

# GASB Issues Their Preliminary Views on Pensions



**IMPLICATIONS TO TMRS CITIES  
BOB SCOTT-CITY OF CARROLLTON  
TMRS ANNUAL TRAINING SEMINAR  
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# Process to Date



- **GASB elected to re-examine their existing Pension Guidance contained in GASB 25 & 27.**
- **GASB issued an Invitation to Comment which discusses several issues and alternative approaches to pension accounting.**
- **This June, GASB issued their Preliminary Views with a September 17<sup>th</sup> comment deadlines.**
- **Public Hearings have been scheduled for New York, San Francisco & DFW (October 13<sup>th</sup>).**

# Where We Go From Here



- After GASB receives input from the public through comment letters and public hearing testimony, the process is expected to proceed as follows:
  - Exposure Draft 2nd Quarter 2011
  - Final Standard 2<sup>nd</sup> Quarter 2012
  - Effective FYE 2014 or 2015

# Current Standards



- **GASB 25 (Pension Plan) & 27 (Employer) were issued in November 1994.**
- **They adopted a “funding friendly” approach that harmonized accounting expense recognition with funding of the plans.**
- **As long as the funding calculation met certain parameters regarding methodology, amortization etc. then the Annual Required Contribution (ARC) in essence became the Annual Pension Cost.**

# Current Standards



- A Statement of Net Assets (balance sheet) liability was recognized only if the employer did not pay the ARC.
- The standards provided considerable flexibility regarding actuarial and amortization methods used:
  - Six actuarial methods to choose from.
  - Two methods with up to 30-year amortization, open or closed.
  - Extensive asset smoothing was permitted.

# Current Standards



- Actuarial Valuations could be performed up to two years before the start of the new fiscal year allowing easy coordination with the annual budget process.
- A ten year phase-in of longer amortization was provided to allow for governments time to “step up” to the more stringent funding standards.

# Proposed Guidance



- **GASB's Preliminary Views represent a complete departure from current standards:**
  - Funding Friendly approach has been abandoned.
  - Methodology options have been all but eliminated:
    - ✦ One actuarial method — Entry Age
    - ✦ Specified Amortization period — remaining years of service
    - ✦ Assets must be smoothed using 15% corridor

# Proposed Guidance



- Discount rate must be a blended rate between expected rate of return and municipal rate of return based on expected cash flows
- Creates a Net Pension Liability (NPL) for any unfunded amounts calculated using GASB's methodology.
- Requires an actuarial update to the employer's reporting date.

# Proposed Guidance



- **Creates greater volatility in the expense numbers by requiring:**
  - ✦ All actuarial gains or losses on retirees and in-actives to be recognized immediately.
  - ✦ All benefit enhancements must be recognized immediately.
  - ✦ A fifteen percent corridor would have caused huge volatility in the recent 2008 market collapse.
  - ✦ Extremely short amortization periods (10-15 years) provide substantially less smoothing than current options.

# Implications to Employers



- It will be impossible to synchronize budget, pension contributions and pension expense because:
  - Retiree/inactive volatility.
  - Investment/Asset Volatility.
  - Requirement to Update Valuation.
  - Short Amortization periods.
- Employers will have huge liabilities recorded in their financial statements regardless of whether they are responsibly funding the plan or not.

# Implications to Employers



- Since “Management” is responsible for the fair presentation of the financial statements, they will have to get comfortable with recording a huge liability that they did not calculate.
- Maintaining funding discipline for sole employer plans will be more difficult in the future.
- TMRS due to requirements of state statutes can help maintain that funding discipline for its member cities.

# Implications to Auditors



- They will now be expressing an opinion on a specific number in the financial statements versus a footnote or RSI disclosure in the past.
- The size and relationship of the NPL to materiality will make it much more likely that the auditor will perform tests on the data underlying the valuation.
- Awkwardness of the employer's auditor testing independent pension plan's data.

# Implications to TMRS



- **TMRS will have to perform two valuations and a update for each of its 837 member cities:**
  - A funding valuation as of 12/31/xx.
  - A GASB compliant valuation as of 12/31/xx.
  - An update of the GASB compliant valuation to the fiscal year end of each of their cities (usually September 30th).
- **Decisions will have to be made how to reconfigure the various sections of the CAFR and which of the two valuations to present outside the Basic Financial Statements.**

# Implications to TMRS



- **TMRS will have to decide whether to try to get the two methodologies closer together; i.e., switching from PUC to Entry Age.**

# Implications to TMRS



- **Pension Plans will have to work hard:**
  - To avoid the perception of “two sets of books.”
  - To educate their members of how to explain the differences between the GASB mandated accounting and numbers used for funding.
- **My prediction is that the funding valuation will continue to be the dominant valuation because:**
  - It is used for budget purposes.
  - Evaluating funding progress over time using a different actuarial measuring stick than was used to develop the funding contribution will not work.
  - Most non actuaries have difficulty understanding even one actuarial method and will not want to deal with both.

# Questions



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