EMPLOYER Outreach

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The OPERS response to recommended changes to GASB's pension accounting and financial reporting requirements

Recently, the Governmental Accounting Standards Board (GASB) issued a series of proposed changes for pension accounting and financial reporting. Specifically, GASB proposed changes in the way government sponsors of defined benefit pension plans account for and report pension assets and liabilities in annual financial reports. It's important for employers to fully understand the proposed changes and how the proposed changes might affect the financial status for each of your organizations.

Current environment

GASB has had reporting standards in place for more than a decade. The current standards for pension accounting integrate accounting standards with actuarial funding characteristics of public pension plans. This integration provides an important linkage between the accounting requirements and funding.

GASB has been studying the current standards and considering changes designed to improve pension liability disclosures. The GASB issued a preliminary views document and invited comments back. Following the close of the comment period, the GASB hosted three days of testimony for any interested organization. GASB will use the feedback from the comments and testimony to either issue another preliminary views document or issue an exposure draft.

What employers need to know

OPERS believes GASB's proposed changes to current reporting standards represent a significant modification in accounting for public pension plans—and have some serious implications for employers.

Following are some of the key aspects of the proposed requirements and how the changes might impact OPERS and OPERS-reporting employers:

- **Proposed requirement:** OPERS would be required to allocate the unfunded pension liability to all employers and, subsequently, all employers would be required to record their portion of the unfunded liability on their financial statements. The current rules allow employers that participate in a multiple-employer cost-sharing system such as OPERS to disclose select pension information provided by OPERS in the footnotes to the employer's financial statements while the pension assets and liabilities and detailed funding information are included in OPERS financials.

  Impact on employers: This requirement would force employers to add a significant and volatile liability that has the potential to dwarf all other liabilities. Requiring this allocation of the pension liability to public employers would be similar to adding Social Security liabilities for private employers—realistically, the amount of each piece is not known. Adding this information could create undue stress and generate short-sighted fiscal decisions as public employers respond to significant changes to the liabilities booked each year.

- **Proposed requirement:** Employers will be required to record pension expense each year (currently employers record a liability to the extent required contributions have not been remitted).

  Impact on employers: As before, requiring employers to report full, unfunded liabilities could introduce significant volatility to financial statements. The pension expense can fluctuate significantly based on market conditions and the relative size of the pension expense will likely overshadow employer's other expenses.

- **Proposed requirement:** OPERS would be required to use a blended discounted figure to benchmark rate of return on assets and to use for projections. The proposed blended rate combines the long-term rate of return to the extent funded (currently 8%) and a high-quality municipal bond index rate (currently 4%).

  Impact on employers: This proposed standard would generate financial projections that currently—and traditionally—do not reflect actual experience. To give an historical overview based on actual experience: Over the past 30 years, OPERS' rate of return has averaged in excess of the 8% discounted rate (there are years OPERS has earned less than 8% and years OPERS has earned more than 8%). A requirement to use a discount rate that is partially based on a risk-free rate of return does not reflect actual expected returns.

Currently, as the proposed standard is written, it would not impact OPERS due to our funded position. However, if OPERS did need to use the blended rate, it would significantly increase the liability. Combine this with the proposal to allocate the unfunded liability to each employer participating in OPERS and the impact to employers could be quite significant.

Additional changes

The current accounting standards include the determination of the Annual Required Contribution (ARC), which is disclosed in the notes to the employer's financial statements. This serves to provide an important link between pension accounting and pension funding. The GASB's proposed changes would separate the accounting from the funding, which could ultimately impact funding. OPERS believes the current standards provide accountability and decision-useful information needed by governing bodies, credit agencies, taxpayers and others and is opposed to the proposed change.

Why GASB is important

Overall, GASB has played a significant role in standardizing and stabilizing how myriad governmental entities report and track financial data to the public—and therefore has a significant impact on the marketplace. Established in 1984, GASB is an independent, non-profit organization that is the recognized authority for governmental accounting and financial reporting standards in the U.S.

It's important to note that GASB has no authority to enforce standards. However, auditors apply GASB standards when performing financial audits of state and local governments. If the standards are not followed, the non-compliance is noted by the auditor—an action that may adversely affect the interest rates that entity pays on future debt.

OPERS' stand on proposed changes

GASB's proposed changes in accounting standards are not useful for employers or for the administrator of a multi-employer cost-sharing entity such as OPERS. The changes recommended to accounting standards will separate pension expense and net pension liabilities resulting in reporting data that is too volatile to be used as a benchmark for funding and, most importantly, may not be truly representative of inter-period equity due to the long-term nature of public pension plans and the employer entities funding those plans. Further, the proposed reporting for cost-sharing employers is not representative of the actual information or expectations, and could lead to short-sighted decisions and ultimately lead to confusion and a lack of trust by the public. Additionally, as the financial status of governmental entities changes, bond ratings—which impact the cost of debt service—could also potentially be affected adversely.

OPERS agrees with GASB on the need for increased transparency and accountability for pension plans, employers and plan sponsors. However, OPERS opposes the philosophical shift that eliminates the connection between the accounting for and funding of pension plans.

OPERS recognizes some changes may be appropriate but believes strongly that modifications to current standards should be researched very carefully to ensure the changes would result in MORE useful information for the users of financial reports—not less.

What's next

OPERS management is working to modify GASB's proposed changes to standards before the changes become accepted and create undue burdens on employers and pension-reporting administrators. GASB has invited public and expert testimony, and OPERS has actively engaged in all provided testimony at one of the hearings. We anticipate GASB will continue to review the information they received and will not issue revisions until June 2011. We will continue to keep employers updated.

More information

Additional information regarding GASB's proposed changes, and the actual change document itself, can be obtained at http://www.gasb.org. Employers are also encouraged to monitor the OPERS website at www.opers.org for up-to-the minute information on OPERS' activities regarding GASB's proposed changes and our advocacy efforts. Your questions and comments are encouraged via the Employer Outreach Call Center at 888-400-0965.