Retirement Dialogues Webinar

GASB Exposure Drafts

Proposed Changes to Pension Accounting & Financial Reporting

August, 3, 2011
2:00 – 3:00 PM ET

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PENSION TRUSTEE ADVISORS

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NATIONAL INSTITUTE ON
Retirement Security
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Agenda

1. Introductions
2. Exposure Drafts Overview
3. Game Changers
4. Next Steps
5. Q&A

Speakers

Moderator: Keith Brainard, Research Director
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President
Pension Trustee Advisors

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Long Path to Two Exposure Drafts

- **January 2006:** Added to GASB research agenda
- **April 2008**: Added to GASB project agenda
- **March 2009**: Invite to comment issued
- **June 2010:** GASB issues Preliminary Views (PV)
- **July 8, 2011**: GASB issues two Exposure Drafts proposing improvements to pension financial reporting by state, local government. Proposed amendments to standards to change how pension costs, obligations are calculated, reported. Two standards consistent.
  - *Accounting & Financial Reporting for Pensions (replace GASB 27)*
  - *Financial Reporting for Pension Plans (replace GASB 25)*

GASB Scope

- Governmental entities that issue GAAP financial statements look to GASB do define GAAP
- GASB is the Governmental **Accounting** Standards Board
- Although GASB 25 & 27 defined an “Actuarially Required Contribution”, GASB has no authority to require a contribution

Exposure Drafts Scope

- Applies to **accounting** statements for:
  - Pension plans, just like GASB 25 did, and
  - Governmental employers, just like GASB 27

- Does not apply to **contributions** unless you've explicitly written it into statute, board policy, etc.

Implementation

- Effective for periods beginning after June 15,
  - 2012 for large single employers and plans
  - 2013 for all others
- Retroactive
  - Restate beginning balance sheet liability
  - Restate deferred inflow/outflows of resources to extent practical

9 Key Implications

1. A new and very large balance sheet liability
2. A larger pension expense (or pension income)
3. Unstable financial statements
4. Contributions will not match GASB expense
5. Communication challenges
6. Re-visit funding policies
7. Additional disclosures
8. More work, reports
9. Get it right – regulators, auditors, public, and the press are watching

Key Changes from Preliminary Views

- Many PV concepts retained
  - Separation of accounting and funding
  - Less flexibility in accounting cost calculations
  - Rejection of full “market value liabilities” paradigm
- Some amortization/recognition changes
  - Gradual recognition over 5 years for difference between actual and projected investment earnings
  - PV had no recognition until 15% corridor, then full recognition
  - All changes in liability from plan changes recognized immediately
- New and substantial disclosures in Notes and RSI, incl:
  - Illustrations of discount rate sensitivity
  - Actuarially Calculated Employer Contribution
  - Information about actuarial assumptions, etc.

The Good, The Bad, The Ugly

- **The Good**
  - Traditional Entry Age Normal chosen as only cost method
  - Discount rate highly influenced by long-term expected rate of return
  - Rejected Market Value of Liability measurement approach

The Good, The Bad, The Ugly

- **The Bad**
  - Delinking pension contributions from pension expense
  - Heavy use of deferred inflows and deferred outflows of resources accounts
  - Immediate recognition of all plan changes (some say this is good)
  - Much more disclosure (again, some say this is good), some of which might create confusion
  - Communication challenges (some say this is will be ugly)

The Good, The Bad, The Ugly

- **The Ugly**
  - Throw away all you knew about government pension accounting
  - Large new costs and liabilities on the income statement and balance sheet
  - Unstable income statements and balance sheets
  - A lot more work to prepare pension-related portions of CAFRs
  - Competing measures of pension cost, which can lead to confusion and selective use

The “Divorce”

- Historically, government accounting and actuarial funding were one . . . . . **married**.
- Now, government employer accounting and funding would be delinked, decoupled . . . . **divorced**.
- Under the divorce:
  - Accounting expense not viable for funding – too volatile, too late for budgeting.
  - No more ARC, APC, NPO.
  - An Actuarially Computed Employer Contribution (ACEC) disclosed in RSI - not accounting expense but a reasonable (yet not well-defined) funding number.
  - Two sets of numbers: accounting and funding.

The "Divorce" (continued)

- **Urban Myth #1**

  "The GASB's new rules will cause an increase in pension contributions."

- **Facts**

  Nothing in the GASB's EDs will require increases in pension contributions. Elected officials, employers and retirement boards decide how much pension contributions should be – not the GASB.

  The new pension expense (for accounting purposes) will never be a good model or a good benchmark for funding plan contributions.

Game Changers:
Measuring Net Pension Liability (NPL)

NPL is projected snapshot of unfunded liabilities as of the end of the fiscal year

- NPL = Total pension liability (using traditional entry age normal) *minus* the market value of plan assets; like an unfunded actuarial accrued liability
- Required to be reported on employer balance sheet
- Includes projected future service, salary increases, automatic and certain ad hoc benefit changes
- NPL is measured at end of the employer’s fiscal year

Game Changers:
Discount Rate Calculation

- Entirely new calculation based on projected benefits and assets for current members (as in the Preliminary Views)
  - Projected assets include contributions to fund benefits for current members
- For projected benefits that are covered by projected assets
  - Discount using the long-term expected rate of return.
- For benefits that are NOT covered by projected assets
  - Discount using yield on 30-year high-quality muni bond index.
- Add these two present values and solve for a single rate that gives the same total present value
  - Use that single equivalent rate to calculate the costs and liabilities

Game Changers:
Discount Rate Calculation (continued)

- **Urban Myth #2:**

  "Poorly funded plans will need to lower their discount rate."

- **Facts:**

  Some poorly funded plans will need to lower their discount rate for accounting purposes, while others will not.

  The discount rate is *not* a weighted average of two rates.

  The discount rate is affected far more by the *funding policy* and *recent funding patterns* than by the current funded ratio.

- Many plans that are receiving actuarially determined contributions will get to use just the long term earnings rate.

Game Changers:
Cost Sharing Plans

- Employers in cost sharing plans will recognize costs and liabilities in financial statements based on their proportionate share of the collective net pension liability.
- Employers' proportionate shares of collective's net pension liability, pension expense and deferred inflows/ outflows would be equal to their proportionate shares of long-term expected contribution effort.
- Employers will have more disclosures, but not quite and much as single and agent employers.

Game Changers:
Cost Sharing Plans (continued)

- Employer's proportionate shares can be determined as of the actuarial valuation date.
- Employer's proportion is applied to net pension liabilities, pension expense and deferred inflows/outflows of resources as of the employer's fiscal year end.

Game Changers:
Balance Sheet & Additional Disclosures

- Employers will report NPL on balance sheet.

- Employers also required to disclose:
  - Description of the plan
  - Authority for determining contributions
  - Information on assumptions
  - Information on investment returns
  - Sensitivity analysis on NPL impact of 1 percentage point increase and decrease in discount rate
  - Changes in NPL for past 10 years
  - Actuarially calculated employer contribution compared to amounts contributed

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Next Steps

- **September 30, 2011**: Deadline for field testing and for comments to GASB on Exposure Drafts
- **October 2011**: Public Hearings and User Forums
  - Oct. 3-4: LaGuardia Plaza, NYC
  - Oct. 13-14: Sir Francis Drake Hotel, San Francisco, CA
  - October 20-21: Renaissance O’Hare, Chicago, IL
- **June 2012**: Final statement adopted


Q&A

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