

GASB Exposure Drafts 25 & 27

Pending Changes in Pension Accounting and Financial Reporting

The Governmental Accounting Standards Board (GASB) has released two proposals for revised accounting and financial reporting standards for public pension plans that will affect KPERS and its affiliated employers.

GASB Statement 25, "Accounting and Financial Reporting for Pensions," contains standards for the financial statement of retirement plans that administer benefits, like KPERS. The proposed standard would change the method KPERS uses to calculate and report the costs and obligations of the plans. It's important to remember that this is for financial reporting standards, *not funding standards*.

GASB Statement 27, "Accounting and Financial Reporting for Pensions" contains standards for state and local government employers that provide pension benefits, like KPERS affiliated employers. Under GASB Statement 27, KPERS is a cost-sharing multiple-employer plan. Participating employers pool or share their obligations to provide pensions to their employees. Plan assets can be used to pay the pensions of the employees of any participating employer. The proposed change would require employers using GASB standards to report in their financial statements their share of the costs and obligations for the governmental pension plans provided to their employees. Until now they have only reported contribution obligations.

GASB Statement 25 and KPERS' 8% Investment Return Assumption

Under existing GASB standards, KPERS' liabilities are calculated using its long-term investment return assumption (currently 8 percent). The proposed standards would require KPERS to calculate liabilities using a rate based on a projection of future assets and benefit payments. If the cash flow projection indicates that current and expected future plan assets will cover future benefit payments as we expect they will, KPERS can continue using the 8 percent return assumption as the discount rate for *financial* reporting.

However, if assets are not sufficient to cover future benefit payments, the 8 percent rate can be applied only to the period where plan assets are sufficient to pay benefits. A high-quality, tax-exempt municipal bond rate must be used for projected benefit payments not covered by plan assets, and the two rates would be blended together to calculate KPERS' liabilities. This change would only affect *financial* reporting and not *funding* standards. In this circumstance, the liability on the financial statements would look different from the actuarial valuation funding information, unless there

What Are GASB Standards?

The Governmental Accounting Standards Board (GASB) establishes standards to be used by governmental entities in their accounting practices and preparing financial statements. It is the official source of generally accepted accounting principles (GAAP) for state and local governments and affects their ability to have an unqualified financial audit. GASB does not establish funding standards for governmental retirement plans.

Who Is Affected?

In Kansas, changes only affect employers using Generally Accepted Accounting Principles (GAAP). Employers that do not use GAAP/GASB standards are not affected. Employers should consult their independent auditors. Some employers that operate on a cash basis may not realize their auditor switches them to GAAP for end-of-year financial reporting.

Timeline

- GASB exposure drafts released, June 2011
- GASB comment deadline, September 2011
- GASB to finalize standards, mid 2012 ?????? Proposals considered tentative until finally adopted.
- Changes *likely* effective for **Local** employers for CY 2013 financial statements
- Changes *likely* effective for **School** employers and **State** of Kansas for FY 2014 financial statements



is a funding policy change. Again, these are proposed standards and are subject to change.

Current cash flow projections show sufficient assets to cover future KPERS benefits, assuming that employers contribute at the projected employer contribution rate using the current statutory caps. Under those circumstances, KPERS could continue to apply its 8 percent long-term rate of return as the discount rate for financial reporting.

How GASB Statement 27 Affects Employers

Revised standards would significantly change current pension accounting and financial reporting for state and local governments. As proposed, they would:

- Disconnect pension accounting measurements from pension funding measurements.
- Require employers to recognize an unfunded pension obligation as a liability on their balance sheets, rather than less prominently in the supplemental notes of the financial statements.
- Require employers to use market value of assets to calculate pension obligation in their financial reporting, unlike the actuarial value of assets used in funding standards for KPERS.
- Require employers to use a new measure of pension expense on their income statements. Pension expenses reported on financial statements have the potential to be significantly different from the actuarially determined contributions and are likely to be more volatile.
- Replace most of the current disclosures and required supplementary information with information on the new measurement basis.

In order for employers to comply with new requirements, they will need to recognize their “proportionate share” of the KPERS’ unfunded pension liability (net pension liability or NPL), as well as most annual changes in the NPL (reported as pension expense or PE) as they occur.

The proportionate share for each employer will be based on the employer’s long-term contributions relative to the collective long-term contributions of all employers in the plan. KPERS will provide this complicated calculation to employers who need the information for GAAP reporting based on each employer’s own fiscal year.

KPERS is working with an actuarial firm and accounting consultants that specialize in governmental pensions to begin developing information for employers, keeping in mind that the exposure drafts have not been finalized.

Employers will be responsible for determining what applies to them for their financial statements and what accounting standards they use. On a state level, it will be up to the State of Kansas to decide what is included on the State’s financial statements.

Information from GASB

Visit www.gasb.org for:

- PDF of exposure draft for Statement No. 25, Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans
- PDF of exposure draft for Statement No. 27, Accounting for Pensions by State and Local Governmental Employers
- Plain Language Supplement

Current GASB Standard	Exposure Draft Standard	Implications
Pension expense reported by employer is equal to statutory contribution rate for KPERS and actuarial rate for KPF/Judges.	Pension expense is the change in net pension liability each year with some deferral on certain items.	Employers who never had a pension liability on their books will now have to report one.
Unfunded actuarial liability does not impact individual employers' financial statements.	Employer is responsible for unfunded actuarial liability and must show proportionate share on its individual balance sheet.	Employers go from no liability on their books to potentially large liability. Potential for confusion and misunderstanding. Real impact is unclear at this time.
Actuarial cost method used by plan for funding calculations is used for ARC (accounting) calculations	All plans must use Entry Age Normal actuarial cost method	No real impact for KPERS as Entry Age Normal already used for valuation.
Expense based on UAL using actuarial value of assets	UAL is calculated using fair market value of plan net assets	Will likely add volatility to both the NPL and pension expense
All projected benefit payments are discounted using one rate – the long term expected investment rate of return.	Blended rate consisting of: <ol style="list-style-type: none"> 1. Investment return assumption 2. Municipal bond rate <ul style="list-style-type: none"> • Higher rate (assumed rate of return) can be used only for period during which assets are sufficient to cover benefit payments (prior to projected exhaustion date). • Lower municipal bond rate must be used to discount benefit payments after projected exhaustion date. 	<ul style="list-style-type: none"> • Use of lower discount rate would mean higher liabilities and pension expense on employer's financial statements. • Most troublesome for plans with fixed contribution rate or plans contributing less than the full actuarial contribution rate. • Requires a projection of assets to determine exhaustion date, if any.
<ul style="list-style-type: none"> • Unfunded liabilities can be amortized over a maximum of 30 years which may be an "open" amortization period. • Unfunded liabilities created by plan changes that affect active liabilities, such as benefit improvements, can be amortized over a maximum of 30 years. • Unfunded liabilities created by plan changes that affect retirees, such as mortality assumptions, can also be amortized over a maximum of 30 years. 	<ul style="list-style-type: none"> • Amortization periods would be significantly shorter so cost recognized more quickly. Only change in UAL amortized. • Unfunded liabilities for active lives must be amortized over the average weighted working career for active employees. If result from benefit change, recognize immediately. • Unfunded liabilities for retirees must be recognized immediately with no amortization allowed. 	<ul style="list-style-type: none"> • More volatile pension expense. • Benefit changes may be more difficult to enact since immediate/near term expense will be much higher. • Ad hoc COLA liabilities are immediately recognized as are changes in mortality assumptions which could cause spikes in costs which flow through to financial statements.