Overview of GASB's Pension Related Exposure Drafts

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Agenda

- GASB
- Comparison of current GASB standards with the proposed changes
- Common concerns

GASB

- GASB's mission is to establish and improve standards of state and local governmental accounting and financial reporting that will result in useful information for users of financial reports, and guide and educate the public, including issuers, auditors, and users of those financial reports.
  - It is an independent, private-sector, not-for-profit, non-governmental organization

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GASB's Pension Standards

- GASB is proposing pension accounting and financial reporting changes to:
  - Improve consistency and transparency
  - Enhance decision usefulness of pension information
  - Assist users in evaluating accountability and inter-period equity related to pensions
- Similar to past changes for other post employment benefits
- SEC looking for more pension liability disclosure

GASB's Current Pension Standards

- GASB Statement 25 – financial reporting for retirement plans
- GASB Statement 27 – accounting and financial reporting for **employers** who have retirement plans

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GASB – Pension Project Timeline

- Staff research completed in 2008
- Invitation to Comment issued in 2009
- Preliminary Views issued in 2010
- Two Exposure Drafts approved in June 2011
- If approved, effective for fiscal year 2014

Underlying Principles

- If an item meets the definition of a liability, it should be recognized in the financial statements, rather than disclosed in the notes to the financial statements

- GASB defines a liability as a "present *obligation to sacrifice resources that a government has little or no discretion to avoid*"

Underlying Principles

- Pension obligations are part of an employee's compensation
- A government has an obligation NOW to provide those benefits in the future
- A government should recognize its pension costs (expense) in the period when employees provided services

Underlying Principles

- The pension plan is primarily responsible for paying pension benefits to the extent the plan has sufficient assets
- The employer is primarily responsible for paying benefits to the extent the plan does not have sufficient assets

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Underlying Principles

- Cost allocation (annual expense) is developed on an accounting basis, not a funding or contribution basis
  - The pension liability determined for the financial statements may be different from the pension liability used to make funding decisions.

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Major Proposed Changes

- Government employers (not the pension plans) would report the unfunded portion of the total pension liability as a liability on the balance sheet portion of their financial statements

Major Proposed Changes

- If current and expected future plan assets related to current members are insufficient to cover the total pension liability, the long-term rate of return cannot be used as the discount rate.
  - The long-term rate of return is used for periods where plan assets are available for benefit payments and a high quality municipal bond rate is used for projected benefit payments not covered by plan assets (a blended rate).

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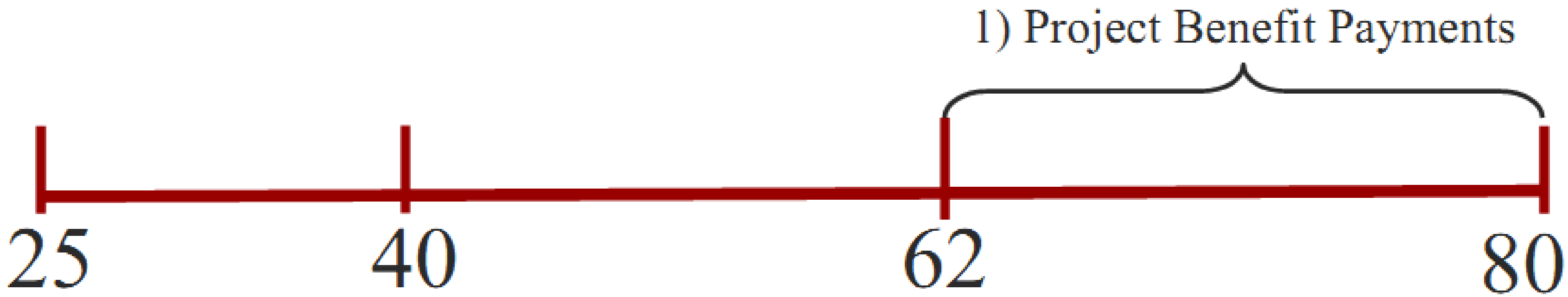
Current Standards vs Exposure Draft

Pension Plan's Unfunded Liability

Current GASB	Exposure Draft	Implications
Is not reported on individual employer financial statements	Employer is responsible for pension plan's unfunded liability and must show it (or a proportionate share) on its balance sheet	Employers who have had no pension liability on their books could now have a potentially large liability

Total Pension Liability
3-Step Measurement Approach



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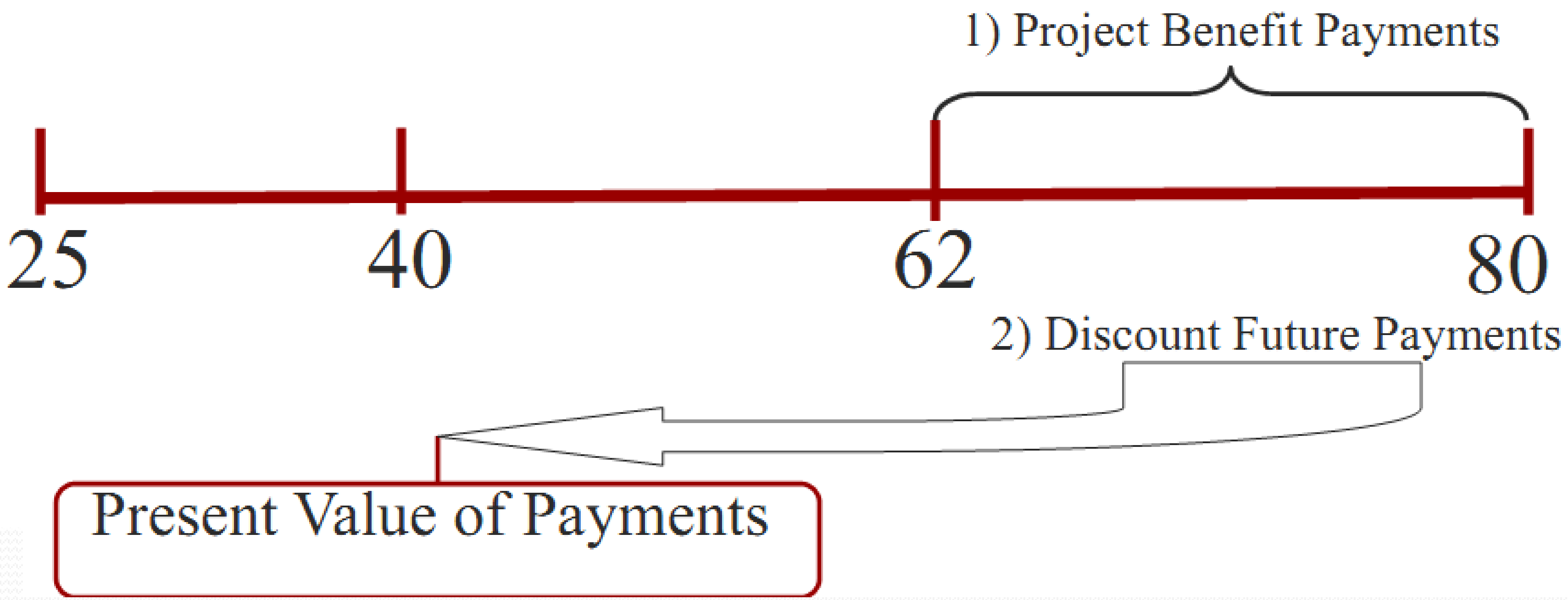

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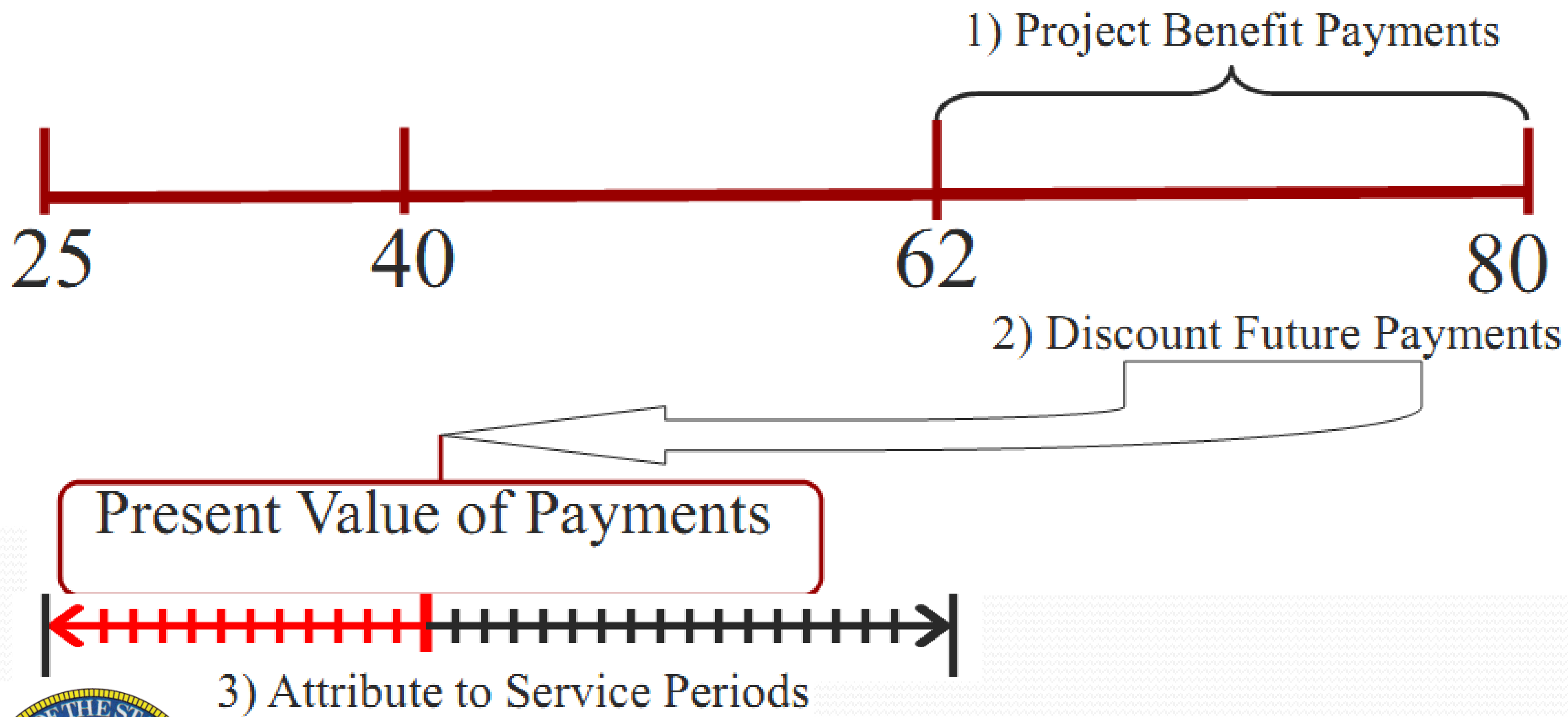

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Employer's Net Pension Liability

- Total pension liability minus market value of assets
- Measured as of the employer's year-end
- For multiple-employer pension plans, each employer reports its proportionate share of the plan's net pension liability
- Required to be reported on the employer's statement of net position
- The addition of this long-term liability to the statement of net assets will reduce unrestricted net assets

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Current Standards vs Exposure Draft

Employer's Pension Expense:

Current GASB	Exposure Draft	Implications
Statutorily required contribution is the expense Liability exists only to the extent the statutorily required contributions have not been paid	Equals the change in net pension liability each year	Employers who never had a pension liability on their books will now have to report one

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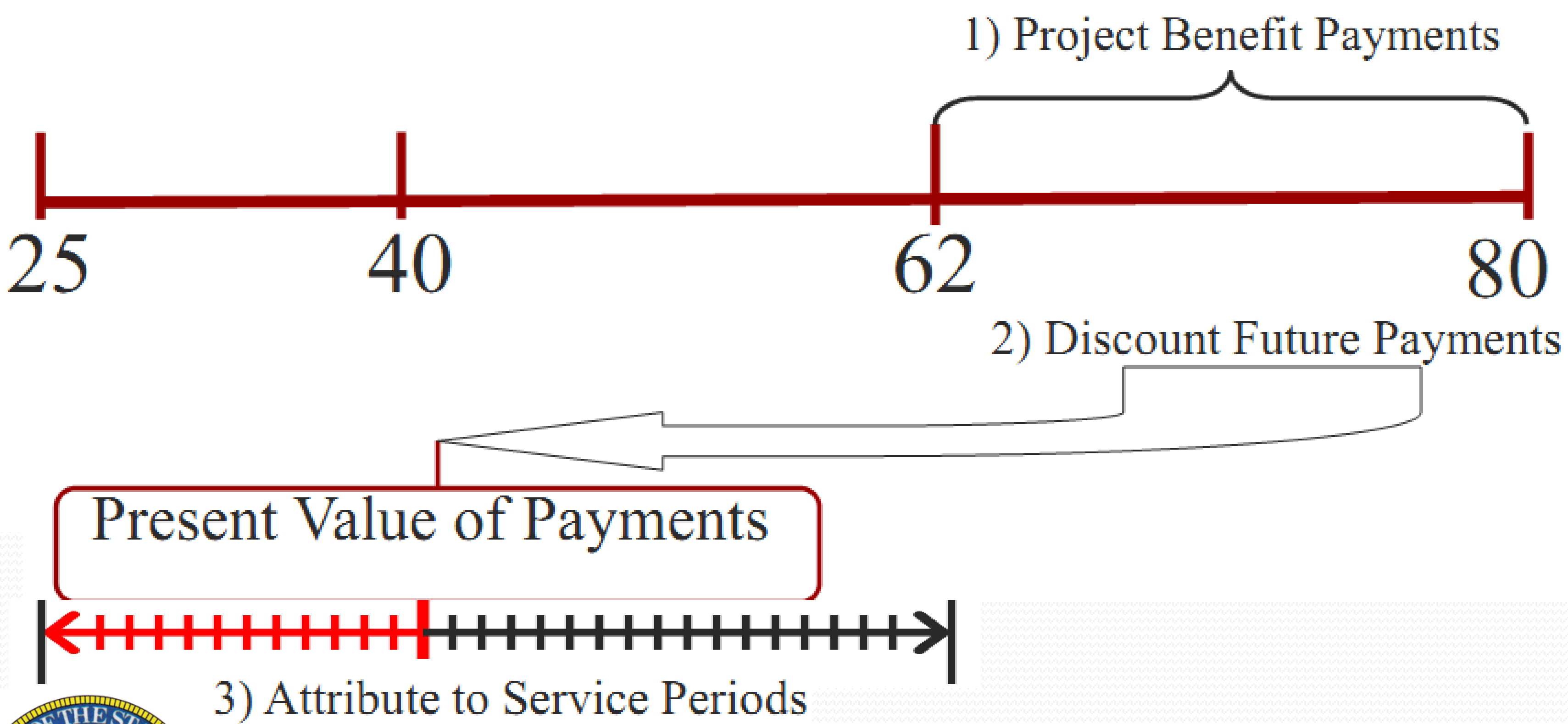
Total Pension Liability
3-Step Measurement Approach



Current Standards vs Exposure Draft

Amortization of Unfunded Liability

Current GASB	Exposure Draft	Implications
Unfunded liability can be amortized over a maximum of 30 years	Plan changes recognized immediately along with change in assumptions and gain/loss on retiree experience Gain/loss on active liability recognized over average working lifetime (generally shorter than 30 years)	Higher pension expense and more volatility

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Current Standards vs Exposure Draft

Discount Rate

Current GASB	Exposure Draft	Implications
Long-term rate of return is used to discount future benefit payments, which determines liabilities	Discount rate is long-term rate of return while assets exist and municipal bond rate after that	If the plan is not fully funded, the municipal bond rate will increase the unfunded amount

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Current Standards vs Exposure Draft

Actuarial Cost Method

Current GASB	Exposure Draft	Implications
Plans can choose from several acceptable actuarial cost methods	All plans must use entry age normal actuarial cost method	May create differences between the unfunded liability determined for financial reporting and the amount used for funding

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Current Standards vs Exposure Draft

Asset Smoothing

Current GASB	Exposure Draft	Implications
Permits use of asset smoothing to determine funded status	Difference between assumed and actual investment return spread over 5 years	Could create more volatility

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Current Standards vs Exposure Draft

Consistency between criteria used for funding and accounting

Current GASB	Exposure Draft	Implications
Funding criteria generally OK for plan's determination of funding status and employer note disclosures	Plan and employer financial statement funding/liability information would be independent of funding criteria	Two sets of numbers could lead to confusion Boards, legislature, or oversight body will have to set funding policy

Common Concerns

- Calculation of the discount rate
- Allocation of the net pension liability to employers in multiple-employer plans
- Volatility of the pension expense and the net pension liability
- Time and cost to implement
- Ability of the pension plans to provide data at employers' year-ends
- Additional complexity to (already) complex financial statements
- Audit concerns

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For more information:

- GASB exposure drafts and comment letters:

http://www.gasb.org

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Questions?