



Update on GASB Impact - the Exposure Drafts

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October 12, 2011

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Overview

- ◆ Background
- ◆ The GASB's Current Standards
- ◆ The GASB's Exposure Drafts
- ◆ Implications of the Changes
- ◆ The GASB's Next Steps



Background

- ◆ On July 8, 2011, the Governmental Accounting Standards Board (GASB) issued its Exposure Drafts (EDs) on pension accounting and financial reporting standards
- ◆ The first, *Accounting and Financial Reporting for Pensions*, proposes standards applicable to state and local governments that provide pension benefits (amending GASB Statement No. 27)
- ◆ The second, *Financial Reporting for Pension Plans*, proposes standards for the financial statements of plans that administer the benefits (amending GASB Statement No. 25)



Background

- ◆ The EDs were issued after a lengthy deliberative process which included:
 - ▶ *An Invitation to Comment* in 2009
 - ▶ *A Preliminary Views* document in 2010
 - ▶ Related hearings and testimony
- ◆ An ED is usually the last public document that the GASB issues before issuing final standards
- ◆ The GASB's decisions are considered tentative until they are made final
- ◆ The GASB's authority extends to accounting and financial reporting but not to actuarial valuations for funding purposes



Background

- ◆ The EDs would significantly change current pension accounting and financial reporting standards for state and local governments
 - ▶ Disconnect pension accounting measures from pension funding measures
 - ▶ Require employers to recognize an unfunded pension obligation on their balance sheets
 - ▶ Require employers to recognize a new measure of the pension expense on their income statements, which would be significantly different from their actuarially determined contributions
 - ▶ Replace most of the current note disclosures and required supplementary information with information based on the new measures



The GASB's Current Standards

- ◆ Accounting standards draw a distinction between “recognition” and “disclosure”
- ◆ Items are “recognized” in the basic financial statements
 - ▶ Statement of Net Assets (e.g., assets, liabilities)
 - ▶ Statement of Activities (e.g., revenues, expenses)
- ◆ Items are “disclosed” in the notes to the financial statements and required supplementary information
 - ▶ Plan Description
 - ▶ Schedule of Funding Progress
 - ▶ Schedule of Employer Contributions



The GASB's Current Standards

- ◆ For employers sponsoring single employer and agent multiple-employer plans:
 - ▶ **Pension Expense** = Annual Pension Cost
 - The actuarially determined “annual required contribution” (ARC) adjusted to reflect interest on actual contributions that are greater or less than the ARC
 - ▶ **Pension Liability** = Net Pension Obligation
 - The accumulated difference between the annual pension cost and actual employer contributions made since the effective date of Statement No. 27
 - In most cases, a relatively small and predictable figure



The GASB's Current Standards

◆ Key Valuation Parameters

- ▶ Six allowable actuarial cost methods
- ▶ Discount rate based on expected long-term investment return
- ▶ Amortization of actuarial gains/losses and other changes in the unfunded actuarial accrued liability over a maximum of 30 years



Now

... forget all that ...
Everything has changed



Net Pension Liability

- ◆ The GASB decided the employer's basic financial statement liability for pension benefits should be a measure of the employer's unfunded pension obligation
- ◆ This "Net Pension Liability" (NPL) will equal:
 - ▶ The employer's "Total Pension Liability" (TPL) minus
 - ▶ The employer's "Plan Net Position" (PNP) measured using fair (market) value of plan assets
 - ▶ $NPL = TPL - PNP$
- ◆ In essence, the GASB will require a measure of the unfunded liability to be shown on the employer's balance sheet

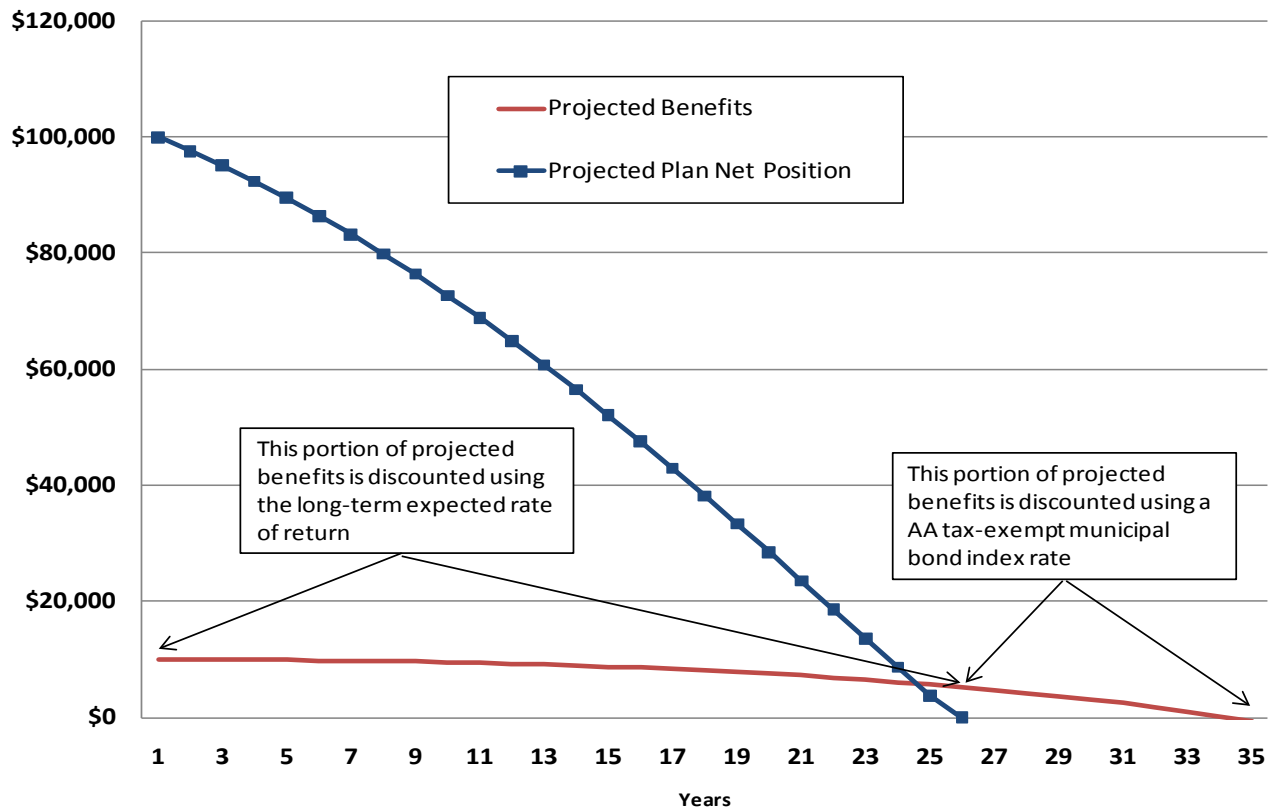


Total Pension Liability

- ◆ As defined by the GASB, the Total Pension Liability is calculated by:
 - ▶ Valuing benefits using the traditional entry age normal actuarial cost method, with service costs determined as a level percent of projected payroll on an employee-by-employee basis
 - ▶ Projecting future benefits related to service, salary, automatic COLAs, and ad hoc COLAs (to the extent they are substantively automatic)
 - ▶ Discounting using a single blended rate that reflects:
 - The long-term expected investment return to the extent current and expected future assets are sufficient to pay benefits and can be assumed to be invested long term
 - Otherwise a 30-year AA/Aa tax-exempt municipal bond index rate

Determining the Discount Rate

Illustrative Projected Benefits and Projected Plan Net Position





Pension Expense

- ◆ Key Components of Pension Expense (PE)
 - ▶ Service cost
 - ▶ Interest on the total pension liability
 - ▶ Projected investment earnings (subtracted)
 - ▶ Difference between actual and projected investment earnings*
 - ▶ Changes in total pension liability*
 - ▶ Actual administrative costs
 - ▶ Member contributions (subtracted)

* Portions of these changes would be either recognized immediately or treated as deferred inflows/outflows and recognized gradually in the pension expense



Pension Expense – Recognizing Changes in Total Pension Liability

- ◆ Immediate recognition:
 - ▶ Changes due to changes in plan terms (i.e., benefits)
 - ▶ Changes related to inactive members (including retirees)
- ◆ Deferred recognition:
 - ▶ Changes in assumptions related to active members
 - ▶ Differences between assumptions and actual experience related to active members
- ◆ Deferred and recognized over the average expected remaining service lives of active members, liability weighted over the closed period




Pension Expense – Recognizing Changes in Investment Earnings

- ◆ The annual difference between actual and expected returns would be amortized over a 5-year, closed period
- ◆ This replaces the Preliminary Views proposal to defer and recognize the accumulated differences between actual and expected returns so long as they did not exceed +/- 15% of the market value of assets




Frequency & Timing of Measures

- ◆ A full measurement of the employer's Total Pension Liability should be made at least every two years
- ◆ The employer's liability measurement need not be at fiscal year end (FYE); however, it should be done no more than 24 months before the employer's FYE
- ◆ If the full measurement is not done at the employer's FYE, it should be projected to that date and updated to reflect all significant changes
- ◆ The value of plan assets should reflect plan net position as of the employer's FYE




Summary of Current GASB Pension Standards for Governmental Employers Compared with Proposed Changes presented in the GASB's Exposures Drafts

For Employers in Single Employer and Agent Multiple-Employer Plans			
	Current Standards	Exposure Drafts	Implications
Pension Liability Recognized in the Employer's Financial Statements (Balance Sheet)	Net Pension Obligation (NPO) - measured as the cumulative difference between the employer's annual required contributions and actual contributions.	Net Pension Liability (NPL) - measured as the difference between the Total Pension Liability (TPL) and the plan's net position (PNP) based on the fair (market) value of assets, with both determined as of the employer's fiscal year end.	Including the NPL on the employer's balance sheet is a major change. The NPL would likely be more volatile than the current unfunded accrued liability, causing confusion about the funded status of the benefits.
Pension Expense Recognized in the Employer's Financial Statements (Income Statement)	Annual Pension Cost (APC) - measured as the employer's "annual required contribution" (ARC) adjusted for interest on the NPO. The ARC is measured as the normal cost (i.e., "service cost") plus amortization of the unfunded actuarial accrued liability over a maximum of 30 years.	Pension Expense (PE) - measured as the current period service cost (based on the traditional entry age normal cost method and the "single discount rate"), plus: Immediate recognition of changes in the TPL due to: (1) interest on the TPL, (2) changes in plan benefits, (3) changes related to inactive members (including retirees), and (4) expected investment earnings; Deferred recognition over the remaining service lives of active members of: (1) changes in the TPL due to changes in assumptions for active employees and (2) differences between assumed and actual actuarial experience for active employees; and Deferred recognition over a closed 5-year period of the difference between actual and expected investment earnings.	The new measure of pension expense would be largely disconnected from the actuarial measure used to fund the benefits. The shorter deferral and recognition periods would increase the volatility of the new pension expense.



Summary of Current GASB Pension Standards for Governmental Employers Compared with Proposed Changes presented in the GASB's Exposures Drafts

For Employers in Single Employer and Agent Multiple-Employer Plans			
	Current Standards	Exposure Drafts	Implications
Allowed Actuarial Cost Methods	Entry age, Attained age, Projected unit credit, Aggregate, Frozen entry age, Frozen attained age.	Traditional entry age, with allocation of service costs as a level percentage of payroll over the employees' expected service starting at entry age.	Restrictions placed on the use of the entry age actuarial cost method could result in differences between the service cost used for accounting purposes and the normal cost used for funding purposes.
Discount Rate	Long-term expected rate of investment return on plan investments.	A single rate based on: (1) the long-term expected rate of return to the extent current and expected future assets are sufficient to pay projected benefits, (2) or otherwise a 30-year AA/Aa tax-exempt municipal bond index rate.	If tax-exempt municipal bond index rates are incorporated into the single discount rate, the accounting measures of the pension liability will be larger (under current economic conditions) and more volatile than the funding measures of the pension liability.
Asset Valuation Method	Market value or smoothed market value.	Fair (market) value of plan net assets.	Use of the fair (market) value would likely add volatility to the net pension liability and pension expense.



Summary of Current GASB Pension Standards for Governmental Employers Compared with Proposed Changes presented in the GASB's Exposures Drafts

For Employers in Cost-Sharing Multiple-Employer Plans			
	Current Standards	Exposure Drafts	Implications
Pension Liability	Pension Liability - measured as the difference between the employer's contractually required contribution and the actual contribution.	Pension Liability - measured as the employer's proportionate share of the cost-sharing plan's collective net pension liability. The employer's proportionate share is based on the employer's long-term contributions relative to the collective long-term contributions of all employers in the plan.	Cost-sharing employers (and nonemployer entities with unconditional legal responsibility for plan funding) would show a new and significantly more volatile measure of the pension liability on their balance sheets.
Pension Expense	Contractually Required Contribution - measured as the employer's contractual contribution to the cost-sharing plan.	Pension Expense - measured as the employer's proportionate share of the cost-sharing plan's collective pension expense.	Cost-sharing employers (and nonemployer entities with unconditional legal responsibility for plan funding) would show a new pension expense that would be more volatile than their contractually required contributions.



TMRS Issues

- ◆ Reporting will be as of employers' fiscal year end date, not the plan's
 - ▶ Requires a roll forward of liabilities from plan's December 31 valuation date to each employer's fiscal year end
 - ▶ Requires monthly allocation of total trust assets to employers on market value basis
 - ▶ Administrative burden on plan to provide required information in a timely manner



TMRS Issues

- ◆ Entry Age Normal cost method required for accounting differs from current TMRS cost method (Projected Unit Credit) used for funding
 - ▶ Consulting costs associated with producing valuation results under two cost methods
 - ▶ May lead to confusion requiring significant communication efforts



Implications of the GASB's Changes

- ◆ Disconnect between accounting and funding
- ◆ A potentially significant measure of the unfunded pension obligation (i.e., NPL) will be included in the employer's basic financial statements
- ◆ The NPL will be volatile as a result of changes in the market value of assets



Implications of the GASB's Changes

- ◆ The pension expense would be significantly different from the actuarially determined contributions, and more volatile
- ◆ Increased administrative costs to comply with proposed standards



The GASB's Next Steps

- ◆ Public Hearings have already begun
- ◆ Comment period ends October 14, 2011
- ◆ Final Statement – June 2012
- ◆ Effective dates:
 - ▶ Reporting periods beginning after 6/15/13 for all TMRS employers and the Plan
 - ▶ First valuation to comply with GASB will be December 31, 2013 (for employers with June 30, 2014 and later fiscal year ends)



Questions?



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