New Pension Accounting Standards from GASB – What You Need To Know

Q. What is different?

A. The new standards will no longer focus on how employers fund the cost of benefits. Said another way, the calculation of the annual required contribution (ARC) will no longer be subject to GASB standards.

Q. What do GASB 67 and 68 standards require?

A. The pension plan's net liability will be calculated differently and reported in the employer's financial statements. As a result, the amount that employers report as a liability in their financial statements will be a much larger than previously.

Q. Is this a big deal?

A. It will be hard to explain. When the Center for Retirement Research at Boston College looked at the impact of the accounting changes, they calculated that the aggregate funded ratio for state and local plans would decline from 76% in 2010 (current standard) to 57% (new GASB standard).

Q. Why would the pension liability be larger if my investment returns have been improving and we have increased contributions?

A. The new standards use a blended discount rate, do not permit asset smoothing, and use the entry age normal actuarial method. The new approach treats the pension liability in a manner similar to other long-term obligations. Currently, governments do not report a liability if they fully fund their annual required contribution.

Q. My local government has never had to report pension liability because we are part of a multi-employer cost-sharing plan. Do the new standards affect us?

A. Yes. The pension plan sponsor will be calculating your government's portion of the total net pension liability for all employers in the plan and you'll have to report that on your balance sheet.

Q. How will the liability be calculated?

A. Future benefit payments will be projected for current and former employees and their beneficiaries. Those payments will be discounted to their present value.

Q. Couldn't this create big swings in liabilities from year to year?

A. Yes. Investments will be marked to market. Smoothing is out in the new GASB accounting standards.

Q. What if my pension plan is poorly funded?

A. If there are not sufficient investments to cover all of the projected benefit payments, your plan will be required to use a municipal borrowing rate (tax-exempt, high quality 20-year GO Municipal Bond index rate) for discounting.

Q. How do I explain these changes?

A. You have time to prepare. The new guidance takes effect for pension plans starting with the fiscal year that ends on 6/30/2014, and one year later for employers. Start now by getting the facts from your finance director and/or pension plan sponsor. Adopt or update your government's pension funding policy.

Q. How do I make budget decisions without the ARC?

A. ICMA and the national associations have established a pension funding task force. The task force consensus is that governments should adopt a pension funding policy that is built around an actuarially determined annual required contribution. The funding policy should address the actuarial cost method, asset smoothing, and amortization policy.

Q. What else should the pension funding policy address?

A. In addition to the ARC, good pension policies should address funding discipline, intergenerational equity, maintaining consistent employer costs, and clear reporting that shows how and when pension plans will be adequately funded. GFOA is developing a new best practice for pension funding policies that will provide more guidance.

Q. In times of fiscal constraints, how can all of these objectives be achieved?

A. Governments will need to strike a balance between any competing objectives and determine the most appropriate time frame in which to meet their goals. For example, a government might adopt a five-year transition amortization policy to move from a 30 years to 25 years.

Save the date: December 12, 2012 Webinar

"What you need to know about GASB's new pension accounting standards"

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