

**GETTING READY FOR GASB STATEMENT NO. 67:
THE MONEY-WEIGHTED RATE OF RETURN**

By

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In June 2012, the Governmental Accounting Standards Board (GASB) released its Statement No. 67, *Financial Reporting for Pension Plans*, and Statement No. 68, *Accounting and Financial Reporting for Pensions*. These pronouncements significantly change financial reporting practices for pensions. GASB Statement No. 67 applies to financial statements issued by individual public pension plans whether in the plan's separately issued report or in the sponsoring employer's report. GASB Statement No. 68 applies to financial statements issued by state and local government employers that sponsor public pension plans. The new pension pronouncements are effective for fiscal periods beginning after June 15, 2013 and June 15, 2014, respectively. GASB Statement No. 67 contains a requirement to report information on a public pension plan's "money-weighted rate of return (ROR)." Advance planning and preparation are important for the efficient incorporation of money-weighted ROR information into financial statements.

According to a poll conducted by the IGFOA, only about 25% of the single-employer pension plans in Illinois (e.g., downstate public safety pension plans) issue stand-alone financial reports. A stand-alone pension plan financial report is a report that contains financial information about a pension plan that is separate from the pension-related information contained in the sponsoring government's annual financial report. If a pension plan does not issue a stand-alone report, it may have been possible for the associated sponsoring government to have set aside GASB Statement No. 67 for a time. However, that time is coming to a close.

The investment performance measure of the money-weighted ROR must be included in the stand-alone financial report of a pension fund or, if the pension fund does not publish a stand-alone report, money-weighted ROR information must be reported in the annual financial report of the government sponsoring the public pension plan. Soon, all local governments in Illinois will need to understand the concept of the money-weighted ROR in order to comply with GASB Statement No. 67. This is because all local governments in the state participate in a multiple-employer pension plan (e.g. the Illinois Municipal Retirement Fund), sponsor a single-employer pension plan (i.e., downstate public safety pension plan), or both.

Investment return is always of interest when evaluating pension fund performance. There are multiple alternatives available for calculating the ROR of an investment portfolio. To promote comparability across reporting entities, the GASB chose to adopt the method of the money-weighted ROR as the common measure for reporting the investment performance of public pension funds. GASB Statement No. 67 defines "money-weighted rate of return" as "a method of calculating period-by-period returns on pension plan investments that adjusts for the changing

amounts actually invested.... (M)oney-weighted rate of return is calculated as the internal rate of return (IRR) on pension plan investments, net of pension plan investment expense.” Inputs (cash flows) for the IRR determination must be considered at least monthly. The pronouncement encourages financial statement preparers to consider inputs on a more frequent basis. The money-weighted ROR is a calculation of investment return that differs from what many investment advisors, actuaries, and other professions have been providing to public pension plans and their sponsoring governments in the past.

Statement No. 67 requires that the money-weighted ROR for the immediate reporting year of a pension plan be disclosed in the notes to the plan’s financial statements. Also, the money-weighted ROR for the immediate and previous nine fiscal years must be reported in a schedule as required supplementary information (RSI). Note 9 to Statement No. 67 specifies that this same information should be included in the financial report of the government sponsoring a pension plan if the plan does not issue a stand-alone report. If a pension plan issues a stand-alone report, the money-weighted ROR information of the plan should be presented in the financial report of the sponsoring government in such a manner that avoids unnecessary duplication. With respect to the RSI schedule, until a full ten years of information about a pension plan’s money-weighted ROR is available, the plan or its sponsoring government should report as many years of return information as is available. The retroactive calculation of money-weighted RORs is not required.

In the case of a multiple-employer pension plan (cost-sharing or agent), the plan will typically arrange for the calculation of the applicable annual money-weighted ROR for its participating governments. The participating governments will then be able to incorporate the information into the notes and RSI in their own financial reports. Thus, it will be relatively easy for governments participating in multiple employer pension plans, such as the Illinois Municipal Retirement Fund, to obtain money-weighted ROR information to comply with GASB Statement No. 67.

The task of obtaining money-weighted ROR information for inclusion in either the stand-alone report of a single-employer pension plan (e.g., downstate public safety pension fund) or the financial report of its sponsoring government will be more challenging. There are two reasons for the challenge. First, in the situation of a single-employer plan, there is no external entity that will be responsible for calculating and providing investment return information. By whatever means, the plan will be responsible for calculating the annual money-weighted ROR. This will take staff time. Alternatively, an investment management consultant or other outside professional engaged by the plan will need to prepare the calculation. The plan or sponsoring government may incur fees for these services. Even for an outside professional, the task of calculating the annual money-weighted ROR will prove to be less burdensome if the cash flow information to be considered in the calculation is compiled periodically (e.g., monthly) instead of all at once after the end of the fiscal year. Thus, single-employer pension plans and the governments sponsoring them are encouraged to undertake the process of compiling data for the money-weighted ROR as soon as possible. If an outside professional is to be engaged for the work, the professional should be identified and be provided with the cash flow data for the ROR calculation at the earliest opportunity.

The second factor complicating the calculation of an annual money-weighted ROR is that multiple investment managers may be involved. For example, a single-employer pension plan may engage one investment manager to manage fixed-income securities and another to manage equity securities. In the case of pension funds with a large amount of assets, even more investment managers may be involved. The more investment managers that are involved, the more complicated the task of calculating the money-weighted ROR becomes. If a pension fund has engaged an investment management consultant to help the fund's pension board oversee all of the investment managers, the pension fund may be able to rely on the investment management consultant to calculate the money-weighted ROR. In any event, lead time will be very helpful to whomever is charged with the responsibility of calculating the money-weighted ROR.

The key points with respect to generating money-weighted ROR information for inclusion in a financial report for compliance with GASB Statement No. 67 are to determine who will be responsible for preparing the calculation and start compiling the data for the calculation as early as possible.

In February of 2014, the IGFOA's Technical Accounting Review Committee published "Recommended Practice for Implementing GASB Statement Nos. 67 and 68," which may be accessed at:

http://www.igfoa.org/content/documents/gasb67_68whitepaper_2014_02_07_final.pdf.

The recommended practice addresses the need to ascertain a money-weighted ROR for a pension plan and other issues pertaining to the implementation of GASB Statement Nos. 67 and 68.