

# When CalPERS Pension Debt Hits Your Budget

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## Agenda

- CalPERS and GASB 68
- Strategies for Unfunded Pension Liabilities
- Upcoming Accounting Changes
- Audit Firm Responsibilities
- Non-CalPERS Plans
- Allocation Issues
- Employer Responsibilities

# GASB 68 and CalPERS

Mary Beth Redding

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## GASB 68 Basics

- Unfunded liability on balance sheet
  - For some may exceed net position
- Significant additional disclosure
- Significant additional audit effort
- NO CHANGE TO REQUIRED CASH CONTRIBUTIONS

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# GASB 68 Pension Expense

- Year to year change in unfunded liability
  - Some changes are deferred
  - Recognized over short periods
- Pension expense  $\neq$  cash contributions

# GASB 68 Basics

- We think these liabilities are not news to bond analysts
  - May be more of a surprise to Councils and taxpayers

# What Is CalPERS Doing

- Separate GASB 68 reports
- Contain almost all information needed
  - Agent Plans: Reports published in July
  - Risk Pool (“Cost-sharing”) plans reports published early September
- Census data files also available now

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# What Is CalPERS Doing

- Agent plans (non-Risk Pool):
  - Net pension liability based on City’s pension obligation & assets
- Cost sharing (Risk Pool):
  - City’s net pension liability based on allocation of total plan’s liability
  - Allocation is complex

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## What Can an Actuary Do To Help?

- Prepare GASB 68 valuation for non-CalPERS plan
- Estimate the effect of data discrepancies
- Opine on appropriateness of assumptions
- Projections
- Other, not strictly actuarial assistance
  - Reconcile census data
  - Adjust for additional trust assets
  - Consolidate more than one plan
  - Allocation to funds/units

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## What Can an Actuary Not Do?

- Prepare GASB 68 valuation for CalPERS plan
  - Estimates won't match CalPERS actual results
  - For Cost-sharing plans, need to value entire risk pool and then allocate
  - No audit assurance unless GASB 68 valuation purchased from CalPERS

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# Strategies for Unfunded Pension Liabilities

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## Options

- Pension Obligation Bonds (POBs)
- Shorter amortization period
- Other
- Irrevocable Supplemental (§115) Trust

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## Shorter Amortization Period

- Discuss alternate amortizations with your CalPERS actuary
  - Examples in your valuation report
- Less interest and lower long term total payments
- Higher short term payments become “required”
- No immediate effect on GASB 68 net pension liability

## Other Ideas

- Council resolution to use one time money to reduce unfunded liability
- Council commitment to fund more than required contribution for a period of time
- Discuss with your auditor/CalPERS actuary in advance

## Irrevocable Supplemental (§115) Trust

- Employer creates a separate legal Trust to fund CalPERS benefits
- Can only be used to :
  - Reimburse for CalPERS contributions
  - Make payments directly to CalPERS
- Assets can **not** be used by Council for other purposes

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## Irrevocable Supplemental (§115) Trust

- Could be used for rate stabilization
- Reduces GASB 68 Net Pension Liability
  - GASB 68 disclosures and accounting adjusted
- Investments significantly less restricted than City assets. Typically:
  - Designed for long term returns
  - Likely much higher investment returns than City funds
  - Often less volatile investments than CalPERS

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# CalPERS and De-Risking

- De-Risking via glide paths
- Reduce volatility as assets & liabilities grow relative to payroll
- We believe this will
  - Increase contribution rates
  - Decrease GASB 68 discount rate → increase net pension liability

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# Upcoming Accounting Changes

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## 3 New GASB Statements

- 73: Unfunded pension plans
  - CalPERS Replacement Benefit Fund
  - FY beginning after 6/15/16
- 74: Accounting by OPEB Plans
  - FY beginning after 6/15/16
- 75: Employer accounting for OPEB Plans
  - FY beginning after 6/15/17

## 3 New GASB Statements

- All follow GASB Statements 67 and 68 very closely
- Unfunded plans measured using AA municipal bond rate → volatile
- Unfunded liabilities on the balance sheet

# GASB 75

- Net OPEB liabilities may be similar in size to net pension liabilities
  - Since pre-funding is not common
- We think these liabilities are not news to bond analysts
  - May be more of a surprise to Councils and taxpayers

## Audit Firm Responsibilities

**Ken Al-Imam**

# Audit Firm Responsibilities

- The AICPA has divided up the audit work that needs to be performed by assigning portions of that audit work to each of the following parties:
  - The audit firm for the plan
  - The audit firm for the employer
- The division of the audit work depends on the type of plan (agent or cost-sharing)
- The AICPA tried to be as practical as possible in deciding what each of these two firms must do with respect to this new pension standard

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## Cost Sharing Plans (Risk Pools)

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## Cost-Sharing Plans – Plan Auditor

- Most of the audit work must be performed by the plan's audit firm:
  - Test controls over the census data held by the plan (for active members, inactive members, and retirees)
  - Compare the census data applicable to active employees to the personnel records of the employer (for selected employers)

## Cost-Sharing Plans – Plan Auditor

- Since the pools have just one actuarial valuation that covers several employers, CalPERS must also engage their auditors (MGO) to opine on a schedule that breaks out by employer all of the relevant pension information applicable to that pool

# Cost-Sharing Report (Audited)

Employer Name	Net Pension Liability/ (Asset)	Difference Between Expected Actual Expense
Yolo Emergency Communications Agency	2,379,173	
Yolo-Solano Air Quality Management District	1,656,926	
Yorba Linda Water District	5,092,626	
Yuba Community College District	142,625	
Yuba County Water Agency	2,942,239	
Yuba Sutter Transit Authority	243,615	
Yucaipa Valley Water District	4,947,011	
Yuima Municipal Water District	2,120,073	
<b>Total for All Employers</b>	<b>\$ 6,222,464,124</b>	<b>\$</b>

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## Cost-Sharing Plans – Employer’s Auditor

- Read the audit report issued by the plan’s audit firm (MGO)
- Check that the proper percentage was used for the pension amounts applicable to that employer
- Document the competence and independence of the plan’s audit firm

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# Agent Plans

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## Agent Plans – Plan Auditor

- Two reports must be issued (and related audit work performed):
  - Issue a report on the completeness and accuracy of the census data that was obtained and held by CalPERS (using one of two reporting formats permitted by the AICPA)
  - Issue a report on the trust assets (“fiduciary net position”) that are held for each agent employer (using one of two reporting formats permitted by the AICPA)

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## Excerpts of MGO Census Report

“...census data used by the System’s in-house actuaries as of June 30, 2013 is complete and accurate based on the accumulation of census data reported by the System.....

In our opinion, management’s assertions referred to above are fairly stated, in all material respects, based on the California Public Employees’ Retirement Law and the respective employer contracts.”

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## Trust Assets (Fiduciary Net Position) Report

Employer Name:	<b>CITY OF BEVERLY HILLS</b>
Rate Plan Number:	<b>1</b>
<b>Additions:</b>	
Contributions:	
Employer	\$ 9,059,681
Plan Member	3,396,516
Net Investment Income	37,472,279
Total Additions	49,928,476
<b>Deductions:</b>	
Pension Benefits, Including Refunds	(13,121,431)
Administrative Expenses	(305,558)
Total Deductions	(13,426,989)
Net Increase (Decrease)	36,501,487
<b>Net Position Restricted for Pension Benefits:</b>	
Beginning of the Year	213,893,278
End of Year	\$ 250,394,765

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## Agent Plans – Employer’s Auditor

- Compare “employer contributions” in the preceding schedule to amounts reflected in the employer’s accounting records
- Ascertain whether the amount of “net investment income” reflected in the preceding schedule is reasonable in light of the “fiduciary net position” of the trust fund for this employer

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## Agent Plans – Employer’s Auditor

- Evaluate the reasonableness of the assumptions used in the actuarial valuation that formed the basis for determining the net pension liability
- Document the competence and independence of the actuary and the plan’s audit firm
- Obtain a copy of the census data that was provided by the employer to CalPERS and compare that data to the personnel records of the employer
- Inquire about significant changes in key totals for census data from the previous actuarial valuation to that used for the current audit period

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## Summary of Valuation Data

	<b>June 30, 2012</b>	<b>June 30, 2013</b>
<b>1. Active Members</b>		
a) Counts	512	496
b) Average Attained Age	47.17	47.94
c) Average Entry Age to Rate Plan	34.21	34.28
d) Average Years of Service	12.96	13.66
e) Average Annual Covered Pay	\$ 54,855	\$ 55,957
f) Annual Covered Payroll	28,085,596	27,754,665
g) Projected Annual Payroll for Contribution Year	30,689,889	30,328,272
h) Present Value of Future Payroll	214,094,138	205,909,765
<b>2. Transferred Members</b>		
a) Counts	157	160
b) Average Attained Age	46.07	46.52
c) Average Years of Service	3.70	3.86
d) Average Annual Covered Pay	\$ 93,905	\$ 95,636
<b>3. Terminated Members</b>		
a) Counts	234	222
b) Average Attained Age	45.56	46.65
c) Average Years of Service	3.35	2.92
d) Average Annual Covered Pay	\$ 39,014	\$ 39,309
<b>4. Retired Members and Beneficiaries</b>		
a) Counts	631	639

# Non-CalPERS Plans

# Primary Pension Plans Other Than CalPERS

- Some cities have their own primary pension plan
- If these plans are defined benefit plans, those cities must engage their own actuaries to provide the information required by GASB 68 to determine the net pension liability, related amounts, and all required disclosures (including required supplementary information)

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# Supplemental Retirement Benefit Plans

- Some cities have supplemental retirement benefit programs

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## Supplemental Retirement Benefit Plans – Defined Contribution Plans

- Many supplemental plans are defined contribution:
  - Amounts paid out to each retiree are limited to amounts contributed into that employee's account (plus investment earnings)
- Virtually no change in accounting for such plans from current practice
- The only liability recognized for these plans is the amount of any unpaid required employer contributions (that had not yet been remitted to the plan as of the end of the fiscal year)
- A liability for total future benefits is not recognized

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## Supplemental Retirement Benefit Plans – Defined Benefit (DB) Plans

- Some supplemental benefit programs are in the form of a defined benefit plan:
  - Amounts paid out to retirees are defined as a function of years of service or some other measure other than accumulated contributions into an employee specific account
- Those cities must engage their own actuaries to provide the information required by GASB 68 to determine the net pension liability, related amounts, and all required disclosures (including required supplementary information)

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# Audit Challenges for Supplemental DB Plans

- Many of these plans are “single employer” plans or “agent” plans
- Census testing must be performed by both the employer and the employer’s audit firm
- Trust assets must be audited

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# Audit Challenges for Supplemental DB Plans

- In some cases, trust 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
- In these cases, separate audited information must be provided for each employer’s “account” in this investment pool

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# Allocation Issues

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## Allocation Issues

- The net pension liability (and other related amounts) will need to be allocated to each fund or component unit that follows the accrual basis of accounting:
  - Enterprise funds
  - Internal service funds
  - Private purpose trust funds
  - Component units that follow the accrual basis of accounting
- Allocations will need be made to each of the above, only if the amounts are material

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## Allocation Issues

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- How should materiality be determined
- This is a judgment call by your audit firm
- Many firms consider 1% of total assets or total revenues to be material
- Assessed separately for the government-wide financial statements and each major fund

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## Allocation Issues

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- What should be the basis for the allocation?
- GASB 68 leaves this to the professional judgment of the reporting government
- GASB Cod. 1500.102 says that liabilities should be allocated to proprietary funds to the extent that they are:
  - Directly related to the fund, and are
  - Expected to be liquidated by the resources of that fund
- Many local governments are basing the allocation on the percentage of current year (2015) pension contributions that were paid by that fund

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## Allocation Issues

- What if there is something skewed or unusual about the 2015 distribution of the pension contribution to the various funds.
- For example, what if a fund had an unusual assignment of PERSable salaries because of an unusually high number of projects requiring direct labor dollars in 2015
- For these situations (which typically won't be material or common), you will want to adjust for such distortions – maybe use a recent year for which that fund's contribution toward the annual payment to the pension trust is more typical

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## Employer Responsibilities and Other Considerations

**Dennis Kauffman**

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## Employer Responsibilities: Agent Plans

- General principle – the local government (“employer”) is responsible for the amounts presented in its financial statements
- The AICPA white paper very precisely defines the measures that the employer must take to fulfill those responsibilities
- Verify the accuracy of all amounts in the audit reports that pertain to that employer

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## Employer Responsibilities: Agent Plans

- Management should obtain on an annual basis the census data file submitted by the plan to the actuary and determine whether the census data is complete and accurate.
- In evaluating the census data file, the employer should compare the information to underlying payroll records and the prior year census data file.
- The employer should prepare a roll forward of the census data from one year to the next and review a reconciliation for any significant differences.

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# Employer Responsibilities: Agent Plans

- City of Sacramento experience
  - Data request process
  - Data
  - Preliminary tests and conclusions
- City of Riverside experience
  - Data request process
  - Preliminary tests and conclusions

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# Employer Responsibilities: Agent Plans

- Communicate to the auditors your view regarding the reasonableness of the following assumptions that are reflected in your CalPERS actuarial valuation:
  - Long-term investment rate of return
  - Future salary increases
  - Future medical cost increases
  - Mortality rates
  - Inflation
- If you disagree with any of the assumptions, and the impacts are material to your financial statements, your agency will need to independently engage an actuarial firm to re-perform the actuarial valuation (in order to receive an unmodified opinion)

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# Employer Responsibilities: Agent Plans

- Agree with the “employer contributions” amount that is presented in that employer’s column in the multi-columnar “Schedule of Changes in Fiduciary Net Position by Employer” that CalPERS will be providing

# Employer Responsibilities: Cost-Sharing Plans

- Verify and recalculate amounts in the audited allocation schedules, including:
  - That the employer’s contribution amount that was used in the allocation agrees with the employer’s records
  - Recalculate the percentage used in these schedules for that employer
  - Recalculate the application of that percentage to the various amounts in the schedules

# GASB 68 Implementation White Paper

## ■ California Committee on Municipal Accounting

- California Society of Certified Public Accountants
- League of California Cities

## ■ Whitepapers

- California-specific accounting and financial reporting issues
- <http://blogs.calcpa.org/buzz/files/2015/05/GASB-68-White-Paper.pdf>

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## Outreach to Stakeholders

### ■ Identify and inform stakeholders

- City Council
- Labor groups
- Rating Agencies
- Public

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# GASB 68 Talking Points

- Accounting and Financial Reporting change
  - Not a cash flow change
  - Not a budgeting change
- New measure of pension liability
  - Different amounts than funding actuarial valuation
  - More volatility due to faster recognition of investment gains and losses

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# More GASB 68 Talking Points

- New terminology
  - Net pension liability
  - Actuarially determined contribution
- New transparency in financial statements
  - Formerly note disclosure only
  - Total net position or unrestricted net position may be negative

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# Even More GASB 68 Talking Points

- Financial statement data is one year in arrears
- Annual pension expense is no longer tied to cash-basis contribution required by CalPERS
- Two sets of CalPERS reports – funding and accounting

## Pension Obligation Bonds

- GFOA Advisory approved by GFOA's Executive Board in January 2015 recommends that state and local governments do not issue POBs for the following reasons:
  - The invested POB proceeds might fail to earn more than the interest rate owed over the term of the bonds, leading to increased overall liabilities
  - Complex instruments that carry considerable risk.

## Pension Obligation Bonds (cont.)

- Issuing taxable debt to fund the pension liability increases bonded debt burden and potentially uses up debt capacity that could be used for other purposes.
- Frequently extends repayment over a period longer than the actuarial amortization period, thereby increasing the overall costs.
- Rating agencies may not view the proposed issuance of POBs as credit positive, particularly if the issuance is not part of a more comprehensive plan to address pension funding shortfalls.

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## Questions?



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