

# **GASB's Game-Changer**

## ***How Accounting Rule Changes Could Affect Your System***

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## **GASB's Postemployment Benefits project**

- “Accounting and Financial Reporting” for “PEB”
- Complete overhaul of pension rules under Statements 25 and 27 (issued in 1994)
  - Carry over to OPEB reporting (Statements 43 and 45)
- Employer financial statements
  - Also plan financial statements
- Sole and Agent employers
  - Also application to cost sharing employers
- See [gasb.org](http://gasb.org) for project details, tentative decisions

## **GASB's PEB project - Timeline**

- Research project – Jan 2006 to April 2008
- PEB Task Force
- Invitation to Comment (ITC) – May-July 2009
- Board Meetings / Tentative decisions – in progress
  - Staff Issue Papers, comments from Task Force
- “Preliminary Views” – June 2010
  - Comment period through September 2010
- Exposure Draft
- Final Standard

## **GASB's Underlying Basis**

- “Objectives of Financial Reporting”
  - Accountability
  - Decision Usefulness
  - Interperiod Equity
- Based on “Concept Statements”
  - Issued since Statements 25 and 27
  - Definition of Liability (Concept Statement No. 4)
  - “Communication Methods” (Concept Statement No. 3)
    - Basic Financial Statements
    - Notes and Supplementary Information

## Two issues: Measurement & Recognition

- How do we measure pension liability
  - Discount rate, Method for determining Service Cost
  - Future COLAS, Pay increases
  - Asset value
- What obligation meets definition of “liability”
  - Contributions less than expense (ARC), i.e. NPO
  - Unfunded accrued cost (i.e., UAAL)
- Where is the “liability” reported
  - Balance sheet or Footnotes

## Two issues: Measurement & Recognition

- How do we expense changes in net liability
  - Immediately
  - Deferred through “amortization”
- What amortization periods – if any – should be used
  - Maximum period or specified period
  - Different periods for different changes in net liability
- Note that in some ways the liability now drives the expense
  - Used to be the other way around

## ***GASB's Tentative Decision: Liability***

- The UAAL goes on the employer balance sheet
  - Present obligation, little or no discretion to avoid
  - Sufficiently reliable for balance sheet status
  - Note GASB terminology is evolving
    - “Net pension liability” is essentially the UAAL
- Big change from current practice
  - Balance sheet liability only if contributions less than expense (ARC), i.e. Net Pension Obligation (NPO)
  - UAAL was in notes (supplementary information)

## ***Tentative Decision: Measurement***

- Include automatic COLAs
- Include ad hoc COLAs if there is a pattern of granting them
- Include future salary increases
- Include effect of future service
  - These last two also related to service cost method

## ***Tentative Decision: Discount Rate***

- Depends on whether projected assets will provide for all future benefits
  - If so, use **long-term expected yield**
  - If not, use long term yield until assets run out, then “high quality tax exempt municipal bond index rate”
- Supports current practice for funded plans
- Similar to current OPEB rule, but not exactly
- Not clear if we use two rates or a blended rate

## ***Tentative Decision: Cost Method***

- Employee service cost determined using “entry age actuarial method”
- Supports current level cost method practice but limits choices
- Largest impact for “Projected Unit Credit” plans
  - Could be significant especially if applied to OPEB
  - Also affects “aggregate” and other similar methods

## ***Tentative Decision: Amortization***

- Changes in net pension liability amortized over “remaining service lives of individual plan members”
  - Not practical, so may change to “average”
- Applies to gain/loss, assumption changes, retroactive benefit changes
- This means that changes in retired liability are expensed immediately
  - Including impact of assumption changes

## ***Tentative Decision: Asset value***

- The asset value used to determine the “net pension liability” seems to be based on market value, not smoothed actuarial value
- But investment earnings different from assumed return are deferred up to a 15% corridor
  - Immediate recognition outside corridor
  - Details unclear

## ***Tentative Decision: Cost Sharing***

- Employers in a cost sharing plan recognize proportionate share of:
  - Net pension liabilities
  - Pension expense
  - Deferred pension expense
- Proportion based on employer's share of contributions
  - Working on details when proportion changes

## Overall Game Changer: Role of the ARC

- Current expense requirement is called the “annual required contribution”, or ARC
- GASB sets rules for accounting, not funding
  - The ARC is only an expense requirement
- Under current practice, the ARC is a viable funding requirement standard
  - For pensions, ARC is often a de facto funding standard
  - Much less so for OPEB

## Overall Game Changer: Role of the ARC

- Under the Tentative Decisions, the new expense requirement will much more volatile than the ARC
  - Immediate recognition of retired liability gain/loss, benefit changes and assumption changes
  - Asset corridor based on cumulative earnings
- In practice, this will likely break any current linkage between expensing and funding
  - Without ARC, no source for contribution standards
  - New challenge: Reconciling pension expense with actuarially determined contributions

## Next Major Steps

- A Preliminary Views “due process” document is due for release by end of June
  - Comment period for the Preliminary Views
  - Past history is that changes may be accomplished at this Preliminary Views stage
- Exposure Draft released
  - Comment period for Exposure Draft
  - Harder to make substantial changes
- Final Standard adopted (Statement No. XX)
  - Effective date(s)



**QUESTIONS**