County of Fairfax, Virginia

MEMORANDUM

DATE: August 20, 2013

TO: Board of Supervisors

FROM: Susan W. Datta, Chief Financial Officer

SUBJECT: Change to Presentation of Annual Financial Statements: Pension Liability

Increasing attention has been given in recent years to the impact of pension benefits on the fiscal affairs of state and local governments. Until now, the emphasis in financial reporting has been on comparing the resources put aside for pensions with amounts that should have been funded for this purpose. Governments have been free to choose from a number of options to value their investments and to determine the annual expense of providing for future benefits. Moreover, this information has been found mainly in notes to financial reports included in the Comprehensive Annual Financial Report (CAFR), not in the statements themselves. The variety of acceptable calculation and reporting options has made comparisons among governments very difficult.

The Governmental Accounting Standards Board (GASB) addresses the concerns of comparability and expanded disclosure in two new pronouncements that go into effect for fiscal years 2014 and 2015. The first prescribes uniform reporting requirements that will apply to the separate financial statements of the County's three pension plans and the Fairfax County Public Schools' supplemental retirement plan. The second pronouncement defines new reporting requirements that will be reflected in the County's Comprehensive Annual Financial Report.

GASB calls for use of new investment valuation methods and future benefit estimate calculations, but the more significant change is what is to now be reported as the County's liability for these pensions. Current reporting standards inform readers of the extent to which the government has made its required annual pension plan contributions. The liability reported is the difference between the annual required contribution (ARC) and the actual contribution. The actual amount of the unfunded liability related to benefits for each pension plan is shown in the CAFR's Notes to the Financial Statements. As long as a government has funded amounts equal to its ARC, there is no liability reported. Under the new standards, the focus shifts from required annual contributions to the total cost of projected benefits. In the future, the liability reported is the difference between the present value of the projected benefits and the value of investments set aside to pay for these benefits. This change in focus can produce a significantly higher amount to report as the liability.

In presenting pension liability information, another major change will take effect in FY 2015. The new standards require that the County's financial statements include liabilities arising from the commonwealth's cost-sharing plans such as the Virginia Retirement System (VRS). The major driver of the VRS liability is teacher pensions. In the past, no liability appeared on the County's statements for

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the VRS because the required contributions, as determined by the General Assembly, have been met. Starting in FY 2015, the liability is to be reported on the statements of jurisdictions participating in these shared plans. The commonwealth will assign the unfunded liability in proportion to each jurisdiction's share of total payroll. The County's share of this statewide $15 billion liability will be almost $2.7 billion. It must be emphasized that while the unfunded liability will be reflected in the County's financial statements, it remains a funding responsibility of both the state and school system.

There is concern among Virginia jurisdictions, which we share, that the new pension reporting requirements will lead to incorrect inferences regarding the entity's solvency, general financial health, or the ability of management to sustain government operations. The current level of funding of these plans is the result of decisions taken by the commonwealth, beyond the control of participating jurisdictions.

The result of applying these new standards is dramatic. The County will be reporting a twelve-fold increase in net pension liability (from $103 million to $1.3 billion). Including the liability for FCPS employees and employees in component units, the total reported liability will rise to approximately $5 billion. It is important to note that this increase is not the result of a change in pension benefits, the performance of the pension plans, the commitment to continued funding of the plan, or a change in the County's financial situation; it is a result of the shift to a focus on projected retiree benefits.

Attached to this memorandum is a portion of the Statement of Net Assets as it appeared in the fiscal year 2012 CAFR. (The pension liability has been highlighted.) Below that is the statement as it would have appeared using the new reporting requirements. As the Attachment shows, the County's reported net assets decrease from $4.4 billion under the current reporting standards to a negative $487 million in the new presentation. Informed users of the CAFR, such as rating agencies and the bond purchasing community are aware of the reasons for this change and they will be seeing similar liability increases (and net asset reductions) in reports across the country. There is no reason to believe that this reporting change will have an adverse effect on the County's bond ratings.

If you have any questions or would like to discuss further, please feel free to contact me directly.

Attachment: FY 2012 CAFR excerpt

cc:
Edward L. Long, Jr., County Executive
Patricia D. Harrison, Deputy County Executive
David J. Molchany, Deputy County Executive
Robert A. Stalzer, Deputy County Executive
David M. Rohrer, Deputy County Executive
Victor L. Garcia, Director, Department of Finance
John D. Higgins, Deputy Director, Department of Finance

ATTACHMENT

This is an excerpt from FY 2012 CAFR showing how the pension liability was reported.

COUNTY OF FAIRFAX, VIRGINIA
Statement of Net Assets
June 30, 2012

Exhibit A continued

	Primary Government: Governmental Activities	Primary Government: Business-type Activities	Total Primary Government	Total Component Units	Reclassifications (See Note A-12)	Total Reporting Entity
Obligations under capital leases and installment purchases	7,415,908	-	7,415,908	75,200,358	-	82,616,266
Insurance and benefit claims payable	24,202,248	-	24,202,248	23,208,055	-	47,410,303
Net pension obligation	103,184,231	-	103,184,231	-	-	103,184,231
Loan from primary government	-	-	-	12,832,200	-	12,832,200
Deferred Rent	-	-	-	2,322,597	-	2,322,597
Other	30,712,220	-	30,712,220	-	-	30,712,220
Total liabilities	6,239,379,971	577,417,372	6,816,797,343	556,409,309	-	7,373,206,652
NET ASSETS						
Invested in capital assets, net of related debt	1,695,143,766	769,135,097	2,464,278,863	2,631,339,336	(1,341,363,468)	3,754,254,731
Restricted for:						
Grant programs	41,886,480	-	41,886,480	-	-	41,886,480
Sewer improvements	-	40,012,810	40,012,810	-	-	40,012,810
Repair and replacement	-	-	-	700,000	-	700,000
Community centers	18,116,465	-	18,116,465	-	-	18,116,465
Housing	-	-	-	24,380,902	-	24,380,902
Transportation	166,406,340	-	166,406,340	-	-	166,406,340
Capital projects	-	-	-	4,582,726	(112,020,512)	(107,437,786)
Debt service	-	11,042,564	11,042,564	1,972,833	-	13,015,397
Unrestricted (deficit)	(1,562,549,365)	117,615,954	(1,444,933,411)	472,932,147	1,453,383,980	481,382,716
Total net assets	$ 359,003,686	937,806,425	1,296,810,111	3,135,907,944	-	4,432,718,055

See accompanying notes to the financial statements.

Note: The highlighted amount above is the unmet funding obligation based on the annual required contribution (ARC) using the corridor method. The actual unfunded liability related to benefits is shown for each plan in Section G of the Notes to the Financial Statements.

This is how the same portion of the financial statements would have appeared if the new GASB requirement had been in effect in FY 2012.

COUNTY OF FAIRFAX, VIRGINIA
Statement of Net Assets
June 30, 2012

Exhibit A continued

	Primary Government: Governmental Activities	Primary Government: Business-type Activities	Total Primary Government	Total Component Units	Reclassifications (See Note A-12)	Total Reporting Entity
LIABILITIES						
Obligations under capital leases and installment purchases	7,415,908	-	7,415,908	75,200,358	-	82,616,266
Insurance and benefit claims payable	24,202,248	-	24,202,248	23,208,055	-	47,410,303
Loan from primary government	-	-	-	12,832,200	-	12,832,200
Deferred Rent	-	-	-	2,322,597	-	2,322,597
Other	30,712,220	-	30,712,220	-	-	30,712,220
Net Pension Liability	1,341,072,764	29,671,941	1,370,744,705	3,652,462,291		5,023,206,996
Total liabilities	7,477,268,504	607,089,313	8,084,357,817	4,208,871,600	-	12,293,229,417
NET ASSETS						
Invested in capital assets, net of related debt	1,695,143,766	769,135,097	2,464,278,863	2,631,339,336	(1,341,363,468)	3,754,254,731
Restricted for:						
Grant programs	41,886,480	-	41,886,480	-	-	41,886,480
Sewer improvements	-	40,012,810	40,012,810	-	-	40,012,810
Repair and replacement	-	-	-	700,000	-	700,000
Community centers	18,116,465	-	18,116,465	-	-	18,116,465
Housing	-	-	-	24,380,902	-	24,380,902
Transportation	166,406,340	-	166,406,340	-	-	166,406,340
Capital projects	-	-	-	4,582,726	(112,020,512)	(107,437,786)
Debt service	-	11,042,564	11,042,564	1,972,833	-	13,015,397
Unrestricted (deficit)	(2,800,437,898)	87,944,013	(2,712,493,885)	(3,179,530,144)	1,453,383,980	(4,438,640,049)
Total net assets	$ (878,884,847)	908,134,484	29,249,637	(516,554,347)	-	(487,304,710)

See accompanying notes to the financial statements.

Significant changes appearing on this statement:

- Liability is now measured by future pay-outs rather than the extent of accumulated funding.
- Statements show liability for participants in non-county retirement plans (primarily VRS.)