



111 SW Fifth Avenue  
Suite 3700  
Portland, OR 97204  
USA

milliman.com

## MEMO

January 2016

To: Oregon PERS; Oregon PERS Employers  
From: Oregon PERS Actuaries (Matt Larrabee, FSA; Scott Preppernau, FSA)  
Re: **Introduction to GASB 68 for Oregon PERS Employers**

### **What is GASB 68?**

Governmental Accounting Standards Board Statement No. 68 (GASB 68) is an accounting standard governing financial reporting by governmental entities that participate in pension plans. It represents a significant change from the GASB 27 standard, which it replaces.

### **When is GASB 68 first effective?**

For employers with a July 1 fiscal year, the statement will first appear in the Comprehensive Annual Financial Report (CAFR) for the fiscal year ending June 30, 2015. Employers with a January 1 fiscal year will first implement GASB 68 in fiscal year end 2015 financial reporting.

### **How will GASB 68 affect the financial reporting of OPERS employers?**

Under the outgoing GASB 27 standard, the pension-related accounting information for most Oregon PERS (OPERS) employers resides only in the footnote disclosures and required supplementary information (RSI) of the financial report. This information does not affect the employer's statement of net position and is often not subject to external audit opinion.

Under the GASB 68 standard, the employer's statement of net position will include an entry for the employer's proportionate share of the system's overall unfunded liability. This change has the potential to materially impact the reported statements of net position of OPERS employers. In addition, since it is a statement of net position entry (rather than strictly a footnote) the pension-related information will likely receive a higher degree of scrutiny and review from employers, auditors, and other users of financial statements.

### **How (and when) is the GASB 68 unfunded liability calculated?**

For a cost-sharing, multiple-employer system such as OPERS, the GASB 68 unfunded liability calculations are done at a system-wide level. The GASB 68 term for the unfunded liability is the **Net Pension Liability (NPL)**, with NPL simply being the difference between system assets and system actuarial liabilities. The system NPL is calculated once a year, using the system-wide assets as of June 30 as calculated by OPERS with review from its external auditor. The assets

are then compared against system liabilities as of the same date, based on the results of an actuarial valuation with the liabilities reported from the valuation “rolled forward” to June 30 using standard actuarial techniques.

### **Can the GASB 68 unfunded liability be less than zero?**

Yes. The NPL, which is a comparison between assets and liabilities, will be a negative number if system assets exceed system liabilities. The assets for employers that have established side accounts are considered system assets for the GASB 68 NPL calculation since the side accounts are invested in the Oregon Public Employees Retirement Fund (OPERF), which is a legally restricted trust whose proceeds are solely for the benefit of OPERS members.

### **As of what date will initial GASB 68 employer unfunded actuarial liabilities be calculated?**

For an employer with a July 1 fiscal year, the NPL entry that appears on its June 30, 2015 CAFR will be based on the NPL comparison of system assets and system liabilities calculated as of June 30, 2014. The use of one-year lag reporting is permitted in the GASB statement, and will allow the calculations to be completed and audited in a timely manner. This in turn will give OPERS employers appropriate time to review their GASB 68 calculations and incorporate them into their audited financial statements.

### **If calculations are at a system level, how is each employer’s share determined?**

While GASB 68 mandates a single, annual system-wide calculation of NPL, it also provides guidance on how the ***proportionate share*** of the system NPL should be calculated for individual employers. The statement directs that:

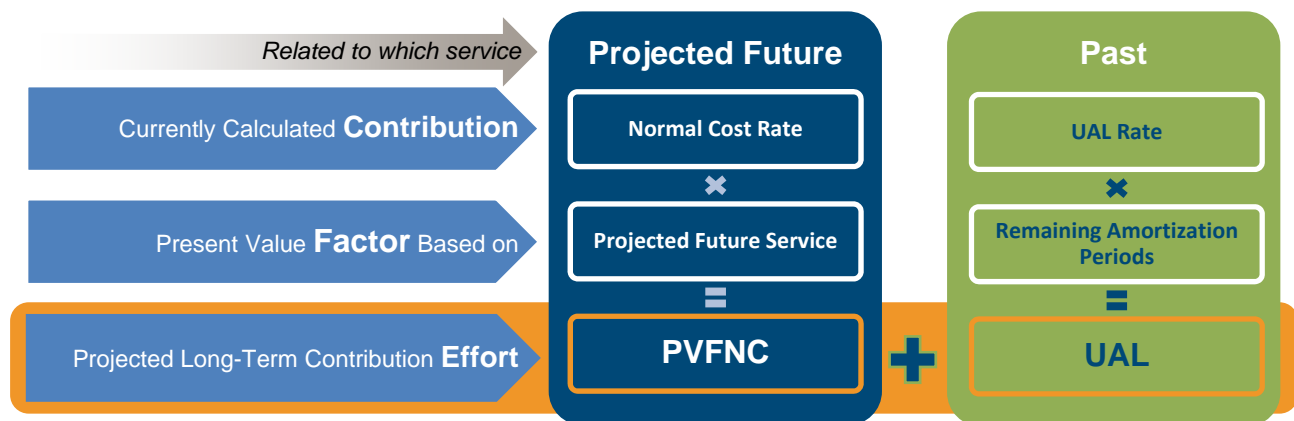
*The basis for the employer’s proportion should be consistent with the manner in which contributions to the pension plan...are determined. The use of ***the employer’s projected long-term contribution effort*** to the pension plan...***as compared to the total projected long-term contribution effort of all employers***...to determine the employer’s proportion is encouraged. [GASB 68, paragraph 48a, emphasis added]*

### **How is the “projected long-term contribution effort” estimated?**

Estimating the long-term contribution effort follows from understanding the general structure of OPERS contribution rates. The rates for every employer have at least two major components:

- ***Normal Cost Rate***: This is the economic value, stated as a percent of payroll, for the portion of each active member’s total projected retirement benefit that is allocated to the upcoming year of service. The rate is in effect for as long as each member continues in OPERS-covered employment based on the data and assumptions used in the actuarial valuation. The current value of all projected future Normal Cost Rate contributions is the ***Present Value of Future Normal Costs (PVFNC)***. The PVFNC represents the portion of the projected long-term contribution effort related to future service.

- UAL Rate**: If system assets are less than the actuarial liability, an Unfunded Actuarial Liability (UAL) exists. UAL can arise in a biennium when an event such as experience differing from the assumptions used in the actuarial valuation occurs. An amortization schedule is established to eliminate the UAL that arises in a given biennium over a fixed period of time if future experience follows assumption. The UAL Rate is the upcoming year’s component of the cumulative amortization schedules, stated as a percent of payroll. The present value of all projected future UAL Rate contributions is simply the **Unfunded Actuarial Liability (UAL)** itself. The UAL represents the portion of the projected long-term contribution effort related to past service.
- Looking at both rate components, the projected long-term contribution effort is just the sum of the PVFNC and the UAL. The PVFNC part of the contribution effort pays for the value of future service while the UAL part of the contribution effort pays for the value of past service not already funded by accumulated contributions and investment earnings. This is illustrated graphically below.

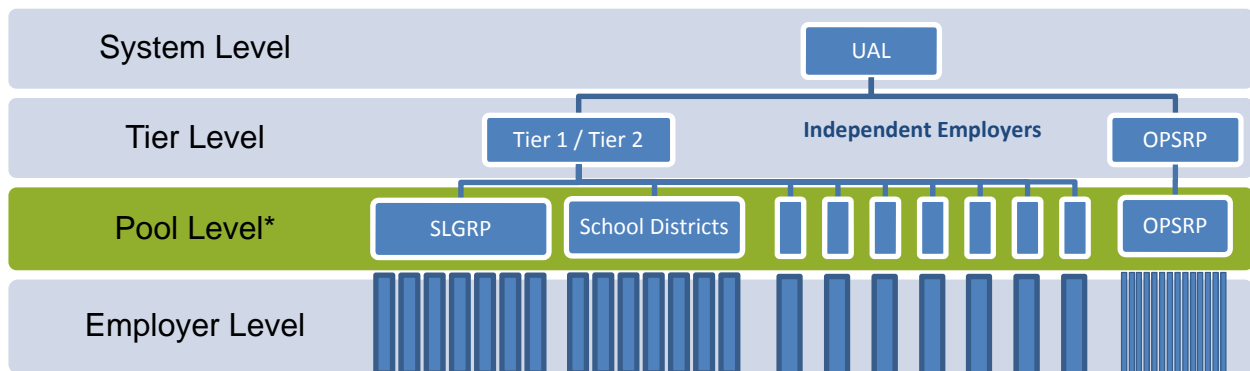


### How is each employer’s “projected long-term contribution effort” determined?

Each of the two contribution effort components, UAL and PVFNC, are first calculated at an employer-specific level. Many of those employer-specific components are then pooled. The sum of the components across all employers is the total projected long-term contribution effort.

The UAL has Tier 1/Tier 2 and OPSRP pieces. The Tier 1/Tier 2 piece is based on the employer’s Tier 1/Tier 2 pooling arrangement. If an employer participates in one of the two large Tier 1/Tier 2 rate pools [State & Local Government Rate Pool (SLGRP) or School Districts Rate Pool], then the employer’s Tier 1/Tier 2 UAL is their pro-rata share of their pool’s UAL. The pro-rata calculation is based on the employer’s payroll in proportion to the pool’s total payroll. For example, if the employer’s payroll is one percent of the pool’s total payroll, the employer will be allocated one percent of the pool’s UAL. The OPSRP piece of the UAL follows a parallel pro-rata approach, as OPSRP experience is mandatorily pooled at a state-wide level.

Employers that do not participate in a Tier 1/Tier 2 pooling arrangement, who are referred to as “Independent Employers”, have their Tier 1/Tier 2 UAL tracked separately in the actuarial valuation. The division of the UAL across employers is shown graphically below.



\* Unfunded liability at the pool level is allocated to an employer based on its proportion of the pool's total payroll.

An employer's PVFNC depends on both the Normal Cost Rates charged on the employer's payrolls, and on the underlying demographics of the respective payrolls. For OPERS funding, employers have three different payrolls, each with a different Normal Cost Rate:

- Tier 1/Tier 2 payroll
- OPSRP General Service payroll
- OPSRP Police & Fire payroll

The employer's Normal Cost Rates for each payroll are combined with system-wide present value factors for each payroll to develop an estimated PVFNC. The present value factors are actuarially determined at a system level for simplicity and to allow for the PVFNC calculations to be audited in a timely, cost-effective manner. Thus for each and every system employer, the PVFNC is calculated following the format in the table below.

	Employer Payroll	Employer Normal Cost Rate	Present Value Factor	Present Value of Future Normal Cost
Tier 1 / Tier 2	\$ 100,000	14.00%	7.0	\$ 98,000
OPSRP General Service	\$ 90,000	7.00%	9.0	\$ 56,700
OPSRP Police & Fire	\$ 10,000	11.00%	12.0	\$ 13,200
<b>Employer Present Value of Future Normal Cost</b>				<b>\$ 167,900</b>

**Are employer side accounts contemplated in the proportionate share calculation?**

Yes. After the employer's projected long-term contribution effort is calculated per the methodology described above, that amount is reduced by the value of the employer's side account. This is appropriate since the side account decreases the employer's projected long-term contribution effort because side accounts are effectively pre-paid contributions. (Employers with side accounts often carry non-pension liabilities on their statements of net position for the debt associated with their side account, since side accounts are frequently established through issuing pension obligation bonds.)

Side account deposits made between the valuation date and the Measurement date for which that valuation is used (for example between December 31, 2013 and June 30, 2015) are reflected in the proportionate share calculation based on the amount of the initial deposit. No adjustments are made for the passage of time between the valuation date and the deposit date.

**For employers in the SLGRP (State & Local Government Rate Pool), are Transition liabilities/surpluses and Pre-SLGRP liabilities/surpluses contemplated in the proportionate share calculation?**

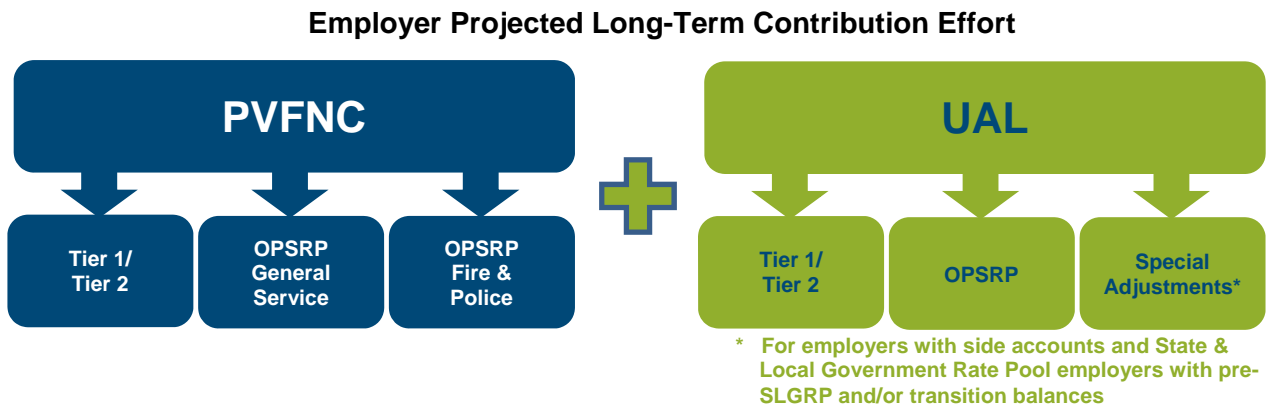
Transition surpluses and pre-SLGRP surpluses are reflected in the proportionate share calculation with the treatment paralleling the treatment of side accounts described immediately above. Adjustments are made to reduce employer's projected long-term contribution effort to reflect the current value of transition surpluses and pre-SLGRP surpluses.

The proportionate share calculation is not adjusted for transition liabilities and pre-SLGRP liabilities. Oregon PERS, in consultation with its external auditor, determined that such liabilities are considered "separately financed liabilities" under GASB 68. Under GASB, these amounts are already reflected in the Fiduciary Net Position as receivables. For consistency, Oregon PERS chose not to include the segment of overall contributions to finance those liabilities in the calculation of GASB 68 deferred outflows/inflows and not to reflect the balance of those liabilities in the proportionate share calculations.

**Can an employer's proportionate share of the projected long-term contribution effort be less than zero?**

No. If the calculation of the employer's projected long-term contribution effort yields a negative number, the employer's portion of the projected long-term contribution effort will be set to zero. Employers with a zero projected long-term contribution effort will not reflect a proportionate share of the NPL on their statements of net position, since their proportionate share of the projected long-term contribution effort is zero.

**What is the summarized individual employer's long-term contribution effort calculation?**



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