TRA | TEACHERS RETIREMENT ASSOCIATION

60 Empire Drive • Suite 400
Saint Paul Minnesota 55103
800 657 3669 • fax 651 297 5999

GASB Q&A FOR TRA EMPLOYERS

The Governmental Accounting Standards Board (GASB) is the independent organization that establishes standards of accounting and financial reporting for state and local governments and school districts. Recently, GASB fundamentally changed those standards as they apply to employers that offer pension benefits, including employers participating in TRA that must produce GAAP-compliant financial statements. Here are some frequently asked questions about the new requirements:

Q. What are the main GASB 68 requirements for me as an employer?
A. GASB 68 significantly changes pension accounting and financial reporting for state and local governments and school districts that prepare a separate summary set of financial statements on the accrual basis called "government-wide" financial statements by separating pension accounting methodology from pension funding methodology. GASB 68:

- Requires employers to include a portion of TRA's "net pension liability" (NPL) on the face of their government-wide financial statements.
- Changes the amount employers report as pension expense and defers some expenses or income to future years by using accounts called "deferred inflows of resources" and "deferred outflows of resources."
- Requires pension costs to be calculated by an actuary. In the past, pension costs were equal to the amount of employer contributions the employer unit sent to TRA during the year.
- Replaces most of the current footnote disclosures and required supplementary information with information based on new accounting and actuarial metrics.
- Changes the amortization periods that can be used for the different components that affect the pension plan's total pension liability.

Q. How are the new pension costs determined?
A. Pension plan actuaries will calculate the NPL, pension expense, deferred inflows and outflows of resources, collectively. TRA accountants will determine each employer's proportionate share (EPS) of those costs and develop schedules that supply employers with the information they need to complete their financial statements. The EPS is determined based on the employer's and other entities' non-employer's contributions for the year, as a percentage of total contributions received by TRA.

Q. What is the difference between "accounting" costs and "funding" costs?
A. Pension funding and pension accounting have different objectives. Separate actuarial valuations are performed annually to address each objective. The funding objective is to maintain reasonably stable contribution rates and to achieve an ultimate funded status of 100 percent over time. To achieve stable contribution rates, our actuarial funding methodology "smooths" out the effects of market fluctuations and amortizes the resulting pension liability over a longer time horizon. The objective of pension accounting is to record the financial events that affect the total pension liability when they occur. Thus, pension accounting calculates the total

TEACHERS RETIREMENT ASSOCIATION

60 Empire Drive • Suite 400
Saint Paul Minnesota 55103
800 657 3669 • fax 651 297 5999

pension liability using the fair value of investments at a single point in time and uses a short-term amortization period for components of the total pension liability.

Q. Will the implementation of GASB 68 cause contribution rates to increase?
A. No. GASB 68 amounts recorded in your financial statements are "paper" entries used for accounting and financial reporting purposes only. The Minnesota legislature will continue to base employer contribution requirements on TRA's actuarial funding report methodology, the objective of which is to maintain reasonably stable contribution rates and to achieve an ultimate funded status of 100 percent over time.

Q. Am I really liable for the net pension liability that will be on my books under GASB 68?
A. No. The net pension liability is recorded in your financial statements is an accounting estimate of your proportionate share of TRA's net pension liability at a specific point in time. That number will change from year to year, and is based on assumptions about the probability of the occurrence of events far into the future. Those assumptions include how long people will live, how long they will continue to work, projected salary raises, and how well pension trust investments will perform. Actuarially-determined amounts are subject to continual revision. In addition, TRA and the legislature historically have worked together to lower liabilities by "sharing the pain" among employers, active members and retirees. The 2010 and 2018 major pension reform laws were structured under this strategy.

Q. Will GASB 68 change the amount of contributions I make?
A. No. While your pension expense amount will change on your financial statements, it will no longer be the same amount as the actual contributions you pay, as it has been in the past. You will continue to be responsible to pay only your required contribution amount, a rate that's set in statute. Any funding weaknesses identified in the actuarial funding report may cause the Minnesota Legislature to increase employee and employer contribution rates.

Q. Why did the net pension liability (NPL) for fiscal year 2017 GASB 68 reporting more than triple from the NPL our school district reported in fiscal year 2016 financial statements?
A. GASB 68 requires employers to report 10-year trends of net pension liability and employer contributions. Until there is a full 10 years to report, employers can build toward that goal. Under GASB 68, the calculation of the net pension liability can be volatile during periods of investment market fluctuation or change in underlying actuarial assumptions implemented by the Minnesota Legislature. For example, the fiscal year 2017 GASB 68 net pension liability amounts reported tripled from the preceding year. The change in amount occurred during a negative investment return for TRA in fiscal year 2016 and the adoption of new member and retire mortality tables reflecting longer life expectancies.

TRA | TEACHERS RETIREMENT ASSOCIATION

60 Empire Drive • Suite 400
Saint Paul Minnesota 55103
800 657 3669 • fax 651 297 5999

Q. Why are some people concerned about the new accounting costs?

A. There are two concerns. The first is that employers must include their proportional share of TRA's liabilities on their balance sheets, even though it's not a liability that they are solely responsible for paying off, and that may be difficult to explain to the public. The second concern is that TRA has two actuarial valuation reports (funding and accounting), which may be confusing to those who set policies. The true health of a pension plan is determined by the funding costs and funding policy, not by the new accounting valuation report used for GASB 68 reporting. The Legislature continues to use the actuarial funding valuation report when evaluating the need for contribution rate adequacy, benefit provisions and other policy reviews.

Q. What has been the experience of the two accounting valuation reports in recent years?

A. The two actuarial valuation reports for fiscal years 2018 and 2019 have produced results very similar to one another. As of July 1, 2019, TRA's net pension liability was $6.37 billion, a slight increase from $6.28 billion on July 1, 2018.

Q. Could the single-equivalent interest rate method every happen again?

It is possible to again trigger the SEIR if a deep decline in the fair value of TRA assets occurs or an extended bear market in the investment environment. The SEIR tends to produce sudden, sharp spikes in the Net Pension Liability. TRA management does not believe that will occur with the July 1, 2020, accounting valuation report that TRA school districts will report in the fall of 2021.

Q. When will the results of the July 1, 2020, accounting valuation be known?

TRA management estimates that the NPL for the fiscal year ended June 30, 2020, may show a slight rise from the fiscal year 2019 amount of $6.38 billion. Final results will be known in early 2021 and distributed to schools in May 2021.