

GRS INSIGHT

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In This Issue

The GASB's Invitation to Comment presents the conceptual framework that the GASB will use to evaluate potential changes in accounting and reporting standards for public pensions and possibly other postemployment benefits.

To respond effectively, it is important to understand the GASB's framework and to address the issues raised.

These discussions will likely play a significant role in shaping state and local government pensions and other postemployment benefits for at least the next decade.

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The GASB's Invitation to Comment on Pension Accounting and Reporting Standards

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On March 31, 2009, the Governmental Accounting Standards Board (GASB) issued its Invitation to Comment (ITC) on potential changes in accounting and financial reporting standards related to public pensions. The ITC is an early step in the GASB's project to review these standards, and is intended to encourage comments from interested parties before the GASB begins its formal deliberations. Written comments are due to the GASB by July 31, 2009, and a public hearing is scheduled during the Board's regular meeting on August 26, 2009.

This article summarizes the ITC, along with various arguments suggested in the ITC for and against potential changes to the standards.² However, the article does not provide a detailed evaluation of the arguments, which will be done in a separate paper. Basically, the ITC requests comments on the following questions:

- Should accounting and reporting standards for state and local government pensions be focused on the process by which the benefits are financed? On the process by which the benefits are incurred? Or both?
- What should the measures of pension expense and liability be for governmental employers participating in defined benefit pension plans?

¹ The author wishes to thank Norman Jones, Brian Murphy, Chris Conradi, and Mary Ann Vitale at GRS, and Stephen Gauthier at the Government Finance Officers Association for their helpful comments on an earlier draft of this article. However, the author retains full responsibility for the accuracy of the information provided.

² While the ITC presents arguments for and against proposed changes in accounting standards, these arguments do not necessarily reflect the GASB's position. Rather they summarize positions presented to the GASB during its research on the potential changes.

- What actuarial cost method should be used to determine the employer's "unfunded accrued benefit obligation?" What discount rate?
- Should a range of actuarial cost methods be allowed for determining the unfunded accrued benefit obligation? Should the unfunded obligation be immediately recognized or amortized over future periods? Should asset smoothing be allowed?
- Are cost-sharing multiple-employer pension plans sufficiently different from single-employer and agent multiple-employer plans to warrant different accounting and reporting standards for participating employers?
- Should state and local pension plans recognize the accrued benefit obligation in their financial statements? Should they provide an annual statement of changes in the unfunded accrued benefit obligation?

Project Objectives and Evaluation Criteria

The ITC is presented in seven chapters. The first chapter provides background information on the project, including its objectives and the key criteria used to evaluate potential changes. The project's primary objective is to comprehensively reexamine the accounting and financial reporting standards for state and local government pensions and other postemployment benefits.³ To do this, the GASB will review the standards presented in GASB Statements 25 and 27, published in 1994, and amended by Statement 50 in 2007. In evaluating alternative accounting and reporting approaches, the GASB will consider the following criteria.⁴

³ The ITC specifically addresses pension benefits. However, because the GASB sees pension benefits as conceptually similar to retiree health care and other postemployment benefits (OPEB), the decisions related to the pension standards will likely play an important role in the decisions related to the OPEB standards.

⁴ The criteria are further discussed in GASB Concepts Statements 1 and 4.

Accountability. This is considered the primary objective of governmental accounting and financial reporting, and stems from the duty of public officials to provide constituents with an accurate accounting of financial transactions.

Decision Usefulness. This reflects the extent to which financial reports provided users with the information they need to make informed decisions. Governmental report users reflect a broad range of stakeholders, including: citizens, legislative and oversight bodies, investors and creditors, plan members and beneficiaries, plan trustees, and others. Related decisions include: determining the size of pension benefits and total compensation offered to employees; evaluating the cost of benefit changes; funding the benefits; determining the plan's funded status and progress; assessing the employer's overall economic condition and credit worthiness; determining the overall cost of government services; and allocating plan assets for investment purposes.

Interperiod Equity. Another criterion is how well the financial information helps report users evaluate interperiod equity. As discussed in the ITC, interperiod equity is achieved when the costs of current services are borne by current taxpayers rather than shifted to future taxpayers. However, the ITC also notes that interperiod equity is "not a goal that is expected to be met for any period of time," but is "a relevant metric to assess accountability."⁵

Comment: In GASB Statement 27, interperiod equity is considered achieved when annual contributions for normal costs are determined as a level percent of payroll over time.⁶ More recently, however, some have argued that leveling pension costs as a percent of payroll does not allocate the current pension cost for service to the current year and, therefore, does not reflect interperiod

⁵ GASB Concepts Statement No. 4, paragraph 27.

⁶ GASB Statement 27, paragraph 97. "The level contribution design facilitates budgeting of pension contributions and is consistent with the budgetary concept of intergenerational equity in terms of the burden on citizens."

equity. This difference in focus is a key feature in the debate over pension accounting and reporting standards.

Current Pension Accounting and Reporting Standards for Governmental Employers

Most of the ITC examines accounting and reporting standards for employers participating in single-employer or agent multiple-employer public pension plans.⁷ Essentially, these employers are solely responsible for funding the benefits promised to plan members.

Generally, accounting and reporting standards establish how financial transactions are defined and measured (e.g., what constitutes an “expense” or “liability”) and where the measures are displayed in financial reports (e.g., in the financial statements, notes to the financial statements, or as required supplementary information). Before discussing the ITC, it would be useful to briefly review the GASB’s current accounting and reporting standards for such employers.

Current Governmental Standards. Under current standards, pension accounting measures are closely related to pension financing measures. The employer’s pension expense is the employer’s “annual pension cost” determined using the same actuarial methods and assumptions that are used to fund the plan. The annual pension cost consists of the employer’s annual required contribution (ARC), plus certain adjustments if the employer has contributed more or less than the ARC over time. The ARC, in turn, is the actuarially determined cost of benefits earned in a given year (the “normal cost”) plus the amortization of any unfunded actuarial accrued liabilities over time.⁸

⁷ As the name implies, a single-employer plan is a plan sponsored by a single employer. An agent multiple-employer plan is a collection of single-employer plans that are administered together. In either case, the employer is solely responsible for funding the benefits promised to its plan members. By contrast, a cost-sharing multiple-employer plan spreads the benefit costs among multiple employers.

⁸ While the ARC may not be less than zero, the standards do not otherwise require a minimum ARC.

The GASB standards set certain constraints on the actuarial methods and assumptions that can be used, including:

- Six actuarial cost methods are acceptable. For the most part, in determining the annual normal cost of benefits, these methods include projected future salary and future service.⁹
- The assumed rate of investment return must reflect the long-term expected return on the plan’s investments. This rate is also used as the discount rate to determine the present value of plan liabilities.
- The period for amortizing unfunded actuarial liabilities is limited to 30 years.
- The actuarial value of plan assets must be market-related; however, investment gains and losses may be averaged over time to smooth the impact of investment volatility on the plan’s funded levels and contribution rates.

The employer’s pension liability, if any, is the difference between the employer’s annual pension cost and the employer’s actual contributions to the plan, accumulated over time. In essence, it reflects the difference between the employer’s actuarially required contributions and actual contributions. This liability is referred to as the “net pension obligation” (NPO) and is reported in the employer’s financial statements.

The current standards also require employers participating in single-employer and agent plans to report extensive information about the plan in the employer’s annual financial report. This information is disclosed in the notes to the financial statements and includes (but is not limited to): a

⁹ The six acceptable actuarial cost methods are entry age, frozen entry age, attained age, frozen attained age, aggregate and projected unit credit. A seventh method, the unit credit cost method, excludes both projected future salary and service. Under current GASB standards, the unit credit method is only acceptable for plans in which accumulated benefits are not affected by future salary levels. (GASB Statement 27, footnote 8)

description of the plan; annual required contributions; actual contributions; actuarial value of plan assets; actuarial accrued liability; funded status; and related actuarial methods and assumptions.

Private-Sector Standards. By contrast, private-sector accounting standards primarily focus on the process by which the employer incurs a pension obligation as a result of employee service to date. As established by the Financial Accounting Standards Board (FASB), private-sector standards allow only one actuarial cost method to be used for accounting purposes, compared with the six actuarial methods allowed by the GASB.¹⁰

In determining the pension cost, the FASB standards limit the maximum amortization period to the expected remaining service period for active employees, compared with 30 years under the GASB standards. In determining the pension liability, the FASB standards use the unfunded projected benefit obligation and recognize it in the employer's financial statements. Under the GASB's rules, the employer's unfunded obligation is disclosed in the notes to the financial statements, but not in the financial statements themselves.

The Focus of Public Pension Accounting and Financial Reporting

In discussing potential changes to current standards, the ITC begins by providing a broad conceptual framework and then progressively narrows the discussion to address various details. The GASB starts by asking:

- What should be the focus of pension accounting and reporting for state and local government employers participating in single-employer and agent plans?
- What processes and transactions associated with the pension benefits should be

¹⁰ FASB Statements 87 and 158 require the projected unit credit method, which produces a "projected benefit obligation" reflecting the cost of benefits earned to date, including projected future salary but excluding projected future service.

measured and reported in the employer's annual financial reports?

Chapter 2 of the ITC discusses the two different ways of viewing pensions from an accounting and reporting perspective. The first is by focusing on the process through which the employer finances the benefits (referred to the "Financing Focus"). The second is by focusing on the process through which the employer incurs an obligation for benefits as a result of employee's service (referred to here as the "Incurrence Focus"). The ITC requests comments on whether governmental accounting and reporting standards should focus on one or the other of these processes, or both.

Financing Focus. The GASB's standards essentially use the financing focus. This has been a long-standing focus of pension accounting, even before the GASB was established. For example, private-sector accounting principles established in 1966 provided that pension costs should be related to the actuarial costs of funding the benefits.¹¹ In 1979, the GASB's precursor organization issued a standard applying the 1966 principles to determining public pension expenses and liabilities.¹² In 1994, GASB Statement 27 called for the pension cost to be determined using the same actuarial cost method as used to fund the plan. As discussed in the ITC, there are several arguments for and against the financing focus, a few of which are presented below.

Arguments For the Financing Focus

- *It harmonizes pension accounting with actuarial funding.*
- *It provides a measure of the employer's pension cost that reflects the on-going nature of governments.*
- *It reflects total pension costs while mitigating the impact of short-term fluctuations.*

¹¹ Accounting Principles Board (APB), Opinion 8, *Accounting for the Cost of Pension Plans*, 1966. Generally, under Opinion 8, the cost of pension benefits should reflect the actuarially determined contributions needed to fund the plan.

¹² National Council on Governmental Accounting, *Statement 1, Governmental Accounting and Financial Reporting Principles*, 1979. Footnote 8 calls for governmental pension plan expenses and liabilities to be recognized in conformity with APB Opinion 8.

Arguments Against the Financing Focus

- *It does not provide specific information about the cost of benefits earned to date.*
- *It does not provide specific information about the current pension cost for service in the current year, since it levels contribution rates over time.*

Incurrence Focus. From this perspective, pensions and other postemployment benefits are part of an exchange transaction between the employer and employees related to total compensation. As employees earn benefits by virtue of their service, the employer incurs an obligation for the benefits earned to date. This approach is fundamentally different from the financing focus, since it would exclude pension costs associated with future service and possibly future salary.

Arguments For the Incurrence Focus

- *It focuses financial reporting on the exchange transaction.*
- *It reflects the employer's current position by measuring the liability for unfunded benefits earned to date.*
- *It provides useful information related to employee compensation decisions.*

Arguments Against the Incurrence Focus

- *It would inappropriately apply a short-term perspective to an on-going entity.*
- *It could introduce misleading volatility into the measurements.*
- *The financing focus is more consistent with public pension funding and current GASB standards.*

Comment: To evaluate the arguments for or against possible changes in the accounting standards, the specific actuarial methods and assumptions would need to be defined. The use of certain methods and assumptions, especially with regard to the discount rate, could affect the results in a way that undermines the standard's intended objectives.

Determining the Employer's Pension Liability and Expense

Chapter 3 of the ITC asks what quantities a governmental employer in a single-employer or agent plan should recognize as the "pension expense" and "pension liability" in its financial statements. As background, the ITC presents the following definitions:

- An obligation is "a social, legal, or moral requirement such as a duty, contract, or promise that compels one to follow or avoid a particular course of action."
- A liability is a present obligation requiring "a duty or responsibility to sacrifice resources that the government has little or no discretion to avoid." The ITC notes that an obligation generally becomes a liability when it is legally enforceable, such as in an exchange transaction.¹³
- An expense is "a consumption of net assets ... by the government that is applicable to the reporting period."

The GASB draws a distinction between amounts "recognized" in financial statements and amounts "disclosed" in the notes to the financial statements. To be recognized in financial statements, an item must be both: (1) an element of financial statements (e.g., an asset, liability, revenue, expense, etc.) and (2) measurable with sufficient reliability. The ITC discusses three alternative approaches to recognizing the pension expenses and liabilities of governmental employers participating in single-employer and agent plans.

Alternative 1. The first alternative is the current approach, under which the employer's pension expense is the annual pension cost and the employer's pension liability is the net pension obligation.

¹³ In addition, there are "constructive liabilities," which are created as a result of the government's conduct rather than a legal requirement, provided there is little or no discretion to avoid sacrificing resources.

Both the pension cost and pension liability are recognized in the employer's financial statements. However, the employer's "unfunded accrued benefit obligation" is not recognized in the financial statements, but rather is reported in the notes to the financial statements. As used in the ITC, the term "unfunded accrued benefit obligation" is intended to describe the employer's obligation for pension benefits attributable to past periods of service, but is not intended to imply a specific funding methodology.¹⁴

Arguments For Alternative 1

- *The measure of pension expense accurately reflects the total cost of pensions over the long-term.*
- *The net pension obligation is a useful measure of the liability.*
- *The unfunded accrued benefit obligation should not be used as the liability, since it is based on assumptions about future events and so would not be measured with sufficient reliability.*

Arguments Against Alternative 1

- *The unfunded accrued benefit obligation better meets the conceptual definition of liability and is measurable with sufficient reliability to warrant recognition.*
- *By deferring the recognition of past service costs, Alternative 1 does not provide useful information about interperiod equity.*

Comment: As discussed earlier, arguments offered for and against the proposed alternatives can only be evaluated after the approaches are fully defined. As presented, the methods and assumptions related to the unfunded accrued benefit obligation

¹⁴ Unfortunately, this term is very similar to the term "unfunded accumulated benefit obligation" which implies the unit credit cost method. Consequently, if the term "unfunded accrued benefit obligation" is used in the standards resulting from this project, significant confusion could result.

are undefined. Consequently, it is difficult to evaluate the validity of the related arguments.

Alternative 2. Under the second alternative, the employer's pension liability would be the employer's unfunded accrued benefit obligation and the employer's pension expense would be the change in the employer's unfunded accrued benefit obligation each year. Both would be recognized in the employer's financial statements.

Arguments For Alternative 2

- *It reflects the effects of the employment exchange on the employer's pension liability.*
- *The unfunded accrued benefit obligation meets the conceptual definition of a liability.*

Arguments Against Alternative 2

- *It could result in financial statement volatility that is not relevant to government employers.*
- *Using different measures to determine the accounting liability and funding liability would create confusion among financial report users.*

Alternative 3. This alternative brings together elements of the first two alternatives. It would recognize the unfunded accrued benefit obligation as the employer's pension liability in the financial statements. In addition, it would recognize the employer's normal cost as the measure of expense. However, it could also allow for certain end-of-year adjustments that would amortize and defer components of the unfunded accrued benefit obligation applicable to future periods.

Arguments For Alternative 3

- *It would allow amortization of costs related to future periods while immediately recognizing certain costs related to past periods.*

- *It offers common ground between Alternatives 1 and 2.*

Arguments Against Alternative 3

- *Supporters of Alternative 1 argue that the unfunded accrued benefit obligation should not be recognized as the liability.*
- *Supporters of Alternative 2 argue that deferring any costs associated with past periods is inconsistent with interperiod equity.*

Measuring the Unfunded Accrued Benefit Obligation

Chapter 4 examines possible ways of measuring the unfunded accrued benefit obligation for financial reporting purposes. Specifically, it asks:

- Should projected future changes be included in the unfunded accrued benefit obligation (e.g., cost-of-living adjustments (COLAs), salary increases, and service credits)?
- What discount rate should be used to determine the present value of benefits? Should it be the long-term expected return on plan investments, the “risk free” rate, or some other rate?

For funding purposes, the vast majority of actuarial valuations for public pension plans include projections of future salary and service, as well as automatic COLAs. This is done to calculate normal costs that, to the greatest extent possible, remain a level percent of payroll over time. This helps the government allocate total pension costs over current and future taxpayers as an approximately level percentage of their purchasing power. In addition, it helps the government better budget its pension contributions.

From the accounting perspective, the measure of the unfunded accrued benefit obligation will depend on the focus used. If the GASB decides to use the financing focus, then an appropriate measure

of the unfunded accrued benefit obligation would likely include projected future salary and service. However, if the GASB decides the focus should be on incurred obligations to date, then basing the unfunded accrued benefit obligation on projected future service would likely be seen as inappropriate, since such service would not yet be incurred.

If the GASB decides the focus should be on incurred obligations to date, the ITC asks which of the following two actuarial measures should be used to determine the unfunded accrued benefit obligation.

Unfunded Projected Benefit Obligation.

This measure includes projected future salary in the value of benefits and only includes future service to the extent it determines an employee’s eligibility to receive benefits. Supporters argue it is appropriate to include future salary since there is an implied contract that future salary increases will occur. Opponents argue that such future salary increases have not yet occurred and, therefore, are not relevant to measuring benefits earned to date.

Unfunded Accumulated Benefit Obligation.

This measure excludes projected future salary and only includes future service to the extent it determines an employee’s eligibility to receive benefits. Supporters argue that this is the proper measure of the plan’s accrued liability. Opponents argue that it is relevant only in the context of a plan’s termination or settlement and, therefore, is not a relevant measure for an on-going plan.

The Discount Rate. Discount rates are used to estimate the value today of one or more payments to be made in the future. Under current GASB standards, the discount rate should reflect the expected long-term rate of return to be earned on the plan’s investments.¹⁵ Since public plans invest in a diversified mix of equity and debt securities, the

¹⁵ GASB Statement 27, paragraph 10c.

expected return would reflect that mix. Currently, public plan discount rates average 8.0% and range from about 7.0% to 8.5%.¹⁶

However, some believe that the discount rate should reflect a “risk free” rate of return (e.g., yields on long-term U.S. Treasury bonds or on similar derivative securities). They argue that basing the discount rate on long-term expected returns does not fully reflect investment risks and so will underestimate plan costs and liabilities. Moreover, they argue benefit payments made by public pension plans are similar to bonds in their amount, timing, and probability of payment and so should be valued (i.e., “priced”) using bond yields.

Comment: It is important to evaluate these arguments in light of their potential impact on benefit costs and liabilities. For example, the yields on 30-year U.S. Treasury bonds have varied from about 14% in the mid-1980s to about 4% today. Such changes would introduce large variations in the measures of pension costs and liabilities, even in the absence of changes in the underlying plan.

Actuarial Methods and Amortization Periods

The above discussion of unfunded accrued benefit obligations took place in the context of the GASB’s possible future decision to apply the incurrence focus. However, the GASB may decide the financing focus is more appropriate. If so, Chapter 5 asks:

- Which actuarial methods should be allowed?
- Should unfunded obligations be amortized and, if so, over what periods?
- Should asset smoothing be allowed?

Actuarial Cost Methods. The GASB’s current standards allow one of six actuarial cost methods to be used to measure pension costs for accounting and

reporting purposes, provided it is the same as the method used to finance the benefits. (See footnote 9 for a list of the allowed cost methods.) The choice of actuarial cost method determines how the total pension cost is allocated to past, present, and future periods, but does not affect the total pension cost itself. In its deliberations over Statements 25 and 27, the GASB concluded that any one of the six methods, when properly applied, would produce an acceptable measure of the annual required contribution and, therefore, an acceptable measure of the pension expense.¹⁷

However, as discussed in the ITC, some have suggested that the ability to choose among six cost methods reduces the decision usefulness of the financial information, since it allows employers to select the most advantageous method. In addition, they argue it reduces the comparability of financial information, and makes interpreting the information more difficult. Consequently, they suggest reducing the number of acceptable methods.

Arguments offered against reducing the number of actuarial cost methods include: (1) the flexibility assists employers in funding the benefits; (2) complete comparability of pension accounting measures is impossible given the differences among the plans; (3) comparability is less important than consistency in reporting over time; and (4) in many governmental units, the method is statutory and reducing the number could force a disconnect between pension cost and pension expense.

If only one actuarial method were to be used, some suggest it should be the entry age normal cost method since it is used by the majority of public plans and is seen as the most effective method for accumulating plan assets. Others suggest that, for accounting purposes, the sole actuarial cost method should be the unit credit cost method, since it is explicitly intended to measure current benefit accruals.

¹⁶ Keith Brainard, *Public Fund Survey Summary of Findings FY 07*, p. 8.

¹⁷ GASB Statement 27, paragraph 99.

Amortization Periods. Generally, under current standards, the unfunded actuarial accrued liability is amortized and included in the employer's annual required contribution in addition to the normal cost. The maximum amortization period is 30 years and can be either open or closed. A closed period amortizes the unfunded amount over a decreasing period each year. An open period amortizes the unfunded amount over the same period each year (e.g., a rolling 30-year period). The amortized amount can be calculated as a level dollar amount or as a level percent of pay.

The GASB tentatively assumes that the normal cost of benefits would be included in the pension cost and recognized in the pension expense as employee services are rendered. Therefore, the choices discussed below relate to how components of the unfunded accrued benefit obligation would be amortized over future periods for the purpose of determining the pension expense.

Immediate Recognition. Some believe that the unfunded accrued benefit obligation should be immediately recognized without amortization.

Arguments For Immediate Recognition

- *Deferring recognition of pension costs that have already occurred inappropriately shifts these costs to future taxpayers.*
- *Amortization does not help financial report users assess whether revenues are sufficient to pay for services each year.*

Arguments Against Immediate Recognition

- *Immediate recognition would introduce unnecessary volatility in the pension expense.*
- *It is more appropriate to allocate actuarial gains and losses over the employee's careers than to recognize them immediately.*

Amortization Over Average Remaining Service Life. Others believe that while amortizing the unfunded accrued benefit obligation is appropriate, it should be limited to the average remaining service life of the active employees.

Arguments For Amortization Over Average Remaining Service Life

- *Amortizing over the average remaining service life is appropriate, since the active members would be providing services over that period.*
- *Amortizing retroactive benefit increases is appropriate, since the increases have the intangible benefit of improving morale over the employees' remaining years of employment.*

Arguments Against Amortization Over Average Remaining Service Life

- *Deferring recognition of pension costs that have already occurred inappropriately shifts these costs to future taxpayers.*
- *Amortization does not help financial report users assess whether revenues are sufficient to pay for services each year.*

Amortization Over Different Periods. Still others believe that different types of pension costs should be amortized over different periods. Under this approach, the incremental pension cost created by retroactively applied benefit increases would be amortized over a much shorter period (e.g. 3 years) than the period for amortizing actuarial gains and losses.

Open and Closed Amortization Periods. The ITC also asks whether the amortization period should be open or closed. Some believe the amortization period should be closed because it would provide for the full amortization of specific costs over a specific period. Others believe the amortization period should remain open on the grounds that it would

avoid abrupt changes in pension costs and better accommodate benefit obligations that continually change over time. Still others believe a combination of open and closed periods would be suitable.

The ITC also notes that an open amortization period may result in amortized amounts that are not sufficient to cover the interest on the unfunded obligation and so result in increasing obligations. Others argue that this is not a problem, since the employer will remain better off so long as the unfunded obligation is a decreasing percentage of payroll for active members. Still others suggest that the maximum amortization period should vary depending on whether the amortization period is open or closed (e.g., a maximum of 20 years if the period is open and 30 years if the period is closed).

Actuarial Value of Plan Assets. Under current GASB standards, the actuarial value of plan assets is used to measure the plan's funded status and unfunded liabilities (and, by extension, amounts amortized in the employer's annual required contribution). While current standards require the actuarial value of assets to be market-related, investment gains and losses may be averaged (or "smoothed") into the value of assets over time, typically 3 to 7 years. This is done to reduce the short-term impact of investment gains and losses on the plan's funded level and required contributions. However, others argue that the (unsmoothed) market value of plan assets should be used.

Arguments For Asset Smoothing

- *It effectively mitigates the impact of short-term investment volatility on contribution rates.*
- *It is appropriate from a long-term, on-going perspective.*
- *It may help reduce the risk of over-reaction by decision-makers in both favorable and unfavorable times.*

Arguments Against Asset Smoothing

- *Changes in unfunded obligations (including those due to investment gains and losses) should be recognized as they occur.*
- *Smoothed assets do not represent the assets that are currently available to fund the benefit obligation.*

The ITC notes that some agree with asset smoothing, but believe more specific parameters should be set, such as providing a maximum smoothing period or establishing a corridor limiting the degree to which smoothed assets may differ from their market values.

Comment: The GASB standards currently require the fair (market) value of invested assets to be reported in the statement of plan net assets.

Treatment of Employers in Cost-Sharing Plans

Up to this point, the discussion has centered on accounting and reporting for employers in single-employer and agent plans. In these plans, employers are solely responsible for funding the benefits of their plan members. By contrast, in cost-sharing multiple-employer plans, employers are collectively responsible for funding the benefits of members across all participating plans. As discussed in ITC Chapter 6, key differences between cost-sharing plans and single-employer or agent plans include:

- Cost-sharing plan obligations are pooled across participating employers and are not directly attributable to any single employer.
- Cost-sharing plan contributions are often determined by statute and payments are contractually required.
- The obligation of any individual employer is limited to their contractually required

contribution and the employer has no control over how contributions are set.

Under current GASB standards, employers in cost-sharing plans recognize their contractually required contribution as their pension expense, regardless of whether it reflects their actuarially determined contribution. The ITC asks whether the relationship of cost-sharing employers to their cost-sharing plan is sufficiently different from that of employers in single-employer and agent plans to warrant different accounting standards.¹⁸

Supporters of the current approach point out that it accurately reflects the fact that the financial obligation of cost-sharing employers is their contractually required contribution. Others generally agree that the current approach is appropriate, but would like to see additional disclosures in the employer's financial reports to help readers better understand the adequacy of the contractually required contributions. Still others believe that the cost-sharing arrangement is not sufficiently different from single-employer and agent plans to warrant different treatment.

Pension Plan Accounting and Reporting

The last chapter of the ITC shifts perspective from accounting and reporting for employers to accounting and reporting for plans. Specifically, Chapter 7 asks:

- Should the accrued benefit liability for defined benefit pensions be recognized in the plan's statement of financial position?
- Should a statement of changes in the unfunded accrued benefit obligation be added as a financial statement of the plan?

The current standards for defined benefit pension plans require the plans to report two financial statements: (1) the statement of plan net assets

and (2) the statement of changes in plan net assets. The statement of plan net assets shows current plan assets (including investments) and current liabilities due and payable, but not actuarial accrued liabilities, which are shown in the notes to the financial statements. The plan's statement of changes in plan net assets shows employer and employee contributions, investment earnings, benefit payments, withdrawals, and other expenses. The plans are also required to disclose additional information about annually required contributions, actual contributions, and funding in the notes to the financial statements and required supplementary information.

Arguments For the Current Approach

- *Benefits that are currently due and payable fit the definition of liabilities.*
- *The accrued benefit obligation is an obligation of the employer rather than of the plan.*

Arguments Against the Current Approach

- *Recognizing plan assets without recognizing accrued benefit obligations provides only half of the picture.*
- *The accrued benefit obligation is, in effect, the liability that assets are being accumulated to fund.*

Recognizing a Liability for the Accrued Benefit Obligation. Others believe that the plan's statement of net assets should include the accrued benefit obligation earned to date.

Arguments For Recognizing the Accrued Benefit Obligation

- *The accrued benefit obligation is the liability that assets are being accumulated to fund.*
- *Recognizing plan assets without accrued benefit obligations provides only half the picture.*

¹⁸ Although not discussed in the ITC, the GASB may also consider narrowing the definition of a cost-sharing plan.

Arguments Against Recognizing the Accrued Benefit Obligation

- The accrued benefit obligation pertains to the employer and not the plan.
- The accrued benefit obligation is already reported as required supplementary information.

Adding a Statement of Changes in the Unfunded Accrued Benefit Obligation. Some also advocate adding a financial statement showing changes in the unfunded accrued benefit obligation. Supporters believe this would provide additional information about the economic condition of the plan. Opponents argue that this information is already included in the notes to the financial statements and required supplementary information.

Conclusion

The GASB's Invitation to Comment presents the conceptual framework that the GASB will use to evaluate potential changes in accounting and reporting standards for public pensions benefits. Consequently, it is important to understand this framework in order to respond effectively to the GASB.

The ITC and the GASB's plain-language summary are available at: www.gasb.org

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Since its inception, GRS has placed special emphasis on services to the public sector. From our network of offices, we serve over 700 clients nationwide, including retirement systems, employers, employee organizations, and government agencies. We have worked with many of our clients for more than 30 years - some for more than 60 years. The far-ranging locations of our clients and the long associations we have enjoyed reflect the quality of the services we provide. Services offered by GRS include:

- Pension Plan Consulting
- GASB 43/45 OPEB Consulting
- Health and Welfare Benefit Consulting
- Retirement Technology Applications

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