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The Impact of GASB Public Accounting Proposals on Employers Participating in State Retirement Systems – Employers May Need to Prepare for Substantial Additional Accounting Requirements

*Much attention has been paid to the debate over the proper discount rate to be used to value public pension plan liabilities and the GASB proposed changes in that regard. It is less noticed that, under a related accounting proposal, GASB would also require participating employers in state retirement systems to include substantial additional disclosures, schedules and information on their own financial statements regarding its participation in the state system. Counties, municipalities, school systems, public hospitals, and prison systems are examples of employers that contribute to state retirement systems, and many are unaware of the substantial negative impact the proposed GASB changes will have on their financial statements. **If these proposals are finalized without change, participating employers will need to substantially revamp their accounting systems at considerable expense. Compliance is expected to be the responsibility of the employer, and the retirement system's ability to provide assistance in many cases may be limited. That may leave the burden of compliance on the contributing government employers.***

On June 27, 2011, the Governmental Accounting Standards Board issued GASB Statement No. 27, Accounting and Financial Reporting for Pensions, and GASB Statement No. 25, Financial Reporting for Pension Plans. Statement No. 25 deals with a state retirement system's own financial statements, and the lion's share of attention in the press has been to the impact of that proposal on the discount rate used to value the system's liabilities. Statement No. 27, on the other hand, deals with the accounting statements of the participating employer, and though less attention has been paid to these proposed rules, their impact on the accounting statements of employers participating in state retirement systems could be quite dramatic.

Participating Employers in State Retirement Systems are Usually Cost-Sharing Employers

The impact of the proposed changes to GS27 on participating employers in state retirement systems derives from special new rules for what is called "cost-sharing employers", which are those employers whose employees are provided with defined benefit pensions through cost-sharing multiple-employer pension plans—plans in which the participating employers pool or 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. This definition covers most of the types of separate participating employers in defined benefit state retirement systems – cities, counties, school districts, public hospitals, prison systems and so on. (Other rules apply to single employer plans and plans where each separate employer is only responsible for its own obligations, known as agent plans.)

Who Has to Prepare This New Information? Primarily the Employer.

The GASB proposals do not directly address who will be preparing this information, but because the information is for the employer's financial statements, it is understood to primarily be the employer's obligation. Some of the information may be available from the system using information it has derived from its own financial statements, but under the current proposal, much of the information will either not be the same as prepared by the system for its own needs. The system, however, is not required to take their information and particularize it to the needs of the individual employer or develop information for the employers' financial statements. The employer would presumably need to have its own accountants, and perhaps its own actuaries, to evaluate and adjust the information from the system for its own needs and modify it to the forms needed for its statements. This sets up further concerns – most systems do not have staff for interacting with hundreds or thousands of employers and their accountants or actuaries regarding the information, nor may they provide accounting services to the employers at the expense of plan participants and beneficiaries. One suggestion has been for plans to charge employers for such information, but that would create additional problems.

So What Exactly does a Cost-Sharing Employer have to do Under the GASB Proposal?

Include Pension Liability and Changes to Liability on Balance Sheet and Income Statement

A cost-sharing employer is generally to recognize in its financial statements (i.e., included as a liability and on its profit and earnings figures) its proportionate share of the collective net pension liability as well as its collective pension expense – which is based on its proportionate share of the increase in liabilities. Those proportionate shares are not based only on the current year's contribution, but are based on specially determined future "collective deferred outflows" and "collective deferred inflows" related to pensions.

How is the Liability Information from the Plan "Proportioned" to the Employer?

Each employer must project its long-term contribution effort to the pension plan as compared to the total of all projected contributions by all contributing employers. Because the plan's information may be as of an actuarial valuation date earlier than the employer's fiscal year end, the employer accountants will have to "roll it forward" to the employer's fiscal year end based upon professional judgment. That is, unless there has been a significant change in the employer's projected proportion between the actuarial valuation date and the employer's most recent year-end. In that case, the employer will have to adjust the proportions to reflect that change. These do not appear to be simple matters, even before considering the possible effect of this estimated liability (which may never have to be paid by the employer) and its fluctuations on the balance sheet and income statement.

The Employer Will Have to Provide Extensive Other Information in Notes

The following is an overview of the major elements of the additional information the employer will be required to develop and include as notes to the financial statement (the actual requirements are far more detailed):

The employer will have to provide extensive information about the plan, including detailed information about the actuarial assumptions and discount rate. That information will also include the presentation of how a 1-percentage-point increase and a 1-percentage-point decrease in the discount rate would affect current-period net pension

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liability recognized by the employer. While some of the information may be fairly basic and some may be made available by referring to plan financial reports that are otherwise available, the employer must also disclose the variations from plan information and summarize some of the information.

In addition, the cost sharing employer must disclose:

- The basis for determination of the employer's contributions to the pension plan, including identification of the authority under which employer contribution requirements are established or may be amended, and significant methods and assumptions used in the calculation of current period contributions, if actual contributions are determined on an actuarial basis.
- The net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense/expenditures recognized by the employer.
- The date of the actuarial valuation on which recognized information is based and, if the recognized amounts are the result of the use of update procedures to roll forward amounts to the end of the employer's reporting period, identification of that fact.
- A description of changes of assumptions that affect measurement of the collective total pension liability.
- A description of changes of benefit terms that affect measurement of the collective total pension liability.
- The amount of the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense recognized by the employer that is attributable to (1) the net effect of a current-period change in the proportion used to calculate the employer's share of collective amounts and (2) the current-period difference between (a) the amount of contributions recognized by the cost-sharing pension plan as a contribution from the employer and (b) the amount of the employer's proportionate share of collective employer contributions recognized by the pension plan. The number of periods over which the employer is recognizing those amounts in pension expense also should be disclosed.
- The amount of current-period pension expense resulting from recognition of the portion(s) of beginning deferred outflows of resources and deferred inflows of resources associated with (1) changes in the proportion used to calculate the employer's share of collective amounts and (2) differences between the amount recognized by the cost-sharing pension plan as a contribution from the employer and the amount of the employer's proportionate share of those contributions recognized by the pension plan.

The Employer will also Have to Provide Three New 10-Year Schedules

A cost-sharing employer is also required to present supplementary information as of the employer's most recent year-end in the form of three separate 10-year schedules:

- A 10-year schedule of changes in the collective net pension liability presenting for each year a summary for all employers, but as of the employer's year-end, reflecting:
 - a. The beginning balances of the collective total pension liability, plan net position, and the collective net pension liability.
 - b. The effects during the period of service cost, interest on the total pension liability, changes in terms, differences between actual and expected experience in the measurement of the total pension liability, changes of assumptions, contributions by the employer, contributions by the employees, net investment income, refunds of contributions, benefits paid; and plan administrative expenses.

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- c. Other changes, separately identified if individually significant.
 - d. The ending balances of the collective total pension liability, plan net position, and the collective net pension liability.
- A 10-year schedule of net pension liability presenting the following for each year, measured at the collective level and then also at the cost-sharing employer level, as of the employer's year end: the total pension liability, the amount of plan net position, the net pension liability, the ratio of plan net position to the total pension liability, the amount of covered-employee payroll, and the net pension liability as a percentage of covered-employee payroll.
 - A 10-year schedule of employer contributions presenting the following for each year: the percentage used to calculate the employer's share of collective amounts, the employer's share of the collective total pension liability, the employer's share of the collective amount of plan net position, the employer's share (amount) of the collective net pension liability, the employer's covered-employee payroll, and the employer's share of the collective net pension liability as a percentage of the employer's covered-employee payroll.

Is This New Obligation Inevitable or is there Anything an Employer Participating in a State Retirement System Can Do About It?

At this point, the comment period for the proposed changes to GASB Statement 27 is formally closed. However, it has been our experience that the accounting standards boards work collaboratively with stakeholders, especially when those stakeholders speak as part of a larger coalition. GASB is now reviewing the approximately 645 comments it has already received. While many of those comments focused on the discount rate issue, not as many have provided substantive discussions of the significant challenges that would face employers participating in cost sharing arrangements in complying with the new rules. Nonetheless, we believe GASB is considering all comments very seriously, including those emphasizing the cost and difficulty of compliance.

How Much Time is There to do Something about the GASB Proposal?

According to its current schedule, GASB will be deliberating its next steps for this proposal between now and May, 2012. We would encourage all cost-sharing employers to advocate for a simpler method of accounting for participation in a cost-sharing plan including data which is more readily available from the state system because the system prepared it for its own use, to clarify that the employer does not have to independently modify such information, and to have all such information reflected in notes rather than directly on the balance sheet and income statement. We have formed a coalition of stakeholders and will continue our efforts to inform GASB Board Members and Staff about these issues.

For More Information:

The GASB Proposal, Statement No. 27, is here:

<http://www.gasb.org/jsp/GASB/Page/GASBSectionPage&cid=1175804830991>

The Employer Cost-Sharing Coalition's detailed comment Letter is here:

http://www.gasb.org/jsp/GASB/CommentLetter_C/ViewCommentLetter&cid=1176158997158

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