



MARYLAND
STATE RETIREMENT
and PENSION SYSTEM

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R. Dean Kenderdine
Executive Director
Secretary To The Board

April 30, 2018

Dear Participating Governmental Unit in the Maryland State Retirement and Pension System:

Re: Guidance on Adoption of GASB No. 68

Introduction

The Maryland State Retirement and Pension System (“the System”) implemented the Government Accounting Standards Board (GASB) Statement No. 67 (Financial Reporting for Pension Plans) which was effective for the System’s FY2014 financial statements. For the years ending June 30, 2015 and thereafter, GASB’s Statement No. 68 (Accounting and Reporting for Pensions) are effective for the financial statements of the System’s participating employers.

The System is a cost sharing, multi-employer defined benefit pension plan for the employees and school teacher personnel for the State’s 24 subdivision boards of education and certain local governmental entities that chose to participate in the System. These “Participating Governmental Units” (“PGUs”) were required to adopt GASB No. 68 in its financial statements for the year ending June 30, 2015. As a PGU of the System, you are required to report its proportionate share of the System’s unfunded liability as of the close of its 2015 fiscal year and each fiscal year thereafter. This letter is to assist you in the adoption of this standard. This information needed from the System to adopt GASB No. 68 can be located at www.sra.maryland.gov/Employers.

Boards of Education Special Funding Situation

Before discussion of the process used to calculate and allocate the net pension liability, it is important to understand Maryland’s particular situation concerning the payment of employer pension costs for Maryland’s teacher population under the 24 Boards of Education (BOE).

At the time that the GASB’s changes were under consideration, an initiative for pension cost sharing was before the 2012 session of the General Assembly. This legislation, which did become law, required each BOE to begin paying the “normal cost” for their teachers starting in FY 2013. It was actually structured as a four-year phase-in to the full normal cost so that 50% was paid in FY2013. Full normal cost is to be paid in FY2017 and each year thereafter.

It was then evident that a serious question as to the responsibility of our local Boards of Education insofar as their own financial reporting requirements were concerned was before us. In that the local jurisdictions were now responsible for a portion of the pension cost, albeit the normal cost, and none of the accrued unfunded liability for teachers, would the local governments have any responsibility regarding the liabilities related to the net pension liability associated with teachers?

Because the State of Maryland pays the unfunded liability and the local jurisdictions pay the normal cost for the teachers' pension, the local Boards of Education are not required to record their share of the unfunded pension liability but instead, that liability is to be recorded by the State of Maryland.

Because the State of Maryland must record the liability for the Boards of Education and because the State of Maryland and the Boards of Education did not fully contribute their normal and past service costs for the teachers' pension, our calculation is adjusted to account for total contributions to ensure the Boards of Education's liability was not improperly allocated to other Participating Government Units.

For Boards of Education, Community Colleges, Libraries, and others note that if you have employees who are members of the employees' pension system (i.e., non-teachers), you do have a responsibility for the funding of those employees contributions and therefore are allocated a proportional share of the net pension liability. The proportional share is based on the employer contributions for those employees only (i.e., you are not being allocated based on the contributions made for the teachers system).

Unfunded Liability Calculation

As explained in my earlier correspondence, the System developed the allocation of the net pension liability by following these steps:

- 1) Calculate the net pension liability as of June 30, 2017, for the entire System in accordance with the provision of GASB No. 67.
- 2) Determine the total contributions to the System by the State and PGUs, inclusive of any underfunding of contributions.
- 3) Based on the number of participants at each BOE, calculate the difference between what each BOE would have contributed if they funded at the rate of all other participating governments and what the BOE actually contributed. The difference between what the Boards contributed and what they would have contributed if they funded at the rate of the other participating governments, is then added to the total contribution to the System, to calculate the System's adjusted calculation.

Note: The purpose of this adjustment to the total System contribution for the share of the Board's contribution that is paid for by the State (BOE's share of unfunded liability to be paid for by the State) is because the State will not fund its share in the current year and we do not want the participating government's share of the total contribution to be greater because of the State's share not being contributed.

- 4) Calculate for each participating government, their percentage of the adjusted System contribution by dividing the total adjusted System contribution into each PGU's contribution.
- 5) Provide each PGU its adjusted percentage of contribution and the System's net pension liability and other related amounts as of June 30, 2017, under the GASB No. 67 requirements.

Information Provided

In accordance with GASB No. 68, we are also providing an audited FY 2017 schedule of contributions and pension amounts. These schedules have been audited in accordance with auditing standards generally accepted in the United States of America and are located at the website above.

The key actuarial assumptions used to perform the June 30, 2017 pension liability calculation are as follows:

Actuarial	Entry Age Normal
Amortization Method	Level Percentage of Payroll, Closed
Inflation	2.65% general, 3.15% wage
Salary Increases	3.15% to 9.15%, including wage inflation
Discount rate	7.5%
Investment Rate of Return	7.5%
Mortality	RP-2014 Mortality tables

System's Verification of Accuracy of Census Data

The development of the calculation of the net pension liability is a process that is done on an annual basis based on information provided by the State of Maryland and the PGUs. The System performs various activities to review the accuracy of the census data and contributions. These activities include, but are not limited to, the following:

- 1) The System routinely reconciles all census data provided by the PGU's to the contributions received from each PGU to provide certain assurance that the census data is not unreasonable;
- 2) The System identifies issues and discrepancies and works with each PGU to rectify the items; and
- 3) Each PGU is subject to a triennial audit in which auditors, on behalf of the System, audit the reported payroll data to ensure that the information includes the correct census data, thereby validating that the data held by each PGU is sufficient to support a clean audit insofar as its proportionate share of the unfunded liability is concerned.

Example Journal Entry

The following is a generic journal entry example to assist you in recording GASB 68 activity. Individual journal entries may be different based on individual facts and circumstances specific to you.

The following entry is based on these assumptions:

- June 30, 2016 PGU's Share of Net Pension Liability: \$50,000,000
- June 30, 2017 PGU's Share of Net Pension Liability: \$58,000,000
- June 30, 2017 Pension expense: \$5,000,000
- June 30, 2017 Deferred inflow (2017 level only): \$(1,750,000)
- June 30, 2017 Deferred outflows (2017 level only): \$10,000,000
- June 30, 2017 Deferred inflow amortization: \$1,500,000 (PY total of \$7.5 million amortized over 5 years)
- June 30, 2017 Deferred outflow amortization \$200,000 (PY total of \$1.0 million amortized over 5 years)
- Year end June 30, 2017 contributions: \$8,000,000
- Year end June 30, 2018 contributions: \$6,000,000

Note: The amounts above, except contributions, may be found on the schedule included in the website noted above. The June 30, 2017, 2016, and 2015 deferred inflows and outflows would come from your financial statements. Contributions would come from your financial information.

June 30, 2018 Journal Entries

Debit: Pension expense - \$8,000,000
Credit: Deferred financing outflow - \$8,000,000
Debit: Deferred financing outflow - \$6,000,000
Credit: Pension expense (contributions) - \$6,000,000

To record the pension expense for measurement period (2017) in the current fiscal year related to contribution activity.

Debit: Pension expense: \$8,000,000
Credit: Net pension liability: \$8,000,000

To record the change in the net pension liability (calculated as current year NPL (\$58,000,000) less beginning of year NPL (\$50,000,000)).

Debit: Deferred financing outflow: \$10,000,000
Credit: Pension expense: \$10,000,000
Debit: Pension expense: \$1,750,000
Credit: Deferring financing inflow: \$1,750,000

To record the 2017 deferred financing inflows and outflows related to items allowed to be amortized by GASB 68 (changes in experience, actuarial assumptions and investment activity).

Debit: Pension expense: \$200,000
Credit: Deferred financing outflow: \$200,000
Debit: Deferred financing inflow: \$1,500,000
Credit: Pension expense: \$1,500,000

To record the amortization of the 2016 deferred financing inflows and outflows related to items allowed to be amortized by GASB 68 (changes in actuarial assumptions and investment activity). Note that you should have amortization entries for each year of deferred outflows and inflows (there is only one for example purposes, but you should have 2015 and 2016 if you have recorded deferred outflows and inflows each year).

Additional information for footnote disclosure and required supplemental information can be found in the schedule noted above, the System's financial statements or from your financial data.

Other Items

GASB 68 will affect each PGU differently and the schedule has been prepared on a consistent basis for all PGU's. Each PGU may have individual facts and circumstances that may affect the net pension liability calculation. Each PGU should consider the calculations of change in proportional share based on their individual circumstances. In the contribution schedule, the System has provided a comparison of contribution rates to allow the PGU to calculate the balances of deferred outflows/inflows related to change in proportional share.

Summary

Considerable attention has been given to the current GASB requirements, how they will generate new numbers on the face of defined benefit plan sponsors' financial statements, and how the numbers may fluctuate year to year. The fact remains however, that the change implemented in 2015 was a change in accounting rules only, and does not affect the funding requirements for any pension system, including Maryland's. Maryland and its participating employers will continue to fund our pension plans according

to statute as it always has. Maryland will continue to progress toward full funding of its pension obligations in the well planned and manageable manner it has established. Funding requirements will not change as a result of the new GASB Statement No. 68.

We believe this information will prove useful to each of the System's participating employers and will facilitate clarity and understanding of the new liability numbers to be recorded in the financial statements. We also expect that this effort will help to ensure an understanding among local officials, and the citizens they represent, as to what these new pension numbers mean and what they do not.

As stated last year and continuing forward you can count on the availability and support of not only this agency, but the Retirement and Pension System's actuary (Gabriel Roeder Smith & Co.) and auditor (SB & Company, LLC.). Please contact me at any time at (410) 625-5600 or dkenderdine@sra.state.md.us.

*Finally, in an effort to more efficiently manage all future communications regarding GASB No. 68, I am asking all recipients of this letter to **please provide my office with your email address**. Please send your email address to: jsirkis@sra.state.md.us. Thank you.*

Sincerely,

A handwritten signature in black ink, appearing to read 'R. Dean Kenderdine', with a long horizontal flourish extending to the right.

R. Dean Kenderdine
Executive Director