GASB's New Accounting Standards for Public Plans – Impact on Teacher Plans

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Background

- In June, 2010, GASB issued “Preliminary Views” on revisions to GASB Statement No. 25, Financial Reporting for Pension Plans, and GASB Statement No. 27, Accounting and Financial Reporting for Pensions
- Statement No. 25 deals with a plan's own financial statements
- Statement No. 27 deals with the accounting statements of the employer
- In June 2011, GASB issued “Exposure Drafts” of revised statements, and began holding public hearings and receiving comments (over 800 at last count)
- In April, 2012, GASB considered the comments and made certain changes to the drafts of revised statements
- In May and June, 2012, GASB considered some further changes, and on June 18 and 25, GASB voted on the final versions, renumbered 67 and 68

Effective dates

- For plans, periods beginning after 6/15/2013
- For employers, periods beginning after 6/15/2014

Major changes

- Accounting for plans (old 25, new 67)
  - A major thrust of the new standards has been to create more uniform accounting assumptions and to de-link accounting standards from funding standards
  - In addition, a major revision has been to change the discount rate used for accounting for liabilities
- Accounting by employers (old 27, new 68)
  - A major thrust of the new standards for employers has been to require plan liabilities to appear on employer balance sheets and to provide more extensive information on what makes up the liability
  - As a part of that, liabilities under a "cost-sharing plan" (e.g., state retirement system) would be apportioned and shown on the participating employer balance sheets

Changes to the discount rate

- The discount rate is a single rate that reflects the following:

(1) The long-term expected rate of return on plan investments that are expected to be used to finance the payment of pensions, to the extent that the plan's fiduciary net position is projected to be sufficient to make benefit payments and plan investments are expected to be invested using a strategy to achieve that return, and

(2) A yield or index rate for 20-year, tax-exempt general obligation bonds with an average rating of AA/Aa or higher (or equivalent quality on another rating scale), to the extent that the conditions in (1) are not met

Discount rate, cont'd

- Observation: while this is a change from the current use of the plan's interest rate for valuing liabilities, it also does not apply the significantly lower discount rate advocated by some economists or in proposed federal legislation
  - See, e.g., Robert Novy-Marx and Joshua D. Rauh (T-bill, taxable state bond rates), Nunes bill (H.R. 567, formula based on T-bill rates)

Reporting of liability

- New rule changes the emphasis on the annual required contribution (ARC) and net pension obligation (NPO), which generally resulted in no liability shown if the NPO equaled the ARC, or in notes
- Employers will instead be required to show the net pension liability on their balance sheet and include extensive supplemental information

Single and Multiple-Employer Plans

- Single-employer pension plans—those in which pensions are provided to the employees of only one employer
- Agent multiple-employer pension plans—those in which plan assets are pooled for investment purposes but separate accounts are maintained for each individual employer so that each employer's share of the pooled assets is legally available to pay the benefits of only its employees
- Cost-sharing multiple-employer pension plans - those in which the pension obligations to the employees of more than one employer are pooled and plan assets can be used to pay the benefits of the employees of any employer that provides pensions through the pension plan

Changes for employers participating in cost-sharing plans

- Cost-sharing plan definition would cover many state retirement systems, including teacher retirement systems
- Under GASB 68, for the first time, beginning with periods beginning after June 15, 2014, a cost-sharing employer must recognize in its financial statements (i.e., included as a liability and on its profit and earnings figures) its proportionate share of the collective net pension liability of the cost-sharing plan as well as its collective pension expense – which is based on its proportionate share of the increase in liabilities

Cost-sharing employer changes, cont'd

- Original GASB proposal:
  - Proportionate shares based on specially determined long-term contribution effort of that employer and future "collective deferred outflows" and "collective deferred inflows"
  - Plan and actuarial information (e.g., asset values) had to be adjusted to employer's financial statement year end
  - Extensive supplemental information and schedules
  - Assumed much of this would be prepared by the plan for the employers

Cost-sharing employer changes, cont'd

- GASB Final Standard:
  - Expanded the permissible methods for determining an employer's proportionate share
  - The long-term contribution effort approach is still the ideal, but if not practical, a cost-sharing employer's net pension liability (asset) may be estimated by calculating a measure of the proportionate relationship of the employer to all employers determined using a basis associated with the manner in which contractually required contributions to the plan are assessed
  - Examples include ratios based on:
    - Current-period contributions or current-period payroll
    - Average historical contributions or average historical payroll (not to exceed 5 years)
    - Single-period forward-looking contributions
    - Other methods that are used internally by the plan to associate a portion of the unfunded pension obligation to individual employers

Cost-sharing employer changes, cont'd

- Employer's net pension liability will be plan's collective net pension liability multiplied by the employer's proportion
- If different contribution rates are associated with different components of the collective net pension liability (for example, different classes or tiers of employees), calculation of the employer's proportionate share of the collective net pension liability should reflect those different components

Cost-sharing employer changes, cont'd

- For the employer's financial statement, employer can use the plan's financial statement as of a plan year end which is not more than 12 months plus one day from the employer's fiscal year-end (the "measurement date"). These numbers in the plan financial statement do not have to be brought forward to the employer's fiscal year end
- An actuarial report can be used if it is as of a date no more than 30 months, plus one day, prior to the employer's year end. In some cases, those actuarial numbers have to be adjusted up to the date of the plan's fiscal year end both for time and for significant changes
- Supplemental information and schedules simplified

Liability of the cost-sharing employer

- Despite numerous comments and arguments by interested parties, GASB voted to retain its position that participation in a cost-sharing plan creates a liability "that the government has little or no discretion to avoid”
- GASB determined that the liability must appear on some entity’s balance sheet, and, as a default, that is the participating employer
- However, where a nonemployer entity has an unconditional legal requirement to make a payment to a pension plan it will recognize in its financial statements its proportionate share of the net pension liability of the employer on whose behalf it contributes
  - So while employer is the default, the liability may be shifted

Who will do the accounting work for cost-sharing employers?

- Final rule recognizes that the employer's financial statements are the responsibility of the employer, not the cost-sharing plan
- "The Board believes that this is most appropriately accomplished through coordination and communication between an agent or cost-sharing plan and the employers and that it might be considered a best practice for agent or cost-sharing plans to provide such information in an audited form on a timely basis to assist participating employers in meeting their accounting and financial reporting requirements."
- What will cost-sharing employers expect?

Summary of final standard

- Blended discount rate is required
  - Reported liabilities likely to increase
- Liabilities will appear on employer balance sheets
  - Including a proportion for employers participating in cost-sharing plans
- Methodology for proportioning cost-sharing plan liability has been substantially simplified

Considerations

- Plans must begin to prepare for their new accounting standards
- Employers must begin to work with their accountants to prepare for including substantially more information on their financial statements
  - Begin considering any collateral effects of showing increased liabilities
  - How much assistance will employers need from plans?

Possible future issues

- Will employers choose not to apply GASB standards?
- How smoothly will interactions between plans and cost-sharing employers take place?
- Exclusive benefit rule and use of plan assets to assist employers in preparing financial statements
- Will there be efforts to shift liability?
- Rating agency impact
- Possible future SEC or federal intervention
- Or will this be a non-event?