

“IN A NUTSHELL” -- GASB PV FACT SHEET FOR EMPLOYERS

The Governmental Accounting Standards Board (GASB) is in the middle of a multi-year project to make changes to the way in which government sponsors of defined benefit (DB) pension plans account for and report their pension assets and liabilities in their annual financial reports, including the balance sheet. These changes would seriously impair the decision-usefulness of that important document, virtually destroying the ability to use it as a tool (1) to provide policymakers and others with a funding target; and (2) to know whether pension plan sponsors are paying their fair share of their pension costs.

Under current GASB rules, a government employer's unfunded actuarial accrued liability (UAAL) for its pension plan is not included on the balance sheet. Rather, it is disclosed in the notes to the employer's financial statements or in other supplementary information. Instead, the amount now shown on the balance sheet, and referred to as the employer's "Net Pension Obligation," is tied to the actual funding of the pension plan. It reflects the cumulative difference between the employer's actuarially determined Annual Required Contribution (ARC) necessary to fund plan liabilities over time and the actual contributions made by the employer. However, GASB has recently indicated in its "Preliminary Views" (PV) that radical changes lie ahead.

First, rather than reporting the cumulative difference between the employer's ARC and its actual contributions as its pension liability on its balance sheet, the employer would instead be required to show a new number, referred to as the "Net Pension Liability," or NPL. The NPL will essentially reflect, as of the employer's fiscal year-end date, the difference between its UAAL and the fair market value of its pension assets. These assets would not be "smoothed," (i.e., averaged over some time period) as currently allowed for funding purposes. Also, the discount rate for valuing the UAAL would in some cases have to be a blended rate that incorporates a municipal bond yield instead of just using the pension plan's long-term expected rate of return, as is now permitted by GASB.

This new NPL will be dramatically larger, in most cases, than the number currently disclosed on the balance sheet. It would also likely be larger than the UAAL contained in the supplementary materials and used to determine the actual pension contribution for funding purposes.

This will "de-link" pension accounting from pension funding. It will create confusion as to which number -- the NPL or the UAAL -- is the "real" liability of the plan. It will mean that an employer's balance sheet would no longer provide a means of determining cumulative underfunding in relation to the employer's required contributions. Finally, because of the disproportionate size of the NPL, it will render the balance sheet effectively worthless for responsible decision-making by the employer in other areas as well as pensions.

Overall, the GASB PV's current direction would inflate employer's perceived costs, increase the perception of volatility in their liabilities, raise public confusion over the adequacy of plan sponsors' funding efforts, and eliminate proven and much-needed tools to help enforce funding discipline.