharing employers need to present the following required supplementary information separately for each cost-sharing pension plan through which pensions are provided. (GASB 68 ¶ 81)

A 10 year schedule with amounts determined as of the measurement date of the collective net pension liability:

- The employer's proportion (percentage) of the collective net pension liability
- The employer's proportionate share (amount) of the collective net pension liability
- The employer's covered employee payroll
- The employer's proportionate share (amount) of the collective net pension liability as a percentage of the employer's covered-employee payroll
- The pension plan's fiduciary net position as a percentage of the total pension liability

If the contribution requirements of the employer are statutorily or contractually established, a 10 year schedule presenting the following with amounts determined as of the employer's most recent fiscal year-end:

- The statutorily or contractually required employer contribution
- The amount of contributions recognized by the pension plan in relation to the statutorily or contractually required employer contribution
- The difference between the statutorily or contractually required employer contribution and the amount of contributions recognized by the pension plan in relation to the statutorily or contractually required employer contribution
- The employer's covered-employee payroll
- The amount of contributions recognized by the pension plan in relation to the statutorily or contractually required employer contribution as a percentage of the employer's covered-employee payroll

Information contained in RSI schedules are different if the employer has a special funding situation.

Information about factors that significantly affect trends in the amounts presented in the RSI schedules should be presented as notes to the schedules.

Previously, covered payroll was defined as pensionable salary; however, under GASB 68, it is defined as the total payroll of covered employees. (IG 210 / 5.192.2)

The RSI schedules should not include information that is not measured in accordance with GASB 68 requirements.

The information for all periods for the 10 year schedules that are required to be presented as RSI may not be available initially. In these cases, during the transition period, that information should be presented for as many years as are available.

Transition

Governments should restate beginning net position. For example, a school district's June 30, 2015, statement of activities should reduce its previously-reported June 30, 2014, net position by the NPL applicable to June 30, 2014. (This would be the NPL computed as of June 30, 2013, if the school district selected a measurement date one year prior to its fiscal year end.)

Beginning net position should also be restated for any contributions made subsequent to the measurement date. As mentioned above, for the remaining deferred inflows/outflows, GASB 68 encourages, but does not require governments to allocate its beginning NPL between net position and deferred inflows/outflows.

Also refer to disclosure requirements related to the restatement of deferred inflows/outflows referenced in the discussion of the collective net pension liability above.

Defined Contribution Plans

On an accrual basis of accounting, pension expense related to defined contribution plans should equal the amount of contributions attributable to employees' services in the period and changes in the pension liability equal to the difference between the amount recognized as pension expense and amounts paid by the employer to the pension plan.

On a modified accrual basis of accounting, pension expenditures should be equal to amounts paid by the employer to the pension plan and the change between the beginning and ending balances of amounts normally expected to be liquidated with expendable available financial resources. This amount represents the extent that contributions are due and payable pursuant to legal requirements, including contractual arrangements.

GASB 68 paragraph 126 identifies the disclosure requirements related to defined contribution plans.

Applicability to Non-GAAP Entities

Governments that prepare Other Comprehensive Basis of Accounting (OCBOA) or Regulatory basis financial statements will not present their NPL on their financial statements and need not disclose their NPL in the notes. However, governments *statutorily* required to prepare GAAP statements, but that choose to prepare OCBOA or regulatory statements instead, will need to disclose pension information in their notes.

~~A sample OCBOA pension note for governments required to prepare GAAP statements but choose to prepare OCBOA statements is available on our website at:~~
~~http://www.ohioauditor.gov/references/gasb68.html~~.

The information needed to update the GASB 68 note each year is available in the pensions systems' audited schedules and the pension systems' ACFR.

Information Available from the Pension Systems

In February 2014, the American Institute of Certified Public Accountants (AICPA) issued two white papers related to the new pension standards. One white paper, "Governmental Employer Participation in Cost-Sharing Multiple-Employer Plans: Issues Related to Information for Employer Reporting" discusses two schedules that will be prepared by the pension systems and audited by the plan's auditor. These schedules will be available through the pension systems and will contain most of the information necessary to implement GASB 68.

Audit Considerations - Employer Responsibilities

While the pension systems will provide much of the information needed to report the NPL, deferred inflows, deferred outflows, and pension expense in their audited Schedule of Employer Allocations and Schedule of Pension Amounts, employers are likely to have to calculate a few of the deferred amounts and related amortizations as described in the *Pension expense and deferred inflows/outflows* section of this bulletin. Employers have various responsibilities related to the implementation of GASB 68. Among these responsibilities are:

- Determine an appropriate measurement date as described above.
- Report complete and accurate census data to the pension systems.
- Periodically reconcile contributions sent to the plan with payroll data.
- Evaluate the appropriateness of the information used to record financial statement amounts.
- Evaluate whether the pension system auditor's report on the *Schedule of Employer Allocations* and *Schedule of Pension Amounts* is adequate and appropriate for employer purposes.
- Verify the employer contribution amounts reflected in the S*chedule of Employer Allocations* agree with the employer's contribution records.
- Recalculate the allocation percentage.
- Ensure all of the employer codes associated with the government are included in the calculations.
- Recalculate the allocation of pension amounts based on the allocation percentage of the employer.
- Maintain all amortization schedules for deferred inflows/outflows and pension expense amounts.

Additionally, employers will need to provide management's representations to their auditors regarding the completeness and accuracy of the data provided to the pension systems as well as the appropriateness of the pension amounts reported in the financial statements. These representations should be included in the management's representation letter the auditors will obtain at the conclusion of the audit.

Audit Considerations - Employer Auditor Responsibilities

Employer auditors are responsible for opining on the financial statements of the employers. As part of the audit process, the employer auditors must obtain sufficient, appropriate audit evidence to reduce the risk of material misstatement to an acceptably low level. Since much of the information needed to calculate the proportionate share, NPL, deferred inflows, deferred outflows and pension expense is only available from the pension system, the pension systems will be preparing Schedules of Employer Allocations and Pension Amounts (the schedules) to provide the information to the employers. The pension system auditors will opine on these schedules in accordance with AU-C section 805.

Actuaries develop the estimates of the NPL, deferred inflows, deferred outflows and pension expense based on financial data and elements of non-financial data known as census data as discussed in the *Calculating the Net Pension Liability (NPL)* section of this bulletin. Since the actuarial valuations are based, in part, on this data and the schedules are prepared based on the actuarial valuations, the pension system auditors must gain assurances that the census data provided to the actuary is accurate and complete before they can opine on the schedules. To gain these assurances, the pension system auditors select samples of employers for census data testing, and identify the elements of census data for which assurances are required. For 2015, the AOS performed examination engagements for each of the employers selected by the pension system auditors and reported the results to the pension system auditors. The pension system auditors used these examination reports to provide assurances that the census data reported to the pension system was complete and accurate. For future years, pension system auditors will continue to select a sample of employers for census data testing. The AOS and/or IPAs will have to perform examinations on the census data elements and report the results to the pension system auditors.

Employer auditors will generally use the pension system auditor's reports on the pension system's financial statements and the audited Schedule of Employer Allocations and Schedule of Pension Amounts as audit evidence that the pension amounts allocated to the employer and included in the employer's financial statements are not materially misstated. Employer auditors have various responsibilities related to using this audited information from the pension systems including:

- Evaluate controls over reporting contributions to the plan.
- Test the contributions to the pension systems.
- Ensure the employer contributions amounts used to calculate the allocation percentage agrees with the employer's records.
- Recalculate the amounts provided in the audited schedules.
- Test all amortization schedules.
- Test the information reported in the notes to the financial statements to ensure all of the required disclosures are included.
- Review the required supplementary information to ensure it includes the required elements.
- Auditors are also responsible for evaluating whether the pension system auditor's report on the Schedules of Employer Allocations and Pension Amounts (the schedules) provide sufficient, appropriate audit evidence.

For AOS Audits: The Center for Audit Excellence (CFAE) will document and evaluate centrally:

- The professional qualifications of the actuary used by the pension systems;
- Whether the actuarial valuation date is appropriate;
- Whether the methods and assumptions used by the actuary are in accordance with GASB 68;
- The professional competence and independence of the pension system auditors; and,
- Whether the pension system auditor's report on the schedules is adequate to provide the sufficient and appropriate audit evidence.

The CFAE will provide a memo to AOS auditors documenting whether they can rely on the audited employer schedules.

For IPA Audits: IPAs will be responsible for their own evaluation of the pension system auditor's report on the schedules.

Resources Available on the Auditor of State's Website

The information needed to update the GASB 68 note each year is available in the pensions systems' audited schedules and the pension systems' ACFR.

~~The Auditor of State's Office has resources related to GASB 68's implementation available on our website at http://www.ohioauditor.gov/references/gasb68.html. The resources consist of shells for note disclosure and Management's Discussion & Analysis; samples which include financial statements and RSI; journal entries; and a FAQ document. These resources will be updated as further information becomes available.~~

Questions

If you have any questions regarding the information presented in the Bulletin, please contact Local Government Services at the Auditor of State's Office at (800) 345-2519.

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