RICK SNYDER
GOVERNOR

STATE OF MICHIGAN
DEPARTMENT OF TRANSPORTATION
LANSING

KIRK T. STEUDLE
DIRECTOR

September 23, 2015

To: Act 51 Transit Agencies that Incur Pension Expense based on Actuarial Reports

Subject: Calculating and Reporting Pension Pursuant to GASB 68 and GASB 71

In June 2015, the Governmental Accounting Standards Board (GASB) issued "GASB 71" *Pension Transition for Contributions Made Subsequent to the Measurement Date—an amendment of GASB Statement No. 68.* "GASB 68" *Accounting and Financial Reporting for Pensions* is effective for fiscal years beginning after June 15, 2014. In response to the issuance of these GASBs, Michigan Employees' Retirement System (MERS) issued the "GASB 68 Implementation Guide" which incorporates the GASB 71 requirements. The Implementation Guide provides guidance to prepare financial statements, and gives examples to construct schedules, journal entries, note disclosures, and other required supplementary information. This Implementation Guide, issued based on different local year-ends, is located at http://www.mersofmich.com/Employer/Work-Scenarios/GASB-68.

GASB 71 is the latest of several statements that were issued after the Office of Passenger Transportation (OPT) issued its Local Public Transit Revenue and Expense Manuals (R&E Manual). The Comprehensive Transportation Fund (CTF) Administrative Rules requires the R&E Manual to be promulgated annually and finalized for inclusion in the annual application process. Essentially, this means that the drafting of each R&E Manual occurs approximately two years prior to its use. This early issue date complicates OPT's efforts to timely incorporate changes required by the GASB statements. Because of the complexity of the GASB statements, the significance of the dollar amount associated with pension costs, and the paramount importance to treat all transit agencies statewide equally, OPT has decided to: (1) adopt the MERS GASB 68 Implementation Guide as the standard for calculating defined benefit pension expense, and (2) make the change retroactive to the FY 2015 and FY 2016 R&E Manual.

Calculating 50220 DB Pension Expense

All transit agencies, whether a member of MERS or not, must calculate 50220 DB Pension expense pursuant to the methodology in the MERS GASB 68 Implementation Guide. The Table of Contents to the Implementation Guide identifies the six steps required to calculate an accrual-based pension expense:

Step 1: Calculate Interest on Total Pension Liability
Step 2: Calculate Net Pension Liability
Step 3: Calculate the Recognition of Experience & Assumption Changes
Step 4: Calculate the Projected Investment Return & Recognition of Investment Gain or Loss
Step 5: Update the Deferred Outflows and Inflows Spreadsheet
Step 6: Calculate Pension Expense

Pension expense reported in 50220 DB Pension must agree with the "Total Pension Expense recognized" as calculated in STEP 6. If the uniqueness of a particular non-MERS defined benefit pension plan requires deviating from the MERS methodology, prior written approval is required by OPT. Pension expense not calculated pursuant to the MERS Implementation Guide and/or without the written approval of OPT are not eligible for 41101 State Operating Assistance reimbursement.

A transit agency is entitled to 41101 State Operating Assistance reimbursement for its entire 50220 pension cost when the cost is both expensed on the books and actually paid (e.g., an out-of-pocket payment). Pension costs expensed on the books but not paid must be subtracted out under 58020 Ineligible DB Pensions. This ineligible pension expense can be "tracked" and is eligible for 41101 State Operating Assistance reimbursement in the year paid. When paid, the payment amount is reported as a *negative* ineligible expense in 58020 Ineligible DB Pensions. Contributions made in excess of the calculated pension expense[1] can also be "tracked" and then matched to pension expense incurred in a subsequent year. This matching of unpaid pension expense in one year with an excess pension payment from another year is only permitted if the CPA audit tracks these amounts in a schedule reported in the Notes to the Financial Statements.

Reporting for Quarterly and Reconciled OARs

The information necessary to calculate the six-step accrual-based pension expense may not be available until the end of the third fiscal quarter (e.g., June 30th). Until the requisite information is available, quarterly reporting of 50220 DB Pension expense should equal the amount of pension contributions actually *paid* in that quarter necessary to cover the estimated pension expense. Because pension expense is only eligible to the extent paid, reporting quarterly pension expense on a cash basis produces the most reliable number for quarterly reporting purposes. When the information becomes available, the annual accrual-based pension expense calculated pursuant to the six-step process should be reported on the reconciled OAR and equitably prorated on the third and fourth quarterly OARs taking into consideration the "cash-based" pension expense reported in the first two quarters. The proration to "reconcile" the third and fourth quarters with the first two quarters should not create a large discrepancy causing a "reporting" hardship or windfall. However, if such occurs, it will be addressed on an individual basis.

Annual CPA Audit Requirements

1. The MERS Implementation Guide states:

> Net Pension Liability does not necessarily need to have its own line in your financial statements; this determination will depend on the size of the liability relative to other items on your financial statements.

In order for pension expense to be eligible for 41101 State Operating Assistance reimbursement, the Net Pension Liability number must have its own line in the financial statements. For disclosure and reporting purposes, GASB may not require its own separate line, but for reimbursement purposes, OPT does require it. The

[1] Again, that being "Total Pension Expense recognized" as calculated in STEP 6 of the MERS GASB 68 Implementation Guide.

presentation of the calculation of pension expense in the financial statements must be detailed such that OPT can verify the pension calculation required by the GASB 68 and MERS Implementation Guide.

2. For a transit agency to be eligible to match an unpaid pension expense in one year with an excess contribution paid from another year, the annual CPA audit must contain a schedule in the Notes to the Financial Statements that track: (1) pension costs expensed on the books, but not paid, and subtracted out under 58020 Ineligible DB Pensions, and (2) contributions made in excess of the calculated pension cost that has yet to be expensed on the books. OPT's policy to allow the matching of unpaid pension expense in one year with an excess pension payment from another year adds complexity to an already difficult calculation. Thus, such matching is only permitted if the annual CPA audit maintains a tracking schedule in the Note to the Financial Statements.

3. If the transit agency participates in a county or city-wide pension/OPEB plan, the transit portion must be broken out and reported separately in the transit portion of the annual CPA audit.

The possibility exists that different entities will have different year-ends. For example, a transit agency with a June 30th local year-end uses actuarial information based on a measurement date ending December 31st when OPT requires reporting on a September 30th year end. Under this scenario, a transit agency may choose a 12-month period to report retirement expenses and the associated ineligibles provided the same 12-month period is consistently applied year after year.

The accounting for retirement benefits is complex with its methods of measurement and recognition. Complying with GASB's reporting and disclosure pronouncements should not undermine the intent of Public Act 51 of 1951, as amended, which is to reimburse actual expenses incurred for public transportation purposes. If upon receipt of this letter, the 2015 CPA audit is substantially complete such that incorporating the required schedules would delay the issuance of the audit, please contact Trish D'Itri, Auditing Specialist, at ditrit@michigan.gov or at (517) 335-2535, to make arrangements to submit the required schedules separately.

If you have any questions or need assistance, please contact Trish.

Sincerely,

Sharon L. Edgar, Administrator
Office of Passenger Transportation