FREQUENTLY ASKED QUESTIONS ABOUT GASB AND THE PV

1. **What is the Governmental Accounting Standards Board (GASB)?**

   GASB ("Gazzbee") is an independent organization – not a governmental entity --that establishes standards of accounting and financial reporting for U.S. state and local governments. It consists of a board appointed by the trustees of the Financial Accounting Foundation (FAF), which is a Section 501(c)(3) organization. GASB was established in 1984 by agreement of the FAF and 10 national associations of state and local government officials, including NASRA. It is currently funded in part from sales of its own publications and in part from state and local governments and the municipal bond community. This funding is currently under review and could be replaced by an annual fee imposed by the Financial Industry Regulatory Authority ("FINRA") on FINRA members.

2. **Why is GASB important?**

   Governments are fundamentally very different from for-profit businesses. Therefore, the accounting and financial reporting standards that apply to governmental entities must be designed to reflect these differences. Furthermore, the information needs of the users of government financial statements are different from the needs of the users of private company financial statements.

3. **Do governments have to follow the GASB standards?**

   GASB's standards are not Federal laws or regulations and GASB does not have the power to enforce their use. Nevertheless, compliance with these standards is required under many state laws, and bond raters consider whether GASB standards are followed. Also, auditors are required to note any departures from GASB standards when they express an opinion on financial reports that are presented in conformity with generally accepted accounting principles.

4. **Who uses the information GASB requires?**

   GASB's goal is to issue standards that produce "decision-useful" information for users of government financial reports. Such users include owners of municipal bonds, members of citizen groups, legislators and legislative staff, other oversight bodies, and taxpayers at large.

5. **What is the GASB "Preliminary Views?"**

   The "Preliminary Views" (PV) represents the latest step in a multi-year process that GASB began in 2006 to review its current pension standards—Statements No. 25, "Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for

Defined Contribution Plans," and No. 27, "Accounting for Pensions by State and Local Governmental Employers."

In 2009, following this review, GASB issued an Invitation to Comment (ITC) that described the key issues it believed were raised as a result and explored potential approaches to addressing them. It received responses from nearly 120 individuals and organizations and held two days of public hearings.

Then, on June 16, 2010, GASB released its Preliminary Views (PV) about how to improve the effectiveness of the existing accounting and financial reporting standards. These are its current views on what it believes are the most fundamental issues related to employer accounting and financial reporting for pensions. GASB's purpose in issuing the PV is to obtain public comments before developing more detailed proposals for changes to existing standards, which are likely to be released next summer in the form of an Exposure Draft.

Furthermore, these preliminary views generally are discussed as principles or concepts rather than as detailed potential requirements. While they represent the Board's current views on the issues discussed, some Board members may disagree with certain aspects of the Preliminary Views, and some may feel more strongly about certain provisions than others do.

6. **Why is GASB considering making these changes to its standards?**

   The standards that GASB is currently reviewing were issued in 1994 and were fully implemented by the late 1990s. The purpose of their review is to determine how well these standards are working, after they have now been in effect for a sufficient amount of time to make such judgments, and to decide what improvements, if any, could be made in them.

7. **Who thinks the GASB standards should be changed?**

   Some academicians and economists think that state and local governmental employers should account for their pensions in the same way that private employers do. They think that pension liabilities should be determined as though the pension funds were all invested in low-risk government bonds and not in balanced portfolios that most pension funds use, which include stocks and other more diversified investments as well as bonds. They believe that this approach more accurately reflects the guaranteed nature of the pension promises that governments make to their employees. Some in the media also think that this method will permit all interested parties to compare one public pension plan with another, notwithstanding the extreme diversity within the governmental plans sector.

Others believe that GASB's current accounting standards permit plans to appear better funded than they otherwise would be, thereby encouraging employees to seek benefit enhancements that are not affordable in the long term, and tempting employers to take contribution holidays that can exacerbate future funding needs in leaner economic times.

Finally, other groups believe that defined benefit (DB) pensions are no longer sustainable for government employees and that they should be replaced with defined contribution (DC) pensions such as 401(k) plans. These groups believe this goal would be furthered if governments reported a higher cost for DB pensions as a result of using that would result from using the private sector accounting standards.

8. Are the supporters of changing the GASB standards correct?

There is no one "right" answer. However, different approaches can produce starkly different results. For example, following years of experience under the current GASB standards, which reflect the fact that governmental plans are different from their private sector counterparts, State and local governments have been able to accumulate more than $2 trillion dollars in real assets for their pension plans – not paper IOUs – even when the recent dramatic market downturn is taken into account. Diversified investments have helped to produce returns that have funded approximately two-thirds of every benefit payment. It should also be well noted that employers' contributions to their pension plans, measured as a percentage of payroll, have remained relatively constant over time under the current GASB standards.

In contrast, private sector DB pension plans have been struggling with their accounting standards and the funding demands that they impose. The resulting volatility in employer contribution rates continues to be given as one of the primary reasons why private DB plans are being frozen or terminated. The situation became so extreme following the recent market declines that the US Chamber of Commerce and other private sector organizations successfully lobbied Congress to ease the very accounting and funding rules that some would now impose on the public sector.

This is not to suggest that nothing should be changed. However, modifications in accounting standards that would produce disproportionately large, rapid and erratic changes to a public plan's costs, accrued liabilities, and funded levels would translate into erratic demands on governmental resources and, ultimately, in plan terminations. Finally, disconnecting accounting and financial reporting from funding would seriously undermine the proven usefulness of the information contained in employer financial statements for decision-making, since most decisions regarding governmental employers' pensions specifically deal with funding.

9. **But doesn't this prove public pension critics' point that if the real costs of pensions were required to be reflected in financial statements, then these pensions would finally be shown to be unaffordable, and they would be closed down?**

Measurements of a plan's total unfunded pension liabilities are important numbers to have, and they are in fact currently developed and disclosed. However, they are shown in the notes and other supplemental material that accompany the financial statement, not on the balance sheet itself.

Why? Because the numbers reported on the balance sheet should be highly reliable, and the long-term pension obligation is subject to a great deal of volatility, particularly as it would be measured by the GASB's proposed new standards. The fact is that pension benefits sponsored by many states and local governments can be altered and actuarial assumptions may need to be adjusted. The resulting differences can be dramatic, as evidenced by recent legislative actions in several states, where the liabilities have changed by as much as 60%!

Also, plans' investment experiences inevitably will vary from expectations. Passing market fluctuations that are essentially meaningless from the long-term perspective of funding public pension benefits could nevertheless produce such extreme volatility that the impact on the employer's balance sheet would be disproportionate to the true funding needs of the pension from year to year. For example, a recent study showed that in years of high market volatility, such as 2008, the market downturn would likely have resulted in an unprecedented increase in the new liability GASB now wants reported on the balance sheet -- more than three times the liability that would be disclosed in the notes and used for funding.

Finally, even if critics were successful in using the proposed new balance sheet entry to so distort budgets that governments might think they have no choice but to close their DB pension plans, the new GASB number would nevertheless continue to be required on the balance sheet for years to come as the plan slowly died. It could actually become a higher number since the closed DB plan, starved of future employees' contributions, would likely see its assets fall and its liabilities increase.

No one would win.

10. **What can I do?**

While GASB relies on the comments of the people who prepare and audit financial statements to assess the technical accuracy of their proposals, including public pension funds themselves and public pension actuaries, it wants to hear from citizens, taxpayers, elected representatives, municipal analysts, and other external users of governmental financial information. ***GASB believes that <u>users</u> of financial statements are in the best***

position to help it understand whether or not the information that would result from the potential approaches would be useful for fulfilling users' need for governmental financial information.

Therefore, the comments of elected representatives and other officials of governmental employers who rely on the numbers in these financial statements for decision-making will be particularly important in influencing GASB's final conclusions in this crucial area.

GASB has requested written comments on the PV by September 17, 2010, and plans to hold public hearings on October 13th in Dallas; October 14th in San Francisco; and October 27th in New York City. It wants to hear from citizens, taxpayers, elected representatives, municipal analysts, and other external users of governmental financial information.

11. If I want to comment, what should I focus on?

GASB clearly knows that it is about to destroy the link between how governments approach the funding of pensions and how they account for and report information about them in financial reports. However, it also thinks that "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 is a very simplistic and unrealistic view of the way in which public pensions and their sponsors operate. It also ignores the very serious consequences that will occur when the public is told that one number (the balance sheet number) represents the pension liability of the government, and yet the government intends to make payments to reduce that liability based on a totally different number(the number in the supplemental materials).

Furthermore, to base the measurement of an employer's unfunded pension obligation on the market valuation of plan net assets at a single point in time will produce an unfunded obligation that will be extremely volatile and much larger than the current number reported on the employer's balance sheet. It also ignores the long-term perspective of pension funding, particularly in the governmental setting with virtually perpetual entities as sponsors.

Therefore, if you believe that GASB's current inclination to destroy this critical link between pension funding and pension accounting is dangerous and should not be pursued, please consider filing a comment letter or even requesting to testify at one of the October field hearings. There are many parts to the GASB proposal, but you do not need to comment on all of them. Instead, you can focus on a few areas, and there are some *talking points attached (see "POINTS TO CONSIDER INCLUDING IN YOUR COMMENTS") that could be useful in making your case.*

Comments can be filed--

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

If you cannot get your written comments filed by September 17th, submit them as soon as you can. Clearly, GASB will still be receiving oral comments through the end of October, and it therefore seems unlikely that they would choose to ignore written input from important users of financial statements during that period as well.