PUBLIC PENSIONS: THE NEW FINANCIAL REPORTING AND AUDITING CHALLENGES

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The New GASB Pension Standards From The Perspectives of:

<u>Pension plan</u>

Minnesota State Retirement System (MSRS)

- Publishes standalone Comprehensive Annual Financial Report (CAFR)

<u>Employer</u>

Minnesota Management Budget (MMB)

- Prepares the State of Minnesota's annual CAFR

<u>Auditor</u>

Office of the Legislative Auditor (OLA)

- provides the audit opinions for both CAFRs

Minnesota State Retirement System

- 5 defined benefit retirement funds
- 4 defined contribution retirement funds
- State Employees Retirement Fund (SERF)
  - over 49,000 active contributing members
  - 36,500 members receiving benefits
- Members of SERF:
  - State of MN employees
  - non-instructional University of MN employees
  - Metropolitan Council employees
  - a handful of smaller agencies

New GASB Pension Standards

- GASB 67 – Financial Reporting for Pension Plans
  - Effective for fiscal years beginning after 6/15/13
  - Retirement systems
- GASB 68 – Accounting and Financial Reporting for Pensions
  - Effective for fiscal years beginning after 6/15/14
  - Gov't employers participating in retirement plans

* For the details of these standards, please refer to the GASB Statements 67 and 68.

Life before GASB 67/68…

- How well funded is the pension plan?
- Pension Plan CAFR
  - Funded status in Note to FS and schedules
  - Unfunded actuarial liability in Notes and schedules
- Employer CAFR
  - Funded status and unfunded actuarial liability in Notes and schedules
  - Pension expense in financial statements = required contributions to MSRS
  - Liability – minimal, if any

New Pension Reporting!

- Who cares about funding?
- Pension Plan CAFR:
  - Total Pension Liability (TPL) in Notes to FS
  - Net Pension Liability (NPL) in Notes (TPL – assets)
- Employer CAFR:
  - Employer share of NPL in their financial statements
  - Pension expense = Employer share of the change in NPL from the beginning to the end of the year

So how big a deal is this?

- SERF funded ratio on 6/30/14 = 83%
- Net Pension Liability = $1,621,572,000
- St of MN/component units=99% of NPL
  - + State Patrol Retirement Plan (MSRS)
  - + Correctional Employee Retirement Plan(MSRS)
  - + Judges Retirement Plan (MSRS)
  - + Legislators Retirement Plan (MSRS)
  - + others…

GASB 67 / 68 implications

- Change to MSRS CAFR
  - Change in Notes to the Financial Statements
  - Change in Required Supplementary Information
  - Change in Schedules
- Educate our stakeholders
  - MSRS Board of Directors
  - MSRS Employer units
  - MSRS members
  - News media
- The numbers

MSRS Approach:

- Learn as much as possible about the new standards
- Think about what our auditors and employer units will need

Learning as much as possible…

- Reading and re-reading the pronouncements, implementation guides, and articles published about the new standards
- Webinars
- GASB technical support
- Combined meetings with other pension systems (PERA, TRA, SPTRFA)

and more learning…

- Pension Standard phone calls (NASACT work group, P2F2 open forum)
- GASB requirements document
  - Essential to demonstrate GASB compliance
- Work with our actuaries
  - Early draft of a new GASB actuarial valuation report
  - Reconciliation schedule

GASB STATEMENT NO. 68 RECONCILIATION *(DOLLARS IN THOUSANDS)*

	Total Pension Liability (a)	Plan Fiduciary Net Position (b)	Net Pension Liability (a) - (b)	Deferred Outflows	Deferred Inflows	Pension Expense
Balance Beginning of Year	**$ 14,099,099**	**$ 10,033,438** [(2)]	**$ 4,065,661**	**$ -**	**$ -**	
Changes for the Year:						
Service Cost	$ 256,155		$ 256,155			$ 256,155
Interest on Total Pension Liability	922,181		922,181			922,181
Interest on Fiduciary Net Position [(1)]		$ 778,245	(778,245)			(778,245)
Changes in Benefit Terms	-		-			-
Liability Experience Gains and Losses	(44,023)		(44,023)	$ -	$ 35,218	(8,805)
Changes in Assumptions	(1,477,308)		(1,477,308)	-	1,181,846	(295,462)
Contributions - Employer		128,037	(128,037)			
Contributions - Employees		131,033	(131,033)			(131,033)
Asset Gain/(Loss) [(1)]		1,051,376	(1,051,376)	-	841,101	(210,275)
Benefit Payouts	(635,928)	(635,928)	-			-
Administrative Expenses		(8,125)	8,125			8,125
Other changes		20,528	(20,528)			(20,528)
Net Changes	**$ (978,923)**	**$ 1,465,166**	**$ (2,444,089)**	**$ -**	**$ 2,058,165**	**$ (257,887)**
Balance End of Year	**$ 13,120,176**	**$ 11,498,604**	**$ 1,621,572**	**$ -**	**$ 2,058,165**	

Source: Gabriel Roeder Smith & Company actuarial valuation report for the State Employees Retirement Fund, 6/30/2014

What do others need?

- Lots of education needed, but what else?
  - Employers
  - Auditors
  - Board
  - Members
  - Media

For our auditors:

- Decisions to be made:
  - Timing
    - When can the employers have their information?
    - When will GASB information be audited?
  - Actuarial Assumptions
    - Demographic
    - Economic
- Assumptions must be reasonable!

Discount Rate

- Projected benefit payments are discounted to their actuarial present values with the discount rate
- Statutory rate reasonable?
- Had an experience study done for economic assumptions
- Reasonable rate = 6.99 – 7.92%
- MSRS rate = 7.9%

The financial impact on NPL:

- 6.9% $ 3,272,613,000
- 7.9% $ 1,621,572,000
- 8.9% $ 249,639,000

For our employers:

- Decision: Provide information! Lots of it!
  - Newsletters
  - Meetings
  - Schedules from AICPA white paper
  - Additional schedules
  - Journal entries
  - Suggested Notes to the Financial Statements
  - Full-day technical training session

End Result:

- Issued our 2014 CAFR with unaudited GASB schedules by our 12/31/2014 statutory deadline
- Issued an Addendum to the MSRS CAFR in April 2015. Contained audited GASB schedules.
- Happy auditors, well-prepared employers
- www.msrs.state.mn.us/financial-information

Employer Perspective

- Educate stakeholders
- Scope of population
- Reaching consensus
- Employer's responsibility
- Allocation to Proprietary Funds

Collaboration

- Educate Stakeholders
  - Tracking Progress: Monthly updates with senior management
  - Meeting with Assistant Commissioners
    - Accounting Services
    - Debt Management
    - Budget
- Work with auditors early

Determine Potential Population

- Start with Official Statement – Pension disclosures
  - Employer Contributions
  - Pension-related local aid
    - Paid to local units of government – not special funding situation: GASB 68 paragraph 15
  - State appropriations – direct aid to state or local plans
    - Contributions related to pensions, or
    - Only entity legally obligated to make contributions

Complexity in Special Funding

- State appropriation set $ amount
  - No requirement to increase contribution unless statutory change
- State appropriation to Police and Fire (P&F)
  - Dependent on P&F AND State Patrol 90% funded
- Plans with multiple sources of funding
  - Direct Aid and amounts unrelated to pensions

Contact Plans

- Early in Process
  - State Retirement Systems
  - Local Government Plans
- Avoid Surprises

Discussion Items with Plans

- Special Funding Situations – consensus
- Plan Audit
- Plan Actuarial Reporting
  - Include GASB 67 and 68 compliance
  - Measurement date
  - Timing

Employers' Responsibility: Verify the Accuracy

- Employer Share Calculations
  - Compare to state's records
    - Contributions
    - Special Funding
  - Compare to Actuarial Report
  - Compare to Audited Financial Statements
- Understand Allocations and Assumptions
  - Review GASB 68 – ask questions if not clear

Allocation to Proprietary Funds

- Retirement Systems
  - TRA and PERA: Allocation to State agencies
  - MSRS: Allocation to State

Allocation Process

- Allocation to State
  - Includes State and component units with agency IDs
- Obtained Contributions by Plan and agency ID from Payroll Division
  - Compared to state's contributions in allocation for materiality

State Agency Challenges

- Communication and Education
  - Standard requirements
  - Allocation methods
  - Defining amounts and accounts
- Built entries for agencies
- Worked with external auditors
  - Allocation methods and assumptions used
  - Links to actuarial reports, employer allocations, sample note disclosures

Proprietary Fund Issues

- Created Fund Deficits
  - No requirement to pay without statutory change
  - Amounts will fluctuate significantly
    - Not a liability to manage the fund – exclude from rates calculations

Work with State's Auditor

- Strong working relationship
- Start early
  - Obtain consensus on approach

Audit Perspective

- Provide audit opinions on the state's CAFR, Minnesota State Retirement System as its plan auditor, as well as the Minnesota Sports Facilities Authority.

Actuarial Work

- FY2014, the OLA hired our own actuary to ensure the plan actuary for MSRS followed the profession's Actuarial Standards Board's (ASB) Actuarial Standards of Practice (ASOP), including:

- ASOP27, "*Selection of Economic Assumptions for Measuring Pension Obligations and Determining Pension Plan Costs or Contributions*"
  - Actuary is to construct a "best estimate range" and recommend a specific point within this range.
  - Revision of this standard just requires the actuary to select a "reasonable" assumption. Reasonable assumptions have no significant bias (neither significantly optimistic or pessimistic)
  - MSRS plan actuary suggested a discount rate ranging between 6.99 and 7.92%

- MSRS had a different discount rate than one of the other pension plans we provide audit opinions for.
  - We wanted to ensure that having a different discount rate was acceptable since the state's investments are all handled through our State Board of Investment, regardless of the retirement system.
  - Our actuary ultimately determined that the plan actuary followed the ASB's ASOP and the discount range provided to MSRS by the plan actuary was a reasonable assumption.
  - ASOPs specifically provide that two different actuaries can analyze the same situation and, using professional judgement, can arrive at two different assumptions, both of which may be reasonable.

- AICPA White paper recommended that cost-sharing plans prepare a schedule of employer allocations, which shows the proportionate relationship of each employer to all employers and the allocation percentage of the net pension liability (NPL).

- MSRS State Employees Retirement Fund NPL was $1.62 billion for the year ended June 30, 2014
  - State of MN was allocated approx 74% of NPL
  - University of MN (a component unit of the state) was allocated approx 16% of NPL
  - The Metropolitan Council (also a component unit of the state) was allocated approx 9% of NPL
  - These entities comprised approximately 99% of the total NPL
  - Approximately 15 smaller entities were allocated the remaining 1% of the NPL.
- The information from MSRS will fold into the state's CAFR prepared by MMB.

- Steps followed to validate MSRS' FY14 Schedule of Employer Allocations in its CAFR:
  - Used the state's payroll system (SEMA4) to independently determine the reasonableness of employer contributions reported by MSRS for the State Employees Retirement Fund (approx $94 million) to ensure allocation percentages were accurate.

- Steps followed to validate MSRS' FY14 Schedule of Employer Allocations in its CAFR:
  - Followed up on the impact of an audit by the University of Minnesota's internal audit staff of Employee Benefits and Retirement programs to ensure that all employer contributions were properly reported to MSRS as these employees are not on the state's payroll system.

- Steps followed to validate MSRS's FY14 Schedule of Employer Allocations in its CAFR:
  - Reviewed MSRS's correspondence with the Metropolitan Council to ensure their employer contributions were correctly reported to MSRS as their payroll information is also not in the state's payroll system.

- AICPA White Paper also recommends that cost sharing plans prepare a Schedule of Pension Amounts by Employer
- Steps to validate the reasonableness of the Schedule of Pension Amounts by Employer:
  - Elements that were determined by the plan actuary were verified to the actuarial report prepared for GASB 67/68 purposes

- Steps to validate the reasonableness of the Schedule of Pension Amounts by Employer:
  - Elements calculated by MSRS (i.e. the change in employer allocation percentages between FY13 and FY14, and the changes in employer contributions between FY13 and FY14) were verified to the proper documentation, including the guidance and requirements provided by GASB 68 to ultimately get to the amount of pension expense to be recognized in the financial statements.

- End Result: Providing an audit opinion that the information provided by MSRS to the various employer units (of which the state is the predominant one), plan auditors, etc, is accurate for their use in preparing their financial statements.

Questions?

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