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GASB Issues Proposals to Revamp Governmental Pension Plan Accounting

As anticipated, the Governmental Accounting Standards Board in June issued proposed changes to its accounting standards for governmental plans, Statements Numbers 25 (regarding the plan's own statements) and 27 (regarding the employer's reporting with respect to its plans). This is the latest step in a process that began in 2009 with an Invitation to Comment followed in June, 2010 with GASB making initial general proposals, expressed in "Preliminary Views". The new proposals just issued are in the form of Exposure Drafts of amended Statements.

The proposals are likely to increase the amount of reported liabilities for public plans at a time when the amount of those liabilities is hotly debated and financial pressures on states and local governments have resulted in many proposals to change such plans, some of which have been adopted already. The proposals also introduce employer-level financial reporting of liabilities that may in some cases be difficult to implement. We would encourage public plans to review these proposals carefully, not just for the larger questions such as the proper assumed interest rates for valuation, but also for the many other changes in accounting that may raise difficulties in application. Where issues appear, it is important to provide comments to GASB to help ensure that the final rules are as workable as possible. Groom can assist in this comment process.

Effective Dates and Date for Written Comments

For some single employers participating in a single-employer defined benefit pension plan with net pension positions (generally, assets) of $1 billion or more in the first fiscal year ending after June 15, 2010, the proposed Statement would be effective for periods beginning after June 15, 2012. For all other employers and plans the proposed Statements would generally be effective for periods beginning after June 15, 2013.

GASB's exposure drafts can be found on their website at www.gasb.org. Written comments are due by September 30, 2011, and at least three public hearings will be held.

The Principal Changes in the Proposals

The proposals generally follow an approach of separating accounting from funding. Under the proposals, a government would report in its financial statements a net pension liability equal to the difference between the total pension liability and the value of assets set aside in a pension plan to pay benefits to current employees, retirees, and their beneficiaries.

Some of the principal proposed changes in accounting include:

- For plan assets related to current employees, retirees, and their beneficiaries, governments would discount projected benefit payments using the plan's long-term expected rate of return. However, to the extent plan assets are projected not to be sufficient for paying benefits to current employees, retirees, and their beneficiaries, because GASB believes that projected benefit payments take on attributes that are similar to other forms of debt, governments would apply a discount based on a tax-exempt, high-quality 30-year municipal bond index rate to reflect that future benefit payments are not expected to be made from long-term investments. Technically, the two rates are then blended.

- Ad hoc COLAs and other postemployment benefit changes would be included in benefit projections if an employer's past practice and future expectations of granting them indicate that they effectively have become automatic.

- All governments would use a single method of allocating present value that is known as entry age normal, and do so as a level percentage of payroll.

- Governments would immediately incorporate into expense changes in the terms of the pension benefits and changes in projected investment earnings *for all persons covered by the plan* <u>and</u> the portion of changes in actual economic and demographic changes differing from what was assumed and changes in the assumptions about economic and demographic factors *for employees no longer working for the government (inactive employee*s). This is likely to increase volatility in the amounts reported.

- However, governments would *not* incorporate the portion of changes in actual economic and demographic changes differing from what was assumed and the changes in the assumptions about economic and demographic factors related to *active employees* into expense immediately. Rather, governments would report that active-employee portion as a deferred outflow of resources or deferred inflow of resources and then introduce part of that amount into expense in each year of the weighted average of the remaining employment of active employees.

- The effects of the difference between actual investment earnings and what was projected would be deferred and incorporated into expense over a five-year period, shorter than plans often use currently; again, increasing volatility.

- In the case of multiple employer plans, the proposal describes *agent multiple-employer plans* (under which separate accounts are maintained to ensure that each employer's and employee's contributions are used to provide benefits only for the employees of that government) and *cost-sharing multiple-employer plans* (under which governments share the costs and risks of (1) providing benefits and (2) administering the plan and the assets accumulated to pay benefits, so that any assets in the plan may be used to pay any employee's benefits, regardless of what participating government they worked for.)

- In a cost-sharing pension plan, each governmental employer will report a net pension liability based on its proportion of the collective net pension liability of all of the governments that participate. The proportion would essentially equal the government's long-term expected contributions to the plan divided by those of all governments in the plan.

- Governments participating in single-employer or agent multiple-employer pension plans would present Required Supplementary Information (RSI) schedules with the following information for each of the past 10 years:

    - The beginning and ending balances of the total pension liability, the plan's net position, the net pension liability, and the effects on those amounts of items such as service costs, benefit changes, changes of assumptions, contributions, net investment income, and benefits paid (essentially the same information as the current-period note disclosure described above, but for 10 years)

    - (1) the plan's total pension liability, (2) the plan's net position, (3) the net pension liability, [(1) minus (2)], (4) the ratio of plan net position to total pension liability [(2) divided by (1)], (5) covered-employee payroll, and (6) the ratio of net pension liability to covered-employee payroll [(3) divided by (5)].

- If a government participating in a single-employer or agent multiple-employer pension plan has an actuarially calculated annual pension contribution, it also would present an RSI schedule with the following information for each of the past 10 years: (1) the actuarially calculated employer contribution; (2) the amount of employer contribution made; (3) the difference between the contribution made and the actuarially calculated contribution [(2) minus (1)]; (4) covered-employee payroll; and (5) ratio of the contribution made to covered-employee payroll [(2) divided by (4)].

- A government participating in a cost-sharing multiple-employer plan would present the schedule described in the preceding paragraph for its individual contributions and for the participants as a whole, if the plan has actuarially calculated annual pension contributions.

What Should Governmental Employers Do?

A governmental employer participating in a defined benefit plan should begin to consult with its accountants as to the practical implications of the proposed changes. Some of those particularly evident are:

Reported pension liabilities are likely to increase due to the new blended discount rate methodology, and the numbers reported are likely to be more volatile from year to year.

Employers participating in cost-sharing defined benefit plans and the plans themselves are likely to have some work ahead to try to figure out how plan liabilities are to be divided amount the employers. Concern has already been expressed by some that the information to do so is not readily available or difficult to derive. We note that similar concerns have recently caused FASB to adjust the manner in which it has proposed that employers participating in private sector multiemployer plans provide information regarding potential liabilities.

While the valuation of pension liabilities is a highly charged political issue, the issue of how liabilities, however measured, are divided among employers under a cost-sharing plan seems more technical, and affected employers may want to weigh in with comments on that element in particular before the end of September. We would be happy to help you analyze the options and issues concerning your situation. We also urge you to contact us if you are interested in providing comments to GASB on the proposals.