NEW ACCOUNTING STANDARDS FOR GOVERNMENT PENSIONS

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The Governmental Accounting Standards Board (GASB) is a standards-setting board of the Financial Accounting Foundation, and was established to improve accounting and financial reporting standards for state and local governments.[1] GASB is considered the official source of generally accepted accounting principles for state and local governments.[2]

In June 2012, GASB approved two new financial accounting statements that replace the previous reporting standards for governmental pension plans and employers. The new GASB pronouncements are Statement No. 67, "Financial Reporting for Pension Plans — an amendment of GASB Statement No. 25," and Statement No. 68, "Accounting and Financial Reporting for Pensions — an amendment of GASB Statement No. 27."[3] Together these new standards will have a profound impact on the reporting of governmental pension liabilities in Kentucky and across the nation.

OVERVIEW OF GASB 67 & GASB 68

GASB 67 was issued to improve financial reporting by state and local governmental pension plans.[4] Similarly, GASB 68 was written to improve accounting and financial reporting by state and local governments that employ individuals that participate in pension plans.[5] The statements represent important changes to public pension reporting that will require significant compliance efforts and will affect the reported financial positions of many state and local governments.

Although the amendments adopted in GASB 67 and GASB 68 are voluminous, there are four main areas in which governmental entities will be impacted: (1) liabilities for pensions that previously were disclosed only in notes must be reported on financial statements; (2) assumptions used to calculate pension liabilities are standardized; (3) the amount and specificity of information that must be included in notes to financial statements are increased; and (4) employers that participate in group pension plans must now report their proportionate share of pension liabilities.

REPORTING LIABILITIES ON GOVERNMENTAL FINANCIAL STATEMENTS

GASB 67 and GASB 68 require governmental entities to recognize items on financial statements that were previously only disclosed in notes. The new statements require that employers recognize their "net pension liability" on their statements of net position.[6] The net pension liability is essentially the actuarial present value of future pension benefit payments less the market value of the pension plan's assets, which is often referred to as the "unfunded liability" if the pension plan's obligations exceed its assets.[7] For governmental entities with largely unfunded pension plans, the inclusion of net pension liabilities on statements of net position will have a major impact on their reported financial health.

Employers must also report any changes in their net pension liability (known as the pension expense) on their statement of activities.[8] Compounding the significance of this change, GASB 67 and GASB 68 also include several rule amendments that will accelerate the recognition of factors affecting an employer's net pension liability.[9]

CALCULATING PENSION LIABILITIES

Under GASB 67 and GASB 68, pension liabilities will be calculated by subtracting the pension plan's assets from the present value of future benefit payments. These future payments and assets are calculated using complicated actuarial models that rely on many assumptions. GASB's goal of increasing "comparability" of pension reporting across governmental entities is achieved by shifting from the "parameters" included in previous guidance to the Actuarial Standards of Practice established by the Actuarial Standards Board.[10] This shift is a part of GASB's separation of funding from accounting calculations for governmental pensions.[11]

The new accounting rules also require that pension assets for plans and employers be measured at their market value; the five-year "smoothing" of investment gains and losses previously allowed for pension plans has been removed. Using the new standards, gains and losses will be reported when actually earned or incurred.[12] However, plans may elect to continue using five-year "smoothing" to determine actuarial contribution rates and to avoid volatility in funding.

With regard to future benefit payments, GASB 67 and GASB 68 require that plans and employers use a single, specified form of actuarial calculation. This method is called the "entry age normal" (EAN) cost method, and distributes pension costs on an individual basis over an employee's career.[13] This change has the effect of shortening the amortization period in many cases when compared to current standards, and will likely increase the reported liabilities of plans and employers. Similarly, "cost-of-living adjustments" (COLA), which are a commonly provided retirement benefit increase, must also be calculated into the total future benefit payments amount.[14]

In addition, the rate used to discount future projected benefits for plans and employers will now be calculated as a blend of the expected investment rate of return and a tax-exempt borrowing rate. The expected rate of return may only be used for the portion of future benefit payments covered by current plan assets. For the portion of future benefit payments not covered by plan assets, a 20-year AA/Aa or higher municipal bond rate will be used.[15] This "blended rate" is expected to be lower than current assumptions for many plans, and thus will likely increase the calculated liability for accounting purposes.

PENSION INFORMATION IN NOTES AND SUPPLEMENTARY SCHEDULES

In addition to financial statement reporting, GASB 67 and GASB 68 also require a variety of new financial and narrative disclosures for both pension plans and employers in notes and required supplementary schedules.[16] The most challenging of these requirements is that pension plans and employers must prepare 10-year schedules of their pension assets, future benefit payments, liabilities, and other statistics regarding pension plans.[17] The notes will also require detailed information about assumed rates of return, and the sensitivity of these rates to a 1 percent positive or 1 percent negative change.[18] Formal actuarial valuation of pension plans must also be completed at least every two years.[19]

REPORTING SHARE OF GROUP PENSION PLAN LIABILITIES

Perhaps the most significant change adopted in GASB 67 and GASB 68 will impact employers that participate in group plans, such as city and county governments that are members of Kentucky's County Employees Retirement System (CERS). Under existing practice, many governmental entities have not reported any pension liabilities so long as the entity paid its required contribution to the group plan each fiscal year.

The new standards require that employers that participate in group pension plans must recognize on their statement of net position their proportionate share of the group plan's collective liability. An employer's share of the group plan liability will be calculated using the same method that is used by the group plan to determine required contributions.[20] Employers participating in group plans are also required to report their proportionate share of the group plan's change in net pension liability (or pension expense) on their statement of activities.[21]

The changes for group plans are designed to mirror the disclosure requirements for single employer plans, and to ensure that those participating in group systems are not exempt from the new financial statement disclosures. Considering that the unfunded liability of the CERS stood at approximately $5 billion (based on market assets) as of June 30, 2013, the impact of these disclosures on the stated financial health of state and local governments will be significant.[22]

CONCLUSION

GASB 67 and GASB 68 constitute major changes to the accounting and reporting of pension-related information by governmental pension plans and participating employers. These statements will significantly impact the reported financial positions of state and local governmental entities, will increase volatility in governmental financial statements, and will likely increase the reported size of the net pension obligation in many pension systems.

GASB 67 and GASB 68 make clear distinctions between funding policies and pension accounting, and state that these changes will not directly impact required pension funding or the cost of pension plans. Nevertheless, the consequences of GASB's new pension accounting and reporting rules will likely result in adverse reactions from many investors, rating agencies, and other users of governmental financial reports. GASB's new pension statements will certainly represent significant compliance challenges for pension plans and government employers.[23] B&B

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1 *See* "Facts about GASB," Governmental Accounting Standards Board (2013-2014).
2 *Id.*
3 GASB 67 took effect on June 15, 2013, and GASB 68 will take effect on June 15, 2014.
4 *See generally* Statement No. 67, "Financial Reporting for Pension Plans—an amendment of GASB Statement No. 25," Governmental Accounting Standards Board (June 2012) (GASB 67).
5 *See generally* Statement No. 68, "Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27," Governmental Accounting Standards Board (June 2012) (GASB 68).
6 *See* GASB 68, at Paragraph 20. Pension plans have separate financial statement disclosures as described in GASB 67, at Paragraphs 14 – 29.
7 *See* GASB 68, at Paragraph 20; GASB 67, at Paragraph 35.
8 *See* GASB 68, at Paragraph 33.
9 *See* "New GASB Pension Statement to Bring About Major Improvements in Financial Reporting," Governmental Accounting Standards Board (June 2012).
10 *See* GASB 67, at Paragraph 38; GASB 68, at Paragraph 23.
11 *See* "GASB's New Pension Standards: Setting the Record Straight," Governmental Accounting Standards Board (2013).
12 *See* GASB 67, at Paragraphs 15 – 19; GASB 68, at Paragraph 20.
13 *See* GASB 67, at Paragraph 46; GASB 68, at Paragraph 32.
14 *See* GASB 67, at Paragraph 39; GASB 68, at Paragraph 24.
15 *See* GASB 67, at Paragraph 40; GASB 68, at Paragraph 26.
16 *See* GASB 67, at Paragraphs 30-34; GASB 68, at Paragraphs 37 – 47.
17 *See* GASB 67, at Paragraphs 32 – 33; GASB 68, at Paragraph 46.
18 *See* GASB 67, at Paragraph 31; GASB 68, at Paragraph 42.
19 *See* GASB 67, at Paragraph 37; GASB 68, at Paragraph 22.
20 *See* GASB 68, at Paragraphs 48 – 51.
21 *See* GASB 68, at Paragraph 53.
22 *See* "Report on the Annual Valuation of the County Employees Retirement System, prepared as of June 30, 2013," Kentucky Retirement Systems (November 8, 2013).
23 *See generally* GASB, "Implementation Guide on Statement No. 67, Financial Reporting for Pension Plans," (June 2013), and GASB, "Guide to Implementation of GASB Statement 68 on Accounting and Financial Reporting for Pensions," (January 2014).

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