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GASB Simplifies Accounting for State Retirement System Liabilities, But Will Still Require Participating Employers to Include Apportioned Liabilities on Financial Statements

At the Governmental Accounting Standards Board (GASB) meeting April 18th through the 20th, the Board voted to greatly simplify the manner of apportioning the underfunding of typical state retirement systems among the individual participating employers. But the Board retained its original proposal that those apportioned liabilities should appear as liabilities on each participating employer's balance sheet beginning as early as 2014.

The Board spent much of its meetings in April reviewing the numerous comments and objections to its proposed revisions to GASB Statement No. 27, "Accounting and Financial Reporting for Pensions", particularly the provisions concerning "cost-sharing plans", which are so-called because the participating employers share their obligations to provide pensions to their employees, and plan assets can be used to pay the pensions of any participating employer's employees. Such plans are in contrast to "single employer" plans and "agent" plans (plans in which plan assets are pooled for investment purposes but are legally segregated to pay the pensions of each employer's employees). The proposed changes to the accounting treatment for cost-sharing plans has been very controversial, generating over 600 comments, many calling for significant changes to the proposals.

The Board appeared to take into account the many objections to the impracticalities and excessive costs inherent in the original proposal, and voted to substantially simplify the methods of apportioning the liabilities in such cost-sharing plans. For example, the Board voted to allow a participating employer to determine its proportionate share of the state retirement system's collective net pension liability by multiplying the collective net pension liability from the plan's financial statements by any of a number of reasonable methods, including:

- A ratio based on current period employer contributions or payroll;
- A ratio based on average employer contributions or average payroll over a number of past periods;
- A ratio based on the present value of the projected future employer payroll; or
- A ratio based on the plan's method of allocating liabilities and assets to individual employers for purposes of determining contributions, if the plan has one.

In addition, the Board voted to generally allow the employer to use the liability figures from the cost-sharing plan's most recent financial statements for this purpose, provided that the plan's year end was no more than 12 months plus one day from the employer's fiscal year end, and that the actuarial report on which the plan's financial statement was based was also relatively recent. The intention of the Board was to minimize the need to modify plan-level financial statements for use by employers.

However, the Board firmly rejected arguments that the apportioned liability did not meet the definition of a liability under its accounting standards, determining that participation in a cost-sharing plan created a liability "that the government has little or no discretion to avoid". The Board consequently voted to retain its prior position that the liabilities of a cost-sharing plan should appear as liabilities on the balance sheet of some entity.

The Board further discussed the arguments of some commenters that the entity which should show such liabilities should not be the participating employer but should be either the plan sponsor that controlled the plan (e.g., the state in the case of a state retirement system) or the plan itself. However, the Board members also rejected those arguments, voting that the default position should be that the liabilities appear on the balance sheet of the participating employer because, in their view, the liabilities arose out of the exchange of services between the employer and employee. Their decision appeared to leave open, however, that a state could move the liabilities from the participating employer statements to the state by an express statutory provision to that effect, or alternatively reduce the liabilities and move them to the system by providing in an express statutory provision that the benefits would be reduced to the extent not funded.

The Board also voted to extend the general effective date of Accounting Statement 25 (the related statement prescribing new plan-level accounting rules) to periods beginning after June 15, 2013, and of Accounting Statement 27 for the employers to periods beginning after June 15, 2014.

The Board is expected to be revising the language of proposed Standards No. 25 and 27 for discussion and adoption at their June 2012 meeting. It will be important for cost-sharing plans and participating employers to watch these developments closely, and further issues may arise in the final standards.

What remains uncertain is what the precise effects of the inclusion of a portion of the liabilities of a state retirement system on the balance sheets of participating employers will be. Of particular concern and uncertainty will be the impact of the additional liabilities on public bond markets, on the rating agencies, on legal or contractual limitations on liabilities on the part of such participating employers, and whether efforts to enact specific state laws reallocating liabilities or reducing benefits will come about as a result. Many commenters brought the potential impacts of its decision to the attention of GASB, and the Board considered such issues, but did not find them sufficient reason to change its accounting approach. However, the new accounting rules seem likely to have some significant impact on state retirement systems and the employers that participate in them.