

Pensions and Other Fiduciary Activities

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Textbook: Government and Not-for-Profit Accounting, Granof

- This presentation contains information, in addition to the material prepared and provided by the professor, from the book Government and Not-for-Profit Accounting, 7th. Ed., Granof which is the textbook assigned for the course CONT 4059 – “Contabilidad para Entidades que no son Negocios” at the University of Puerto Rico, Río Piedras Campus.



Pensions

Pensions

1.1 General

- The accounting for pensions is, and no doubt will continue to be for many years to come, among the most important, yet controversial, issues of our era..
- The accounting for pensions would be important for no other reason that the magnitude of the assets and liabilities involved.

Pensions

1.1 General



California Public
Employees' Retirement
System
(June 30, 2014)

\$301.8 billion assets

California State
Teachers' Retirement
System
(June 30, 2014)

\$190.4 billion assets

The liabilities are no less huge.

Pensions

1.2 Type of Pension Plans

Pensions

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1. Defined Contributions Plans:

Pensions

1.2 Type of Pension Plans

1. Defined Contributions Plans:

- **Definition:** An employer agrees to make a series of pension contributions to a pension fund. Typically, the amount is expressed as a percentage of each employee's salary, and very often the pension fund is totally independent of the employer.
- *Example:* A College may contribute 8% of a faculty member's salary to the pension plan, provided that the faculty member also contributes a corresponding percentage.

Pensions

1.2 Type of Pension Plans

1. Defined Contributions Plans:

- **Employee Risk:**

- The employee bears all the investment risks. If the investment portfolio does well, the employee reaps the benefits.
- If it does poorly, it is the employee who will have to cut back on his or her anticipated retirement lifestyle.

Pensions

1.2 Type of Pension Plans

1. Defined Contributions Plans:

- **Financial or Accounting Complexities:**
 - The employer reports an annual expense for the amount that it is obligated to contribute to the pension fund.
 - As a result, the plan has no unfunded actuarial liabilities.

Pensions

1.2 Type of Pension Plans

2. Defined Benefit Plans:

Pensions

1.2 Type of Pension Plans

2. **Defined Benefit Plans:**

- **Definition:** The employer specifies the benefits, the actual pension payments, that the employee will receive.
- Usually the benefits will vary according to length of service and salary.

Pensions

1.2 Type of Pension Plans

2. **Defined Benefit Plans:**

- **Employer Risk:** The employer guarantees the outputs, not the inputs. It is, therefore, up to the employer to ensure that it sets aside sufficient resources each year to make the required payments.

Pensions

1.2 Type of Pension Plans

2. Defined Benefit Plans:

- **Financial or Accounting Complexities:** Both funding and accounting decisions relating to defined benefit plans are complex, mainly because of the uncertainties about the amounts that will have to be paid to the retirees **and** that will be earned on fund investments.

Pensions

1.2 Type of Pension Plans

2. Defined Benefit Plans:

- **Key Uncertainties:**

- Employee life expectancy
- Employee turnover rates
- Future wage and salary rates
- The investment returns on pension fund assets



Pension Accounting

Pension Accounting

2.1 GASB Approach Rationale

- The GASB approach is grounded on the assumption that pensions are a form of compensation that is provided to employees in exchange for the services that they provide to the government.

Pension Accounting

2.2 Employer Measure the Pension Obligation

- Per GASB Statement No. 68, the government employer is required to report as its pension liability the difference between the **total pension liability** and the **net plan position**.
- Total pension liability = Actuarial determination.
- Net plan position = Total assets less liabilities.

Pension Accounting

2.2 Employer Measure the Pension Obligation

- Per GASB Statement No. 68, the government employer is required to report as its pension liability the difference between the **total pension liability** and the **net plan position**.

● Total pension liability = Actuarial determination. **\$100,000**

● Net plan position = Total assets less liabilities. **60,000**

Pension Liability **\$40,000**

Pension Accounting

2.3 Total Pension Liability

- The GASB specifies that for purposes of accounting and reporting, the allocation must be made using a method called the **entry age actuarial cost method**.
- This method allocates the present value of the projected benefits over the course of an employee's career as a level percentage of payroll.
- The total pension liability as of a specific date is that portion of the present value of projected benefits that has been allocated to the past years up through that date.

Pension Accounting

3.1 Financial Statements

Pension Accounting

3.1 Financial Statements

- Statement of Fiduciary Position
- Statement of Changes in Fiduciary Net Position

See pages 434 and 435.