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GASB's New Rules on Uniformity and Disclosure

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An overview of the newly issued GASB rules applicable to public pension plans, the reasons for their implementation and issues created by the new standards.

The 2008 economic collapse and subsequent slow recovery stressed public pension plans, as tax revenue declined during a period of increasing plan costs resulting from poor market returns. During this same period the Government Accounting Standards Board (GASB) has been revising the accounting and financial reporting rules applicable to public pension plans requiring increased uniformity and disclosure. This article will provide an overview of these newly issued GASB rules, discuss the reasons for their implementation, highlight the most significant changes and address issues created by the new GASB standards.

HISTORY AND BACKGROUND

The current public pension plan accounting rules are found in GASB Statements 25, 27 and 50. Statements 25 and 27 were issued in 1994 and became effective in the late 1990s.

GASB 50, which was issued in 2007, amended the applicable notice disclosure and Statements 25 and 27 required supplementary information.

In January 2006, the GASB approved a project to review Statements 25 and 27 effectiveness creating a post-employment benefit accounting and financial reporting project. From October 2009 through June 2010, the GASB reached tentative conclusions on basic employer accounting and financial reporting issues, which were presented for public comment. The GASB's *Preliminary Views on Pension Accounting and Financial Reporting* was subsequently issued on June 26, 2010.

Following a comment period and an exposure draft, on June 25, 2012, the GASB issued Statements 67 and 68 amending GASB Statements 25, 27 and 50. Statement 67 details plan-level financial reporting rules for state and local governments and pension plans, and is effective for fiscal years beginning after June 15, 2013. Statement 68 details the accounting and financial reporting rules impacting a jurisdiction's balance sheet and income statement effective for fiscal years beginning after June 15, 2014. (Note that the GASB encourages earlier application of these rules.)

REASONS FOR ACCOUNTING CHANGES

The main reasons for changing the accounting rules are pension accounting standardization and a purposeful intent to reflect a plan's "true" liability on the sponsoring jurisdiction's balance sheet. Like the private sector pension accounting rules, the new GASB requirements will standardize the three methods used in reporting and disclosing a public plan's liability and expense:

- the funding method used to determine the plan's liability and expense
- the methods used to amortize unfunded liability changes
- the discount rate determination process

Ultimately, the public pension accounting changes will provide financial report users a clearer picture of the size and nature of a defined benefit plan's financial obligations.

Historically, a public pension plan's unfunded liability (actuarial accrued liability less plan assets) was a disclosure item, while the asset or liability on the jurisdiction's financial statements reflected the cumulative difference between the annual pension cost and the employer's contributions to the plan. In many instances there was a modest difference between the pension cost and actual plan contribution, generating an insignificant balance sheet impact. Under the new rules, the unfunded liability becomes a balance sheet item which most likely will adversely affect a jurisdiction's financial statement.

SUMMARY OF SIGNIFICANT CHANGES

The following summarizes the significant changes required by the new GASB pension accounting rules.

Determination of Total Pension Liability

The total pension liability is determined using a uniform funding method, namely the entry age normal (EAN) method. Prior to GASB Statements 67 and 68, actuarial methods and assumptions used for financial reporting purposes were the same methods and assumptions used to determine the plan's funding requirements. Under the new rules, pension accounting does not need to reflect the methods used to determine a plan's funding requirement.

Asset Recognition

Assets will be recognized at fair market value.

Net Pension Liability

As mentioned above, the net pension liability (EAN liabilities less market value of assets) will be a balance sheet item.

Determining a Plan's Funding Requirement

There is no specific requirement to change the method used to determine a plan's funding requirement. However, the new GASB rules require a standard methodology to determine the expense reflected in a jurisdiction's financial statement, which may not have any correlation to the methodology used to determine a jurisdiction's funding requirement.

Discount Rate

One of the most significant issues already subject to close scrutiny with respect to public pension plans is the discount rate used to determine a plan's funding, accounting and financial reporting requirements. Typically, the discount rates used by public pension plans are in excess of the corporate bond rates used by private sector plans. The new GASB rules now require documentation on how the discount rate was determined and the assumed asset allocation and the long-term expected real rate of return for each major asset class must be included in the disclosures.

Furthermore, a projection of a plan's assets is required to determine if the assets are projected to deplete before all benefits promised to current participants are paid. If the assets are not anticipated to deplete, the GASB discount rate is the expected return on assets based on the trust's investment allocation. If assets are anticipated to deplete before all benefits have been paid, a tax-exempt, high-quality municipal bond rate must be used from the time assets deplete to the time all benefits are paid. If plan assets are anticipated to deplete, the discount rate will be a blend using the expected return on assets and the municipal bond rate. This will lower the GASB discount rate and adversely impact the GASB expense and liability.

Recognizing Unfunded Liability Changes

The new GASB rules define

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the time period the plan's unfunded liability changes must be recognized. Liability experience gains/losses and changes due to an assumption change must be amortized over the average expected remaining service lives of active and inactive participants. In determining the average expected remaining service lives, the expected inactive participant remaining life expectancy is zero which produces a shorter amortization period to recognize these changes impacting unfunded liability. A shorter amortization period leads to greater year to year pension expense volatility.

A very noteworthy change is the fact that the total value of an unfunded liability change resulting from a plan amendment must be recognized immediately, which impacts the annual pension expense creating greater volatility. In some cases this rule change may make a jurisdiction think twice prior to improving plan benefits since the decision's full cost will be immediately recognized in the jurisdiction's pension expense.

FALLOUT FROM THE GASB CHANGES

The new GASB rules will affect public plans beyond the numbers used on a jurisdiction's financial statement. The following issues are going to necessitate close attention by jurisdictions sponsoring defined benefit plans.

Discount Rate

The relatively high discount rate used by public plans is already under scrutiny. The new GASB requirements will now require disclosure of the method used to establish the discount rate, possibly inviting media scrutiny.

There is no requirement the GASB discount rate also be used for funding. However, when the GASB discount rate methodology is disclosed, it will be difficult for a jurisdiction to abandon that methodology and use a different funding rate.

Unfunded Liability

Sophisticated users of governmental entities' financial statements, such as a bond rating agency, for example, will already have read the disclosures required by GASB Statements 25 and 27 to determine a plan's underfunding. However, a less sophisticated statement user, such as the news reporter, may suddenly see a hit to a jurisdiction's fund balance (same as private sector net equity) caused by the balance sheet recognizing the plan's unfunded liability, and perhaps create a panic that the plan has suddenly suffered a funded status change.

Determining Funding Needs

While the new GASB requirements do not require a change to the method used to determine a plan's funding needs, the rules will ultimately affect the plan's funding.

It bears repeating that if plan assets are anticipated to deplete before all projected benefits have been paid, a municipal bond rate will need to be used for discounting from the point of anticipated depletion until all plan payments are satisfied. Therefore, jurisdictions are encouraged to develop a contribution policy that will avoid depleting trust assets at any future point. As a result, the new GASB requirements could indirectly affect public pension plan funding.

CONCLUSION

While this article introduced the GASB Statements 67 and 68 requirements, the reporting and disclosure these statements generated is very extensive, and were not intended to be fully addressed here.

At a time when public pension plans are under greater scrutiny due to the challenges revealed by our economy and the bankruptcy filings of certain jurisdictions, most prominently the city of Detroit, the new pension accounting rules aim to bring greater disclosure and transparency. Governmental entities with pension plans need to address and understand these new requirements to effectively determine the financial statement and cash flow impacts, as funding may need to be adjusted along with media relations. PC

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