Pension Plan Accounting and Reporting

School business officials must understand the implications of the new GASB standards.

By Corey Arvizu

The funded status of retirement pension plans has received a lot of attention in the last few years. Television, newspaper, and online reports have spotlighted the financial health concerns of pension plans, not just in the United States but worldwide. Included in the discussion have been the financial health and funded status of government employer pension plans.

Many parties have a role in addressing the challenges of government pension plans, including legislatures, constituents, policy makers, advisers, and both the management and members of the respective pension plans. As the accounting and reporting standard-setting body for state and local governments, the Governmental Accounting Standards Board (GASB) has issued two new standards to improve the *accountability* and transparency of pension plan financial reporting. The overall objective of these standards is to provide financial information to decision makers so they can properly assess the financial effects of a government's commitments related to pension benefits.

The GASB issued these two new accounting and reporting standards in June 2012. Many believe these standards, of any standards issued to date, will have the most significant impact on the financial reporting of governments. The two new standards, which are actually amendments to the current pension plan guidance, are GASB Statement No. 67, "Financial Reporting for Pension Plans," which applies to state and local pension plans, and GASB Statement No. 68, "Accounting and Financial Reporting for Pensions," which applies to the government employers that sponsor a plan or provide pensions to employees through contributions to a pension plan.

The standard applicable to the pension plans is effective for fiscal years beginning after June 15, 2013, and the standard applicable to government employers is effective for fiscal years beginning after June 15, 2014.

Impact of the New Pension Standards

During the GASB's due process of the project, the most-debated concept of the new standards was the requirement for the government employer to recognize the net pension liability in the government's financial statements. The input throughout the project on this key element was diverse and represented both support and disagreement with this requirement. Realistically, both

sides had valid positions regarding whether to report a pension liability in the financial statements.

The following are some of the arguments in support of reporting the pension liability:

- It represents a true obligation of the government employer.
- It will make governments accountable for benefits provided.
- It provides the true cost of employee compensation.
- It provides information to assess costs to future generations.
- The method is currently applied by private-sector companies.

And these are some of the arguments against reporting the pension liability:

- The obligation is difficult to measure.
- Recognition would result in volatile financial statements.
- Funding decisions should be based on long-term assessments.
- Unfunded obligations are only one element that provides information as to plan health.
- Governments are inherently different from private-sector companies.

The GASB modified or clarified certain elements of the standards based on the input it received during due process; however, it ultimately decided to retain the concept of recognizing the net pension liability in the financial statements.

Many parties have a role in addressing the challenges of government pension plans.

The following are some of the more significant changes these standards will have on the financial reporting of a government employer that sponsors a plan or provides pension benefits to employees through a pension plan:

- The recognition of the government's net pension liability and related pension expense in the financial statements;
- Specific guidance regarding the actuarial methods and assumptions used to measure the net pension liability; and
- Additional note disclosures and required supplementary information related to the pension's activity and balances.

Net Pension Liability and Pension Expense

As noted previously, one of the more significant changes of the new pension standards is the requirement for the government employer to measure and report the employer's net pension liability in the financial statements. The net pension liability of the pension plan is the total pension liability, as determined through the application of actuarial measurements, less the value of the plan assets available to pay the related benefits.

Many government employers, including most school organizations, participate in a cost-sharing multiple-employer plan administered by the state or another administering entity. Historically, if the government employer made the annual required contribution, as determined by the plan administrator, the government's participation in such a plan simply required certain note disclosures in its financial statements, even if the plan was in an unfunded position. Under the new pension standards, the government employer is now required to report its proportionate share of the collective net pension liability of all employers participating in the plan.

In addition, under the current standards, the pension expense is simply the employer's annual required contribution under the plan requirements. Under the new pension standards, the pension expense will be the change in the employer's proportionate share of the net pension liability. The difference between these items may be significant, and the pension expense under the new standards will likely be more volatile from period to period.

A reason for the increased volatility is that changes in the annual required contributions under the current standards are typically "smoothed" over a number of years, therefore resulting in less volatile expenses related to these contributions. However, no such "smoothing" will be applied to the pension expense related to the change in net pension liability under the new standards. As net pension liability is a product of the plan's assets, changes in financial market conditions will directly affect the net liability and the related pension expense.

Other items related to the change in the net pension liability will be reported as either a "deferred outflow of resources" or a "deferred inflows of resources." These items are new reporting elements that will be effective upon the implementation of GASB Statement No. 63, "Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position." This standard is a separate project recently undertaken by the GASB that essentially reevaluated the elements of the statement of financial position and the terminology used in the financial statements. In developing the new pension standards, the GASB determined that certain items related to the pension liability meet the definition of a "deferred inflow or outflow of resources" rather than an asset or liability.

The net pension liability and related pension expense are required to be reported in financial statements using the accrual basis of accounting, that is, the government-wide financial statements and proprietary fund financial statements. There are no significant changes to

the accounting for pensions in the government fund financial statements under the modified accrual basis of accounting. Expenditures recognized will continue to be the amounts paid by the employer to the pension plan during the year.

Measurements of the Net Pension Liability

Another area that will affect government employers is certain changes to the measurement of the net pension liability. One of these changes relates to the actuarial cost method that may be used to measure the pension obligations. The measurement of a pension obligation generally requires the projection of benefit payments, discounting the projected benefits to actuarial present value, and then attributing the present value of the benefits to the periods of member service.

The pension expense will be the change in the employer's proportionate share of the net pension liability.

This basic concept of measurement has not changed under the new standards. However, what has changed is the method that may be used to attribute the projected benefits to the periods of member service. Under the current standards, the benefits could be attributed to the years of service using one of several available actuarial cost methods. Under the new standards, the "entry age normal" method is the only method that may be used to attribute the benefits.

Another measurement change is the discount rate that must be used to project benefits to a present value. Under the new standards, the long-term expected rate of return will be used to the extent that plan assets are sufficient to make projected benefit payments, assuming the plan assets are invested in a strategy to achieve the long-term rate of return. In addition, this long-term expected rate of return must also be blended with a 20-year, tax-exempt municipal bond rate to the extent that plan assets are not sufficient to make projected benefit payments. The date at which a portion of the projected benefits are discounted using a tax-exempt municipal bond rate is commonly referred to as the "cross-over date." The determination of the cross-over date will certainly be one of the more challenging requirements of the new standard.

Whether there is a cross-over date, and when that date occurs, are based on a number of factors, primarily the funding policy of the plan and whether that funding policy is being followed.

It should be noted that the measurement changes noted above are required only for determining the net pension liability for purposes of reporting using generally acceptable accounting principles. A pension plan is not required to use these methods and assumptions in

determining pension obligations or funding requirements for the employer's annual required contributions.

Note Disclosure and Required Supplementary Information

As with many new GASB pronouncements, additional note disclosures will be required for government employers under the new pension standards. Some of the note disclosure requirements are similar to those required under the current standards. They include a description of the plan, benefit terms, information on contributions, and availability of the plan report. Additional information to be disclosed is the significant assumptions and other inputs used to determine the pension liability, such as the inflation rate, salary changes, mortality assumptions, and dates of experience studies.

Another required disclosure is the discount rate used to measure the total pension liability. Although the disclosure of the discount rate may be expected, the new standard also requires government employers to disclose the sensitivity of the government's proportionate share of the net pension liability to changes in the discount rate.

One of the new schedules requires additional information related to the net pension liability.

Therefore, in addition to reporting the net pension liability using the plan's long-term expected rate of return, the government employer must also disclose the net pension liability using a discount rate that is both one percentage point higher and one percentage point lower than the long-term expected rate of return used to calculate the net pension liability reported in the financial statements.

In addition to the note disclosures described above, government employers in a cost-sharing plan will also need to include in the financial statements certain 10-year schedules as supplementary information. This requirement is another significant change as the current standards do not necessitate such disclosures for cost-sharing employers.

One of the new schedules requires additional information related to the net pension liability, such as the employer's proportionate share of the collective liability, the employer's proportionate share of the net pension liability as a percentage of covered-employee payroll, and the pension plan's net position as a percentage of the total pension liability. Additionally, if the contribution requirements of the plan are statutorily or contractually established, the employer must also include a schedule that reports certain information regarding the contributions and the relationship of the contributions to other key financial information.

Although the presentation of 10 years of information is ultimately required, the employer may present the schedules prospectively if the information is not initially available upon implementation of the standard.

Implementation Considerations

Clearly, the new pension standards are going to have a significant effect on the financial reporting of a government employer that provides pension benefits to its employees. In particular, a government that participates in a cost-sharing employer plan may be the most affected since historically the reporting requirements have been limited to brief disclosures regarding the plan and contributions.

A cost-sharing government employer not only will now be required to report its proportionate share of the pension liability but will also have greatly expanded note disclosures and required supplementary information schedules. Cost-sharing employers will also need to work closely with the plan sponsor since much of the information to be reported, including the employer's proportionate share of the net pension liability, will be most efficiently provided by the plan sponsor through the actuarial valuations that the plan must obtain under the current reporting standards.

Ultimately, the effective implementation of these standards will only be accomplished through the collaboration of several parties, including the government employer, the government's auditor, the plan sponsor, and the actuary and auditor of the pension plan.

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