June 16, 2010

PRELIMINARY VIEWS SUPPLEMENT

Preliminary Views of the Governmental Accounting Standards Board: Plain-Language Supplement

Pension Accounting and Financial Reporting by Employers

This plain-language supplement to a Preliminary Views is issued by the Board for public comment.

Written comments should be addressed to:

Director of Research and Technical Activities
Project No. 34

Comment Deadline: September 17, 2010

Governmental Accounting Standards Board
of the Financial Accounting Foundation

To order additional copies of this supplement (Product Code No. GV12S) or copies of the full Preliminary Views (Product Code No. GV12), contact the GASB Order Department at 1-800-748-0659, or order online at www.gasb.org.

Copyright © 2010 by Financial Accounting Foundation, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116. All rights reserved. Permission is granted to make copies of this work provided that such copies are for personal or intraorganizational use only and are not sold or disseminated and provided further that each copy bears the following credit line: "Copyright © 2010 by Financial Accounting Foundation. All rights reserved. Used by permission."

Preliminary Views of the Governmental Accounting Standards Board:

Pension Accounting and Financial Reporting by Employers

June 16, 2010

CONTENTS

Page Number

Overview ... 1
The Nature of a Government's Pension Obligation ... 2
    Responsibility for the Pension Obligation ... 2
    The Net Pension Liability ... 2
    Summary of GASB Views ... 3
Measuring a Government's Pension Liability ... 4
    Cost-of-Living Adjustments ... 4
    Discount Rates ... 5
    Method of Attributing the Present Value of Benefit Payments to Specific Periods ... 6
    Summary of GASB Views ... 6
Reporting Changes in a Government's Net Pension Liability ... 7
    Changes to Be Reported as Expenses Each Year ... 8
    Changes to Be Reported as Expenses over the Remaining Period of Employment ... 8
    Investment Earnings ... 9
    Summary of GASB Views ... 10
Governments in Cost-Sharing Multiple-Employer Pension Plans ... 11
    Net Pension Liability ... 12
    Changes in the Net Pension Liability ... 12
    Summary of GASB Views ... 12
The Timing and Frequency of Pension Measurements ... 13
    Summary of GASB Views ... 14
What Information Does the GASB Need to Proceed with This Project? ... 14
What Is the Purpose of This Supplement? ... 15
How Can You Share Your Opinions with the GASB? ... 15

This document is a plain-language supplement to the Preliminary Views, *Pension Accounting and Financial Reporting by Employers,* issued by the Governmental Accounting Standards Board. This supplement is prepared for citizens, taxpayers, elected representatives, municipal analysts, and other external users of governmental financial information and contains a minimum of technical terminology. The supplement references the Preliminary Views and should be read in conjunction with it. The Preliminary Views can be downloaded from the same location as this supplement: www.gasb.org. Questions for *users* of governmental financial information are posed throughout this supplement. Instructions for responding to the questions are on pages 15 and 16. *Preparers and auditors of financial statements and actuaries are requested to answer the questions posed in the Preliminary Views.*

OVERVIEW

The primary goal of the Governmental Accounting Standards Board (GASB) is to develop high-quality standards of accounting and financial reporting for state and local governments. High-quality standards lead to information in financial reports that improves transparency, assists users in assessing accountability, and is useful for making decisions. The GASB periodically reviews its existing standards to determine whether they continue to achieve these objectives effectively.

The GASB's standards for accounting for and reporting on the pension benefits that governments provide to their employees have been in effect for over a decade. In 2006, the GASB began a research project to examine whether those standards are effective in providing decision-useful information, supporting accountability and transparency, and helping people to assess interperiod equity (the degree to which a government raises sufficient resources in a given year to cover that year's costs, as opposed to, for instance, consuming resources accumulated in previous years).

In 2009, the GASB issued an Invitation to Comment that described key issues identified during the research project and explored potential approaches to addressing them. After considering responses from nearly 120 individuals and organizations, the GASB has developed a Preliminary Views containing a set of broad principles and concepts that may lead to changes to the existing standards to improve their effectiveness.

It should be noted that the Preliminary Views relates solely to accounting and financial reporting and does not apply to how governments approach the funding of their pension plans. At present, there generally is a close connection between how governments fund pensions and how they account for and report information about them in audited financial reports. The principles and concepts in the Preliminary Views would separate how the accounting and financial reporting is determined from how pension benefits are funded. Should the GASB's preliminary views become accounting and financial reporting standards in the future, governments would not be required to mirror the accounting and financial reporting changes in their funding approaches.

This supplement discusses issues in the order they are raised in the Preliminary Views. Each section of this supplement concludes by posing questions specifically written to ask users of governmental financial information how the GASB's preliminary views would affect the decision usefulness of the information they receive and their ability to assess government accountability and interperiod equity. Users also may answer the questions posed in the Preliminary Views. *Other readers of this supplement, such as actuaries or persons who prepare*

or audit government financial statements, are requested to answer the questions in the Preliminary Views rather than the questions in this supplement.

THE NATURE OF A GOVERNMENT'S PENSION OBLIGATION

Key Issues: How does an obligation to provide pension benefits arise? Does a government's promise to provide pension benefits when its employees retire constitute a liability that should be reported in the financial statements?

Employees of state and local governments generally receive two types of compensation in return for their labor—current compensation (salaries and health insurance benefits, for the most part) and deferred compensation (primarily pensions and retiree health insurance). Both current and deferred compensation are earned by the employees as they work. But whereas salaries and other forms of current compensation generally are received by employees while they are employed by the government, deferred compensation is not received until after employees have retired or otherwise left the employment of the government. The most common form of deferred compensation is pension benefits.

In the Preliminary Views, **the GASB affirms this understanding of the nature of pension benefits—that they are a form of deferred compensation that is earned as employees work for a government**—an understanding that underlies the existing pension standards.

Responsibility for the Pension Obligation

The fact that pension benefits earned today are not received by the employees until some point in the future when they retire means that a government has an obligation *now* to provide those benefits at that future time. Most governments make payments to a pension plan to accumulate resources for the purpose of making future payments when they come due and thereby meet that obligation. The contributions to the pension plan are calculated to be what is needed to acquire investments that will have sufficient value to meet this objective.

The Preliminary Views states that for financial reporting purposes, **the employer is primarily responsible for the obligation to the extent that sufficient assets have not yet been set aside to satisfy the obligation. The pension plan is primarily responsible for the obligation to the extent that dedicated assets exist.** (This decision is discussed in Chapter 2 of the Preliminary Views.)

In other words, if on a given date the obligation for pension benefits equals $1 million, and the value of assets in the pension plan equals $800,000, then the pension plan is responsible, first and foremost, for $800,000 of the pension obligation. The government is primarily responsible for the remaining $200,000 and secondarily responsible for the $800,000 obligation, should the assets in the plan decline in value.

The Net Pension Liability

At present, neither the total obligation for pensions nor the unfunded portion is reported as a liability in a government's financial statements. Rather, a liability is reported if a government contributes less than the annual required contribution calculated by actuaries (based on the

requirements of the GASB's standards). In developing the Preliminary Views, the GASB considered whether the portion of the total obligation for which the government is primarily responsible constitutes a liability that should be reported in the government's financial statements. GASB Concepts Statement No. 4, *Elements of Financial Statements* (which did not exist when the current standards were written), defines liabilities as "present obligations to sacrifice resources that the government has little or no discretion to avoid."

In the Preliminary Views, the GASB has taken the position that **the portion of the pension obligation that is not covered by assets in the pension plan—the *unfunded* obligation—is a liability of the government.** (Chapter 3 of the Preliminary Views discusses the applicability of each of the components of the definition of a liability.)

Furthermore, the GASB believes that **this liability meets the criteria for being reported in the government's accrual-based financial statements** (all statements except those for the governmental funds), as described in Concepts Statement No. 3, *Communication Methods in General Purpose External Financial Reports That Contain Basic Financial Statements.* That is, the liability (total pension liability minus plan net assets) is believed to be "measurable with sufficient reliability." The Preliminary Views refers to this liability as a *net pension liability.*

Summary of GASB Views

- Pension benefits are a form of compensation promised by governments to their employees in exchange for work performed.
- The pension plan is primarily responsible for the pension obligation to the extent that assets have been accumulated in the plan (by government and employee contributions and investment earnings) to finance the pension benefits; the government is secondarily responsible for this *funded* portion of the obligation.
- The government is primarily responsible for the remaining *unfunded* portion of the obligation.
- The unfunded portion of the pension would be reported as a *net pension liability* in the financial statements of the government.

Questions for Users about the Nature of the Pension Obligation

1. ***Do you agree or disagree with the GASB's views regarding the nature of the pension obligation? Why do you agree or disagree?***

2. ***How would those views affect any or all of the following:***

   a. ***The usefulness of the information to the analyses you perform, the work you do, or the decisions you make?***

   b. ***Your ability to assess a government's accountability?***

   c. ***Your ability to assess interperiod equity?***

MEASURING A GOVERNMENT'S TOTAL PENSION LIABILITY

Key Issues: How should the amount of the pension liability be measured? What methods and assumptions should be used in the calculation?

Because pension benefits are paid in future years and are based in part on events that have not occurred yet (for instance, future salary increases), governments employ actuarial methods to estimate how much the benefit payments will be in future years. An actuary's *valuation* is the product of many assumptions regarding the factors that affect the amount of benefits that will be paid to employees and their beneficiaries in the future. These assumptions are based on historical experience and expectations about the future.

The factors that are included in estimates of the amount of benefits to be paid may include, but are not limited to:

- How many employees of a government are expected to receive benefits
- How long employees are expected to work for the government
- How long employees are expected to live after retiring (and, hence, how many years they will receive benefits).

The projected future cash outflows for pension benefits are converted (discounted) to their present value—their estimated value in today's dollars. Portions of the present value generally are attributed to the past, current, and future years during which employees have worked or are expected to work in exchange for the benefits.

The portion of the present value related to services provided by employees in prior years serves as the basis for determining the total pension liability described in the previous section. As previously noted, the total liability minus the net assets in the pension plan equals the net pension liability a government would report in its financial statements.

The GASB affirms in the Preliminary Views the general current practice of incorporating expectations of future employment-related events (such as salary increases and years of continuing employment until retirement) and other assumptions into projections of pension benefit payments. (This and the following views described in this section are discussed in Chapter 4 of the Preliminary Views.)

Cost-of-Living Adjustments

Some pension plans include provisions for adjusting benefits to keep pace with rising prices—*automatic cost-of-living adjustments* (COLAs). *Ad hoc COLAs,* on the other hand, are not written into the provisions of the pension plan; they are made at the discretion of the government. Automatic COLAs are currently included in benefit projections, but ad hoc COLAs are not.

Under the Preliminary Views, **ad hoc COLAs also would be included in benefit projections if an employer's past practice of granting ad hoc COLAs indicates that the COLAs effectively have become automatic.**

The implication of this view is that, for some employers, the amount of projected future pension benefit payments would be greater than under current standards. As a result, the present value of the future benefit payments and the net pension liability to be reported by those governments also would be larger. The GASB believes that this would be a more accurate

reflection of the total obligation of a government that provides ad hoc COLAs in a virtually automatic manner.

Discount Rates

If you were to try to calculate how much you would receive in the future if you invested a certain amount today, you would need to determine how much the investment would earn—the interest rate. For any given amount invested today, a higher interest rate anticipates larger future returns. Alternatively, for any given payments to be received in the future, a lower interest rate would require you to invest a larger amount today. For example, if you wanted to receive annual payments of $100 for each of the next 10 years, and the interest rate were 6 percent, then you would need to invest about $736. However, if the interest rate were 3 percent, then you would need to invest more—about $853.

The process of converting or discounting projected pension benefit payments into their present value is a similar process and requires assuming an interest or *discount rate.* At present, the accounting and financial reporting standards require governments to apply a discount rate that is based on their expected rate of return on the investments of the pension plan over the long term.

However, in some cases, the assets held by a pension plan over time, including future contributions and earnings, may not be expected to fully cover projected benefit payments. In such circumstances, the GASB does not believe that it is appropriate to use the rate of return on plan investments to calculate the present value of future benefit payments for which plan assets will not be available.

It is the GASB's view that a reasonable long-term expected rate of return on the plan's investments would continue to be the basis for discounting projected benefit payments to their present value, ***but only to the extent that the current and expected future plan net assets will be sufficient to cover the future benefit payments.*** This portion of the pension liability is not like traditional debt or other long-term liabilities, in that assets are set aside in an irrevocable trust and invested on a long-term basis to satisfy the pension liability.

Benefit payments that are expected to occur beyond the point at which expected plan assets are projected to be exhausted would be discounted to their present values using a high-quality municipal bond index rate. This portion of the liability is more akin to other forms of long-term debt.

The result of combining these two rates is an average rate that is weighted according to proportions of future benefit payments for which plan net assets are projected to be available or not. The impact of using a single weighted average discount rate depends on whether the high-quality municipal bond index is higher or lower than the long-term expected rate of return. For example, at the present time, most high-quality municipal bonds carry an interest rate that is lower than that of average long-term pension plan investment returns. Therefore, if a government's benefit payments are expected to exceed projected plan assets, all other things being equal, the result of using a lower discount rate would be a larger present value and therefore a larger net pension liability in the financial statements. The GASB believes that this is a more accurate depiction of the level of resources that will be consumed by the promised benefit payments.

Method of Attributing the Present Value of Benefit Payments to Specific Periods

After the projected benefit payments have been discounted to their present value, an actuary allocates that present value over a period related to the years when the employees work or are expected to work for a government and earn the benefits. At present, governments can choose among six methods for attributing the present value of benefit payments to specific years, for accounting and financial reporting purposes. The way in which the present value is divided among prior, current, and future years has an effect on the amounts of the benefits that are identified as being related to services in each period and therefore the amount reported as pension expense in the financial statements. In addition, the method of attribution affects the amount of the benefits assigned to past periods—the total pension liability.

The attribution of the present value of benefit payments is done either in *level dollar* amounts or as a *level percentage of projected payroll.* The level dollar method divides the liability into equal dollar amounts over the appropriate number of years. The level percentage method calculates payments so that they equal a constant percentage of projected payroll over time.

Some people like having multiple attribution methods to choose from because it is flexible and supports consistency between how governments make funding decisions and how they account for and report pensions in their audited financial reports. However, other people believe that allowing numerous approaches to allocation adversely affects the comparability of the resulting information, making it difficult for financial statement users to compare governments.

The Preliminary Views would require, for the purposes of accounting and financial reporting, that all governments discount projected benefits to their present value when employees first entered the government's employment (the entry age method) and attribute that value to employees' expected periods of employment as a level percentage of projected payroll. (Again, it should be noted that this requirement, as with any aspect of the GASB's pension standards, would apply only to accounting and financial reporting; governments may make other choices when deciding how they wish to fund their pension plans.)

The GASB views the attribution patterns that result from the entry age and level percentage of payroll methods as more representative of how pension benefits are earned. In other words, the entry age and level percentage of payroll methods reflect the ongoing annual exchange of service for benefits over the course of an employee's period of employment in amounts that keep pace with the employee's projected salary over that period.

Although moving from a choice among six attribution methods to a single required method would be a significant change, the GASB believes that potential disruption would be minimized for two reasons. First, the entry age method is the most commonly used of the six options at present. Second, most governments currently choose a level percentage of payroll approach over level dollar.

Summary of GASB Views

- Future salary increases and future periods of employment with the government would continue to be incorporated into projections of pension benefit payments.

- Automatic COLAs would continue to be incorporated into projections of pension benefit payments, and ad hoc COLAs would be included as well if an employer's practice indicates that the COLAs are essentially automatic.
- A single weighted-average discount rate would be used, based on the long-term expected rate of return on the assets of the plan to the extent that projected benefit payments will be covered by current and expected plan assets, and a high-quality municipal bond index beyond the point at which assets are not available.
- Projected pension benefits would be discounted to each employee's entry age and attributed to the employee's expected term of service as a level percentage of payroll.

Questions for Users about Measuring the Total Pension Liability

3. ***Do you agree or disagree with the GASB's views regarding how the total pension liability should be measured? Why do you agree or disagree?***

4. ***How would those views affect any or all of the following:***

a. ***The usefulness of the information to the analyses you perform, the work you do, or the decisions you make?***

b. ***Your ability to assess a government's accountability?***

c. ***Your ability to assess interperiod equity?***

REPORTING CHANGES IN A GOVERNMENT'S NET PENSION LIABILITY

Key Issues: When should year-to-year changes in the net pension liability be reported as expenses? Should there be different timing of expenses depending on the type of change in the net pension liability?

The size of a government's net pension liability changes from year to year for a variety of reasons:

1. Employees work and earn more benefits
2. The outstanding liability accrues interest
3. Actual economic and demographic factors differ from what was assumed in the calculation of the pension liability
4. Changes are made in assumptions about economic and demographic factors
5. Changes in the terms of the pension plan affect benefits associated with employee services in past years
6. The value of plan net assets changes.

The amount of the net pension liability, as discussed so far, equals (a) the portion of the present value of the future pension benefit payments a government will make to its current and former employees that is attributed to past periods *minus* (b) the net assets set aside in the plan that are available to pay benefits. A key accounting and financial reporting issue is when to recognize period-to-period changes in the net pension liability as a cost of a government's operations—as expenses in the accrual-based financial statements.

Changes to Be Reported as Expenses Each Year

The Preliminary Views discusses how changes in the net pension liability would be reflected in the financial statements. (The tentative decisions described in this section are discussed in Chapter 5.) **Each year, benefits earned by employees in exchange for their services and the interest on the beginning balance of the total liability would be reported as expenses.** (Refer to Items 1 and 2 above.) Pension benefits and interest costs are reported as expenses annually as they are earned or accrue, respectively. Likewise, the effects of changes in plan net assets other than investment earnings (for instance, contributions) would be incorporated into expenses when the changes occur.

In contrast, the effects of other changes in the net pension liability would be accumulated and systematically reported as expense each year until an employee retires.

Changes to Be Reported as Expenses over the Remaining Period of Employment

Predictions of economic and demographic factors are not precise, and in general, the actual experience turns out to be different from what was assumed. Furthermore, governments may change their assumptions periodically to acknowledge a persistent difference between assumed and actual experience, or because some other event (such as a long-term economic downturn) suggests that future experience will be different. **Changes in the liability related to (1) the difference between assumed and actual economic and demographic factors and (2) changes in the assumptions would be systematically spread over the employees' remaining service periods—the time from now until the employees retire—and each year's portion would be reported as expenses,** based on the Preliminary Views. (Refer to Items 3 and 4 above.) If a key goal of financial reporting is to aid in the assessment of interperiod equity, then it is rational to recognize expenses while the benefits are being earned—that is, over an employee's term of employment.

Occasionally, the terms of a pension plan may be changed in a way that retroactively changes the amount of benefits that were considered earned by employees for service in past years. Because most states, through constitutions or statutes, prohibit a reduction in the pension benefits of current and former public employees (as opposed to prospective reductions in the benefits of employees hired in the future), virtually all of these retroactive benefit changes are improvements in benefits that increase the size of the net pension liability and the annual costs. (Refer to Item 5 above.)

An increase in the net pension liability due to retroactive benefit improvements would be recognized as expense over periods representative of the employees' remaining service. In concept, the GASB believes that it is appropriate that the cost of benefit improvements be

expensed while the employees are still working for the government and not assigned to periods after they retire when the government is no longer receiving service from them.

At present, governments may recognize the changes resulting from Items 3–5 over a period of up to 30 years. The implications of the GASB's views in this area would be that most governments would recognize these costs as pension expenses sooner than they do at present. For instance, benefit changes affecting retirees and other persons no longer working for a government (and thus with no remaining service period) would be recognized as expense immediately.

Again, it should be noted that these proposals would be required only for accounting and financial reporting purposes. Governments would not have to change their annual pension contributions to match the change in expense reporting.

Investment Earnings

Broadly, a pension plan's assets that can be used for providing benefits derive from three sources—employer contributions, employee contributions, and earnings on the investment of those contributions. As noted previously, all other things being equal, a relatively greater return on investments would lower the amount a government would need to contribute to ensure that sufficient assets are available in the plan to pay benefits when due. Alternatively, a relatively lesser return would require a government to contribute more.

The long-term expected rate of return on plan investments, therefore, is a key factor in determining what it costs a government (reported as expenses) to provide a given level of pension benefits. To the extent that investments earn less than expected, a government's pension expenses will be greater. To the extent that investments earn more than expected, it serves to net against and lower a government's pension expense.

Under the existing accounting and financial reporting standards, annual changes in the value of pension plan investments may not immediately impact the unfunded pension obligation or pension expense. Rather, the increases or decreases in value are permitted to be recognized over several years (most often three to five); this is often called asset smoothing. This is done as part of planning how a government will fund its pensions. The objective is to minimize the impact of normal year-to-year volatility of investment values on the size of the obligation, so that annual contributions to the pension plans follow a reasonably predictable trend over time.

The incorporation of asset smoothing into the present accounting and financial reporting standards has been criticized by some because, in their view, it may delay a government's reaction to significant changes in the value of plan assets, and it diminishes the comparability of the unfunded obligation measure from government to government.

The Preliminary Views describes a different approach that bridges these concerns about current practice. The net pension liability would be calculated by subtracting pension plan net assets available for benefits, including the fair value of investments (not a value based on smoothing annual changes in fair value), from the total pension obligation.

As with assumed economic and demographic factors, assumed returns on plan investments would be incorporated into the pension expense each year. But should actual returns above or below the assumed rate be part of the expense calculation as well? The Preliminary Views would not include differences between the assumed and actual returns in the expense calculation immediately. (Refer to Item 6 above.) Rather, **the annual difference between the assumed and actual investment return would accumulate in the financial statements as deferred inflows**

(returns above the assumed rate) or deferred outflows (returns below the assumed rate), but only to a certain extent.

What does that mean? Generally, actual returns are greater than assumed in some years and lower than assumed in other years. Over time, these differences would be expected to approximately offset each other. The GASB believes that it generally is not appropriate to include in the calculation of annual pension expense these differences in returns that are expected to offset one another.

However, there is a limit to how much would be deferred and not included in the pension expense. **If the deferred outflows (or inflows) accumulate to an amount that exceeds 15 percent of the plan's investments, then the excess amount would be reported as expense (or a reduction of expense) immediately.**

This proposal would serve to remove normal fluctuations in investment values that, over time, are expected to have no net impact on expenses. However, events that have a cumulative impact on asset values that is expected to take a relatively long period to offset (an impact that exceeds the 15 percent limit), such as a large increase or decline in the stock market, *would* be incorporated in the expense calculation immediately.

Summary of GASB Views

Changes in the amount of the net pension liability would be incorporated into the calculation of annual pension expense in the following ways:

- (1) Pension benefits earned, (2) interest cost on the beginning balance of the total pension liability, and (3) changes in plan net assets not related to investments would be reported as expenses each year as they occur.
- (a) Differences between expected and actual economic and demographic factors relevant to the calculation of the total pension liability, (b) changes in assumptions about those factors, and (c) changes in pension plan terms that affect the amount of benefits attributed to past years, would be systematically reported as expenses over a period representative of the remaining service periods of employees.
- Differences between assumed returns on pension plan investments and actual returns would be deferred as long as the accumulated deferred inflows or deferred outflows do not exceed the equivalent of 15 percent of the fair value of pension plan investments. Any amount beyond 15 percent would be incorporated into the expense calculation immediately.

Questions for Users about Reporting Changes in the Net Pension Liability

5. ***Do you agree or disagree with the GASB's views regarding when changes in the components of the net pension liability should be reported? Why do you agree or disagree?***

6. ***How would those views affect any or all of the following:***

   a. ***The usefulness of the information to the analyses you perform, the work you do, or the decisions you make?***

   b. ***Your ability to assess a government's accountability?***

   c. ***Your ability to assess interperiod equity?***

GOVERNMENTS IN COST-SHARING MULTIPLE-EMPLOYER PENSION PLANS

Key Issue: Should governments that participate in a cost-sharing multiple-employer pension plan report a net pension liability, as would governments in sole and agent multiple-employer plans?

The issues discussed to this point have related almost entirely to governments participating in single-employer and agent multiple-employer pension plans. As their name indicates, single-employer plans involve only one government, whereas multiple-employer plans include more than one government.

In *agent* multiple-employer plans, separate accounts are maintained to ensure that each employer's contributions are used to provide benefits only for the employees of that government. Individual employers are responsible for benefits associated with their own employees only, and separate actuarial calculations are made for each participating government in the plan. It is like a collection of single-employer plans. However, to take advantage of economies of scale, the cost of administering the plan is shared by the participating governments, and the plan assets generally are pooled for investment purposes.

In a *cost-sharing* multiple-employer plan, on the other hand, governments pool (share) the costs of providing benefits and administering the plan and the assets accumulated to pay benefits. A single actuarial valuation is conducted for all of the employees of the participating governments *combined.*

The present accounting and financial reporting requirements for governments participating in cost-sharing plans reflect the pooling of risks and assets by not requiring actuarial information to be presented for individual employers. Instead, this information is required to be presented in the cost-sharing pension plan's own financial statements. For instance, the disclosures and supplementary schedules that track the level of plan funding over time and compare actual contributions with the amount the actuarial calculations say should be contributed are not presented by the individual governments, only by the plan.

However, it does not appear that the needs of the users of information about cost-sharing plans and their participating governments are substantially different from the needs of users of sole and agent pension plan financial reports. For instance, users want to know if a government in a cost-sharing plan, like other government employers, incurred an obligation to provide pension benefits to employees as they have worked.

Net Pension Liability

Similar to the tentative conclusion that the unfunded portion of the pension obligation of a single or agent employer is a liability of the government that should be reported in the financial statements—a net pension liability—the GASB believes that the unfunded portion of a cost-sharing pension plan's obligation is the primary responsibility of the participating governments as a group. **Each participating government, therefore, would report a net pension liability based on its proportion of the unfunded obligation of all of the participating governments.**

Changes in the Net Pension Liability

Broadly, there are two sources of changes in the net pension liability that would affect each individual participating government. First, the collective employers' pension obligation changes due to the factors described in the preceding section (Items 1–6). The collective effect of those changes on expense and deferred outflows (inflows) would be determined using the same methods proposed for governments in single-employer or agent multiple-employer plans. (Refer to the Summary of GASB Views in the preceding section.) **A participating government would report its proportionate share of those collective changes.**

Second, a change in a government's proportionate share of the collective employers' pension obligation would change the liability it reports.

Summary of GASB Views

- The portion of a cost-sharing multiple-employer pension plan's pension obligation for which assets are not available—the unfunded pension obligation—is a liability of the participating governments, not the plan itself.
- A government participating in a cost-sharing plan would report a liability in its own financial statements that is equivalent to its proportionate share of the collective unfunded obligation.
- A government participating in a cost-sharing plan would report its proportionate share of changes in the employers' collective pension obligation using the same methods (expense or deferred outflows/inflows) proposed for governments in single-employer and agent multiple-employer pension plans.

Questions for Users about Governments in Cost-Sharing Plans

7. ***Do you agree or disagree with the GASB's views regarding governments in cost-sharing multiple-employer plans? Why do you agree or disagree?***

8. ***How would those views affect any or all of the following:***

a. ***The usefulness of the information to the analyses you perform, the work you do, or the decisions you make?***

b. ***Your ability to assess a government's accountability?***

c. ***Your ability to assess interperiod equity?***

THE TIMING AND FREQUENCY OF PENSION MEASUREMENTS

Key Issues: How often should actuarial measurements take place for the purposes of accounting and financial reporting? When should actuarial measurements take place in relation to a government's fiscal year-end?

The Preliminary Views states that the net pension liability would be measured as of the end of a government's fiscal year. Doing so would require determination of two key pieces of underlying information—the total pension liability and the value of plan assets.

An actuarial valuation of the pension obligation would need to be performed at least once every two years, according to the Preliminary Views. The valuation date would not need to be the employer's fiscal year-end; however, it would need to be a date no more than 24 months prior to the fiscal year-end on which the net pension liability is being reported.

Measurements made earlier than the fiscal year-end would have to be updated to incorporate changes that took place in the interim that have an effect on the net pension liability. How would an update compare with a new actuarial valuation? The procedures needed to update an actuarial valuation to the employer's fiscal year-end would depend on the extent of the impact of events and transactions since the last actuarial valuation. An update might adjust the net pension liability for benefits earned, interest on the total liability, and benefit payments since the last actuarial measurement. However, if there have been significant changes since the last actuarial measurement, a new actuarial valuation might be needed.

The actuarial valuation that produces the measure of the unfunded pension obligation under current standards also is required to be conducted at least every other year. In practice, many governments have annual valuations. At present, it is possible that the underlying actuarial valuation on which a government's pension expense is based could be more than two years old by the end of the fiscal year for which the government is reporting, or more than three years old if a government has valuations done every other year.

The result of pursuing this view would be more up-to-date information about the size of a government's unfunded pension obligation. Comparability across governments would be improved as well, because each government's net pension liability would be based on

information as of the end of its fiscal year. That would alleviate concerns about outdated information.

Summary of GASB Views

- The net pension liability (total liability minus the value of plan net assets) would be measured as of the end of a government's fiscal year.
- Actuarial valuations to measure the total liability would take place at least every other year.
- The date of the actuarial valuation used to report an employer's net pension liability would not have to be the employer's fiscal year-end; however, it would have to be no more than 24 months prior to the end of a government's fiscal year.
- Measurements of the net pension liability that take place earlier than the end of a government's fiscal year would be updated to reflect all significant changes between the actuarial valuation date and the fiscal year-end.

Questions for Users about the Timing and Frequency of Measurements

9. ***Do you agree or disagree with the GASB's views regarding the timing and frequency of the measurement of the net pension liability and its components? Why do you agree or disagree?***

10. ***How would those views affect any or all of the following:***

a. ***The usefulness of the information to the analyses you perform, the work you do, or the decisions you make?***

b. ***Your ability to assess a government's accountability?***

c. ***Your ability to assess interperiod equity?***

WHAT INFORMATION DOES THE GASB NEED TO PROCEED WITH THIS PROJECT?

When the GASB sets standards, a crucial part of its "due process" activities is the publication of documents for public discussion and comment. The GASB relies on the comments of the people who prepare and audit financial statements to assess the technical accuracy and appropriateness of potential approaches to addressing accounting and financial reporting issues. The GASB often poses questions regarding critical issues in its due process documents.

The users of financial statements, on the other hand, are in the best position to help the GASB understand whether or not the information that would result from the potential approaches would be useful for fulfilling their need for governmental financial information. The substance of the comments from each of the GASB's constituents is more important to the GASB's deliberations than the total number of people for or against a certain approach. A Preliminary

Views is not an opinion poll, and the GASB's ultimate decisions are not necessarily those with the most popular support.

You can help the GASB to complete this project by reviewing the issues raised in the Preliminary Views and answering the questions posed throughout this supplement.

WHAT IS THE PURPOSE OF THIS SUPPLEMENT?

To help achieve its mission of setting accounting standards that result in information that is useful for making decisions, the GASB makes a concerted effort to communicate with the public in a more understandable and broadly accessible manner. In particular, the GASB occasionally uses "plain-language" supplements in conjunction with its due process documents.

This document is a plain-language supplement that accompanies a Preliminary Views discussing potential changes to the GASB's existing standards for pensions—*Pension Accounting and Financial Reporting by Employers.* The intention of this plain-language supplement is to make it easier for you to participate knowledgeably in the GASB's standards-setting activities. This supplement attempts to achieve this goal by (1) presenting the issues with as little of the Preliminary View's technical and implementation-oriented vocabulary as possible and (2) focusing on the impact the issues may have on the information you find in government financial statements. This supplement focuses on situations that most typically occur and does not address certain circumstances that are less common. The complete discussion of the issues can be found in the Preliminary Views, which should be read in conjunction with this supplement.

The GASB hopes that, as a result of its efforts to present these issues in less technical language, more users of governmental financial information will respond. The GASB will consider this feedback, and that expressed in three public hearings, during its future deliberations on the pension standards.

HOW CAN YOU SHARE YOUR OPINIONS WITH THE GASB?

It is essential to the Board to receive feedback from users like you, in response to the questions presented above. You may also wish to address other issues raised in the Preliminary Views. *(Preparers and auditors of financial statements and actuaries are requested to answer the questions posed in the Preliminary Views rather than the questions in this supplement.)*

If you would like to submit written comments to the GASB about the views expressed in this document, there are two ways you may do so:

- By email—send your comments to director@gasb.org
- By traditional mail—include your comments in a letter and mail to:

Director of Research and Technical Activities
Project No. 34
Governmental Accounting Standards Board
401 Merritt 7, PO Box 5116
Norwalk, CT 06856-5116

Submissions are requested by September 17, 2010.

The GASB has scheduled three public hearings at locations around the country:

- October 13, 2010 in Dallas, Texas
- October 14, 2010 in San Francisco, California
- October 27, 2010 in New York City.

If you wish to speak at a hearing, you should notify the GASB of your intent in writing and submit a copy of your comments, using the address above, no later than September 17, 2010. You can testify in person or via telephone. Please read the participation requirements in the notice of public hearing in the Preliminary Views.