GASB Exposure Drafts

NCTR "Members Only" Webinar

July 21, 2011

Today we'll learn:

- High Level Overview of Exposure Drafts
- What do the EDs mean for Systems and Sponsors?
  - No more ARC
  - Contribution likely different from GASB expense
- Major provisions of EDs
  - Clear divorce of accounting from funding
  - Quicker amortization
  - Rejection of risk free rate to the extent funded by plan assets
  - Unfunded liability (at market value of assets) on balance sheet
- What's next?

Two Exposure Drafts

- Accounting for Pension Plans
  - Would replace GASB 25
- Accounting for Governmental Employers
  - Would replace GASB 27
- The two standards are completely consistent

Major Changes from Preliminary Views

- Many General Preliminary Views Concepts were Retained
  - Separation of Accounting and Funding
  - Much less flexibility in accounting cost calculations
  - Rejection of full “Market Value Liabilities” paradigm
- Some changes in asset smoothing
  - PV had no recognition until 15% corridor, then full recognition
  - ED has 5 year smoothing, then full recognition
  - GASB 25/27 permits smoothing, then amortization up to 30 years
- New “Actuarially Calculated Employer Contribution” (ACEC) acknowledged as “substitute” for ARC
- Illustrations of sensitivity to discount rate

Major impact to plans

- Old rules
  - Actuarial Required Contribution (ARC) is the accounting expense,
  - Often, this was the amount the plan advises the sponsor to pay
  - The plan discloses difference between ARC and actual contributions, which is placed on the sponsor's balance sheet
  - Total unfunded liabilities merely disclosed in plan notes
- New rules
  - Actuarially Calculated Employer Contribution (ACEC) will be disclosed in plan notes
  - This is not the accounting expense, which will be a different amount based on snapshot of market-based plan condition
  - The total Unfunded Liability is on the sponsor's balance sheet

Major impact to plans (continued)

- No more ARC (Actuarially Required Contribution)
  - ARC has been gold standard…
  - But we've got Actuarially Computed Employer Contribution
  - This ACEC is not the accounting expense, just a funding number
  - Likely divergence between accounting and funding
  - So which gets paid to plan? ACEC or accounting expense?
  - How do you explain the difference to the public, press?
- More actuarial calculations required
- Much more rapid amortizations
- "Entry Age Normal" – rather than choice among six actuarial cost methods

Major Impact to Employers

- Unfunded Liability (at Market Value of Assets) on Balance Sheets
  - likely be a much larger number than current Net Pension Obligation (NPO)
- Mismatch between funding number (ACEC) and accounting expense
- Accounting expense is essentially the year-to-year tracking of balance sheet liability
- But what exactly does employer balance sheet mean?
- What will sponsors pay to plan when ACEC is more than accounting expense?
- How do you explain all this to the public, press?

Discount Rate

- Current approach: Expected Return on Plan Assets
- Financial economics approach: “Risk Free” Rate
- GASB PV/ED approach
  - Expected return on plan assets to extent projected benefits are funded by plan assets
  - Risk free rate otherwise
  - Result would be a “blended” rate
  - Actuaries have to (get to?) make projections to determine this split
  - Untested. Field test may help

Where's the ARC?

- It's now the ACEC
  - Actuarially Calculated Employer Contribution
  - Presented in Required Supplementary Information (RSI) "If the employer(s) contributions are actuarially determined"
- But ACEC won't match accounting cost
  - unlike ARC which really was accounting cost, not contribution
- Many opportunities for confusion

Asset Smoothing

- Current practice
  - Unexpected swings in the assets are “smoothed”, typically over five years
  - Then this “smoothed” deviation is amortized by up to 30 years before it hits the ARC
- Preliminary Views Approach
  - Don’t need to do anything until asset deviation is 15% greater or less than market value
  - But then immediately and fully recognized in accounting cost
- Exposure Draft Approach
  - Can smooth over five years, but no longer
  - But then immediately and fully recognize in accounting cost; no more amortizing

More Rapid Amortization Periods

- Immediate recognition, not amortization for:
  - Changes in liabilities attributable to retirees
  - Retroactive plan changes
  - Recognition of asset volatility once smoothed over five years
- No more increasing amortization
- No more 30 years
  - will be based on a period equal to a weighted average remaining service lives
  - a much shorter period; maybe 15 years?

Cost of Living Adjustments

- GASB 25/27 permitted up to 30-year amortization of Ad Hoc COLAs
- Many Ad Hoc COLAs will be recognized immediately
- If Ad Hoc COLAs are "considered to be substantively automatic", then will be included in projections instead of recognized when granted

Cost Sharing Plans

- Many complications for employers in cost sharing plans
- Plan must calculate proportionate share of net pension liability and other variables for each employer
- Many other complications for agent multiple-employer plans too
- Field tests will be very important in identifying the real problems in these areas

Employer Balance Sheets

- Old Rules – Net Pension Obligation
  - This was the difference between cumulative:
  - Actuarially Required Contribution (ARC) and
  - Actual amounts contributed
- New Rules – Net Pension Liability
  - This is the difference between:
  - Total Actuarial Liability and
  - Current Assets (market value, not smoothed)
  - Essentially, NPL is the Unfunded Liability
- Huge difference in the magnitude of numbers
- Uncertain tangible real impact
- But could be a lightening rod

Next Steps

- Comments due by September 30
- Hearings October 3 – 21
  - New York City: October 3-4
  - San Francisco: October 13-14
  - Chicago: October 20-21
- Standards expected early 2012?
- Standard expected to be effective first fiscal year after June 15, 2012 for plans with more than $1 billion
  - For July-June plans, this means 2012-2013 CAFR
  - For calendar year plans, this means 2013 CAFR
  - Effective for Fiscal Years after June 15, 2013, for others

Conclusions

- Clear separation of accounting and funding
- No more ARC
- Contribution likely different from GASB expense
- Quicker amortization
- Rejection of risk free rate to the extent funded by plan assets
- Unfunded liability (at market value of assets) on balance sheet

Questions?

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