



MEMORANDUM

TO: NASRA Members
FROM: Keith Brainard
DATE: May 17, 2012
SUBJECT: Perspectives on Recent "GASB Won't Let Me" Report

Governmental Accounting Standards Board (GASB) standards are accounting guidelines, not funding requirements, a fact that will come into even sharper focus this summer when GASB issues its expected revised statements for pension accounting. The new standards are expected to remove the link between pension accounting and funding, achieved in part by eliminating the Annual Required Contribution (ARC).

Robert Costrell, professor at the University of Arkansas, has authored a paper, "*GASB Won't Let Me*"—*A False Objection to Public Pension Reform*. Sponsored by the Laura and John Arnold Foundation, the paper points out that, although GASB standards follow actuarial principles regarding amortization policy, lawmakers have the authority to establish their own funding policy. Indeed, as Professor Costrell correctly observes, policymakers may determine the period and basis with which to amortize unfunded pension liabilities, without regard to GASB standards.

Sensible reasons exist, however, to consider pension reforms in terms that comply with the sound actuarial principles on which these GASB standards are based. The Government Finance Officers Association recommends as a Best Practice that its members "[e]stablish a period for amortization of unfunded actuarial accrued liabilities that does not exceed the parameters established by GAAP."¹ This GFOA recommendation is rooted in upholding the principle of intergenerational equity, i.e., each cohort of taxpayers should pay for the costs of services provided during their lifetime, and future generations should not be charged for the cost of services associated with prior generations.

Constitutional and statutory provisions in many states require policymakers to apply amortization periods that are consistent with the actuarial principles contained in the current GASB standards. For example:

"Public retirement systems shall be funded with contributions and investment earnings using actuarial methods and assumptions that are consistent with generally accepted actuarial standards." [Arizona Constitution, Article XXIX]

¹ Government Finance Officers Association, "Sustainable Funding Practices of Defined Benefit Plans," 2009

"Each fiscal year beginning with the fiscal year starting July 1, 1997, the Legislature shall appropriate funds that will retire in 31 years or less the unfunded liabilities of the Maine State Retirement System that are attributable to state employees and teachers. [Maine Constitution, Article IX, §18-B]

"The State's appropriation to the funds ... shall equal the sum of the normal cost ... plus the payment required to amortize the unfunded actuarial accrued liability using an open amortization period of 20 years." [Delaware Code Title 29, Chapter 55, Subsection III]

Beyond transition costs and maintaining intergenerational equity, policymakers considering pension plan changes must also examine such factors as the ability of the new plan to meet key stakeholder objectives; the additional financing costs associated with extending the amortization period; the administrative costs associated with establishing a new plan; the potential response of bond analysts to a failure to comply with GASB standards, and the effects—on liquidity, asset allocation, and investment returns—of closing a plan.

The impact of a change in amortization policy is only one of many factors policymakers must consider when evaluating pension reform. Just as every pension plan is unique, so also are the adjustments needed to preserve or restore a plan's sustainability, which must reflect a wide range of variables. Although GASB standards do not directly tie the hands of governmental plan sponsors, the principles on which these standards are based are primary considerations and should, with cost and other analyses, be calculated for policy makers to determine the full impact of retirement plan changes.