

GASB Update for Pension Plans

TEXPERS

San Antonio, Texas

August 18, 2008

Karl Johnson
Project Manager, GASB

The views expressed in this presentation are those of the speaker. Official positions of the GASB are issued in the form of Statements and Interpretations after extensive deliberation and due process.



GASB “lives in interesting times”



Current events

Current events—GFOA

- The *principal* subtext of tension between GFOA and GASB in 2006-2007 probably was a long-standing difference regarding jurisdiction over SEA reporting
 - GFOA has long classified SEA reporting as (only) a subset of budgeting and has long opposed potential GASB efforts to establish standards in that area
 - GASB has long viewed SEA reporting as related to the financial reporting objective of reporting results of operations (see Concepts Statements 1 and 2)
- Then, in November 2006, notwithstanding GFOA's opposition, trustees of the Financial Accounting Foundation expressed support for:
 - The position that SEA is a legitimate part of the scope of GASB standard setting activities
 - The addition of an SEA project to the GASB's active technical agenda

Current events—GFOA

- GFOA then sent a letter to the FAF recommending:
 - That the GASB be abolished
 - That standard-setting for state and local governmental entities be transferred to the FASB (reversing GFOA's position in 1984 and 1989 and until recently)
- The episode was concluded in May 2007, when the FAF (parent of FASB as well as GASB) formally responded to GFOA:
 - Rejecting GFOA's proposal
 - Reaffirming GASB is the appropriate standard setter for governmental accounting
 - Urging GFOA to resume its traditional support of the GASB
- Subsequently, on July 31, 2008, GASB issued a public request for response on suggested guidelines for voluntary reporting of SEA performance information—comments are due by October 31, 2008

Current events—states

- Legislative moves in two states in 2007 and 2008 to create exemptions from GAAP or to interpret what is GAAP
 - These were interpreted by the press as connected but really were not
- Texas—re: exemption from applying Statement 45
 - Bill passed after amendment to make non-compliance with Statement 45 optional
 - Most Texas counties and cities are expected to implement Statement 45
- Connecticut—re: GAAP-basis budgeting requirements in state law; proposal to let state comptroller establish “GAAP”
 - Proposed twice; problem ultimately addressed in a way that does not imply comptroller can establish what is GAAP

Current events—SEC

- Representatives or surrogates of the SEC were quoted in the media in 2007 expressing concern about issues related to the municipal bond market and various ideas related to regulation of the municipal securities market
 - Comments included expressions of support for the GASB and for financial reporting in conformity with GAAP and of concern regarding adequate, appropriate funding for the GASB
 - Interestingly, comments included references to the GFOA, Texas, and Connecticut developments discussed previously
- The FAF issued the following response:
 - We appreciate SEC chairman's support of independent standard setting and recognition of the need for stable, long-term funding for GASB
 - GASB remains focused on our mission to develop standards that educate, inform, and provide transparency to the public
 - That is our first priority, and FAF is committed to listen to and work with all parties to ensure that GASB has the best structure to provide this value to our constituents

Current events—Financial Accounting Foundation/FASB/GASB restructuring

- 2007—FAF Special Committee on Governance Review conducted extensive review of FAF, FASB, and GASB structure and operations
- Feb. 2008—FAF trustees adopted a set of recommended changes, in several areas:
 - Trustee election—expanded pool of nominating organizations; more trustee discretion over appointments; more flexibility in achieving appropriate balance of experience and skills; enhanced ability to add trustees with investor experience
 - Oversight of standard-setting process—enhanced trustee oversight procedurally but not as to the substance of issues and standards
 - Technical agenda and board size—FASB reduced from 7 to 5 members, GASB unchanged at 7 members (6 part-time); chairmen empowered to set standards agendas
 - Other strategic initiatives—continued work on comprehensive strategic plan and action steps to achieve goals

Current events—U.S. public sector accounting in broader context

- Developments in the private sector
 - Convergence of FASB and IASB standards, leading eventually to the adoption of IASB standards for publicly traded companies in U.S. markets
- Developments in the public sector
 - Work of the International Public Sector Accounting Standards Board (IPSASB)
 - Dissatisfaction with the timeliness of financial reporting
- Cross-cutting developments
 - Principle-based accounting standards or rules?



Where things stand, standards-wise

Recently issued GASB pronouncements
of potential interest to pension plan
trustees and administrators

Current and approaching effective dates

Illustrated for reporting periods ending June 30

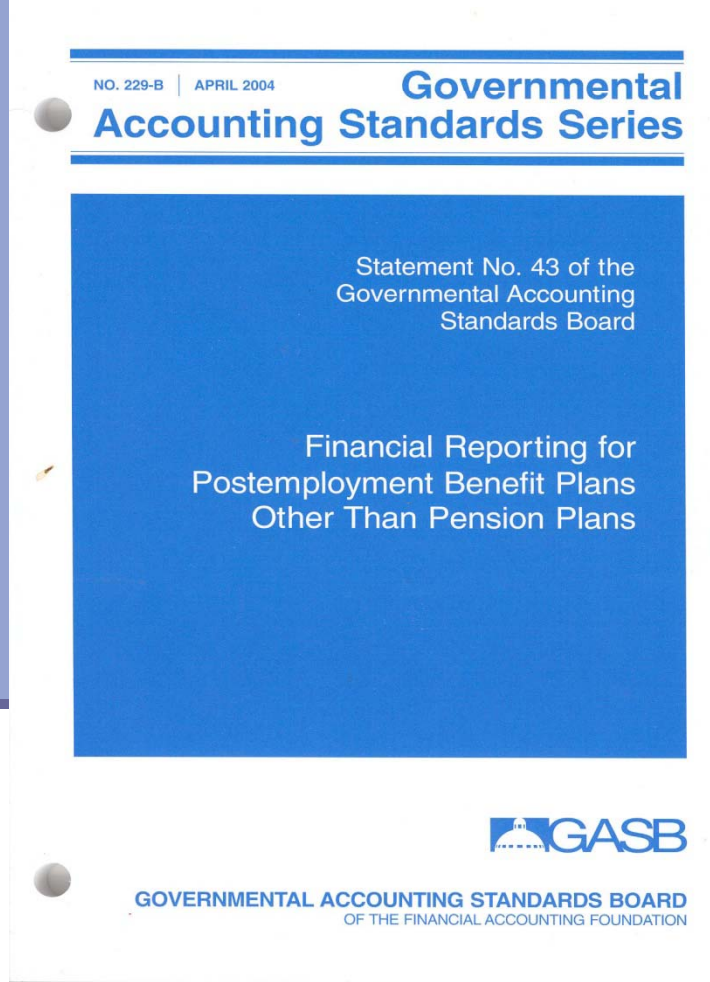
- June 30, 2008
 - Statement 43 (OPEB plans)—Phase II
 - Statement 45 (OPEB employers)—Phase I
 - Statement 48 (Sales, pledges, intra-entity transfers)
 - Statement 50 (Pension disclosures)
- June 30, 2009
 - Statement 43 (OPEB plans)—Phase III
 - Statement 45 (OPEB employers)—Phase II
 - Statement 49 (Pollution remediation obligations)
 - Statement 52 (Real estate investments of endowments)
- June 30, 2010
 - Statement 45 (OPEB employers)
 - Statement 51 (Intangible assets)
 - Statement 53 (Derivatives)



Statement Nos. 43 and 45

Other postemployment benefits—for plans
and employers

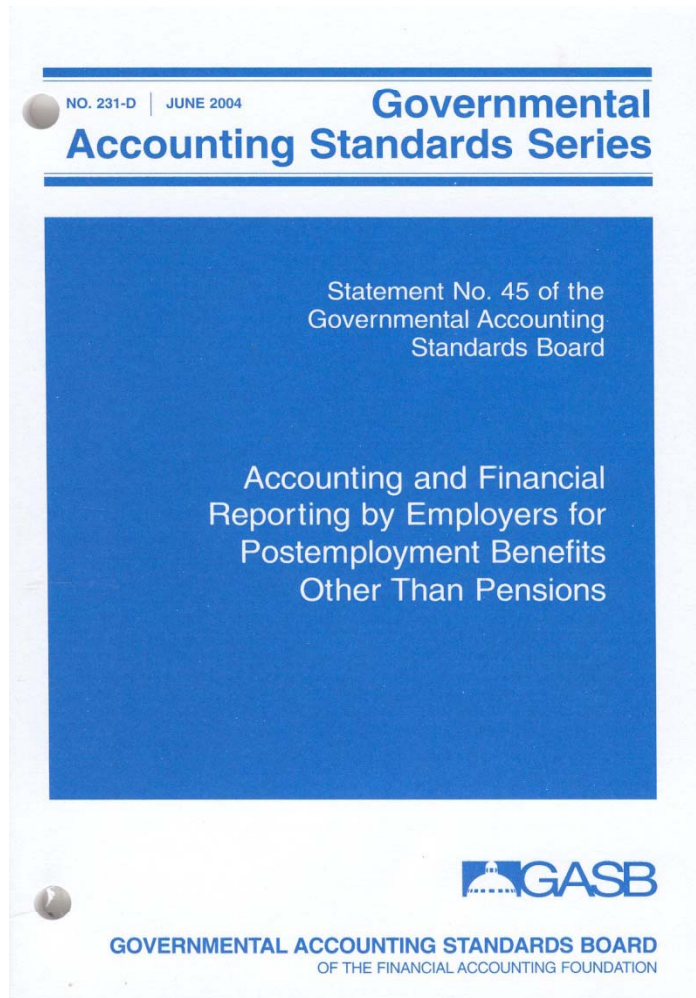
In a Nutshell: Statement 43 (for Plans)



- Subject: **reporting on stewardship of plan assets** by:
 - A trustee or plan administrator that is a governmental entity (stand-alone plan reporting)
 - An employer or plan sponsor that includes the plan as a trust or agency fund in its own financial report
- Includes provisions for reporting:
 - Plans that are administered as qualifying OPEB plan trusts
 - Multiple-employer plans that are *not* administered as qualifying OPEB plan trusts

In a Nutshell:

GASB Statement 45 (for Employers)

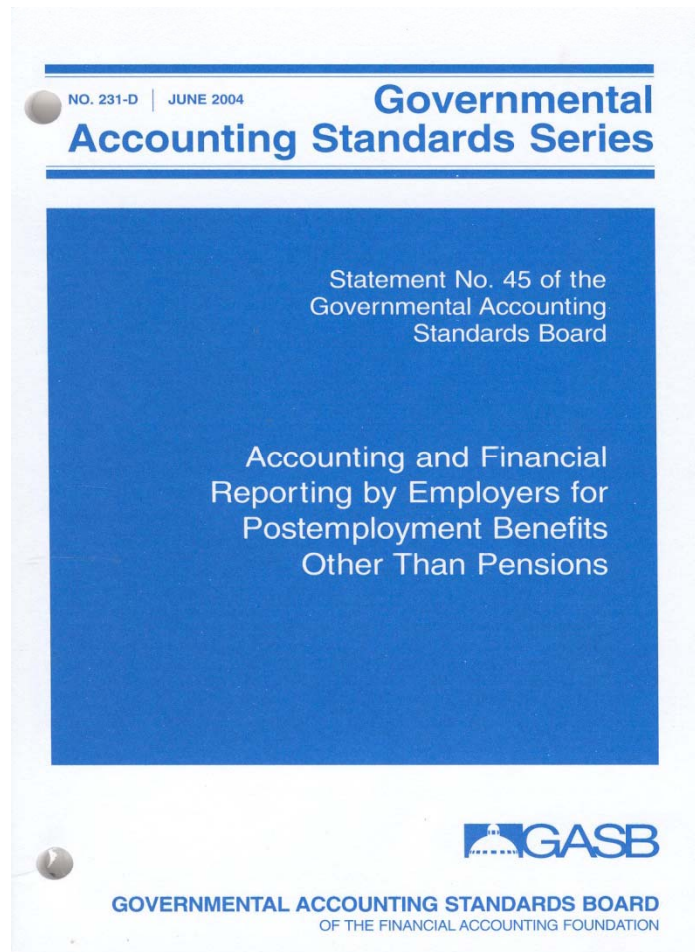


- Subject: accounting and reporting by employers for their annual cost (**expense**) and **obligations** associated with retiree healthcare and other forms of OPEB provided as compensation for employee services
- Applies to all employers that pay all or part of the cost of benefits—based on **claims costs**, or **age-adjusted premiums**, for retirees (i.e., including “implicit rate subsidies”)
- Takes different approaches to measurement, recognition, and disclosure for *sole and agent employers* and for *cost-sharing employers*

In a Nutshell:

GASB Statement 45 (for Employers)

(continued)

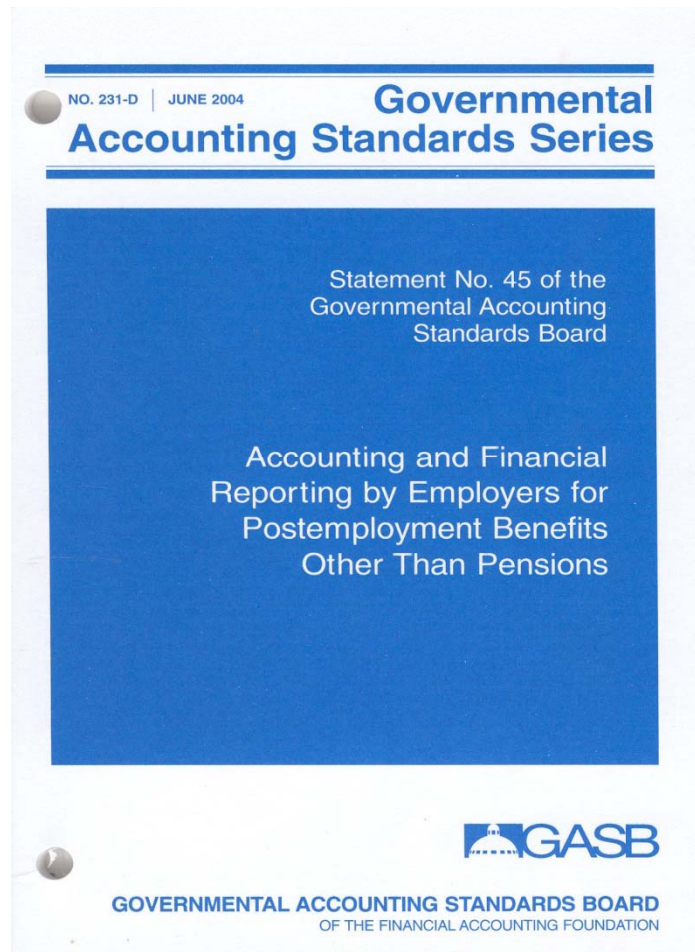


- Requires a **change**:
 - **From pay-as-you-go accounting**—in which expense is not recognized until OPEB obligations are finally *paid* after retirement
 - **To accrual-basis accounting**—in which expense is recognized during years of active service (for which OPEB is part of the compensation package)
- Changes the *measurement and recognition* (timing) of expense
- Contributes to better measurement of the total **cost of government services**

In a Nutshell:

GASB Statement 45 (for Employers)

(continued)



- Requires **actuarial valuations** every 2 or 3 years for accounting and financial reporting purposes (sooner if something major changes)
 - Calculations using an *alternative measurement method* are a possibility if < 100 total plan members
- Requires measurement and *disclosure* of **funded status information**, including:
 - The **total actuarial accrued liabilities** for past service costs
 - The net **unfunded actuarial accrued liabilities** after subtracting plan assets, if any, that have been set aside to pay accrued benefits as they come due
 - The plan's **funded ratio**



Statement No. 50



Pension disclosures

Scope

- Resulted from a narrowly focused project
 - *All that was considered* was disclosure requirements that were crafted differently in Statements 43 and 45 (OPEB, 2004) than in Statements 25 and 27 (pensions, 1994)
- Aligns disclosure requirements for pensions with those for OPEB
- Enhances information in notes and in RSI

Amendments for plans and sole and agent employers

- Notes to financial statements
 - Plans and sole and agent employers should disclose (specifically meaning *in notes*) **funded status** as of *most recent actuarial valuation date*
 - Plans also should disclose actuarial methods and significant assumptions used in the most recent actuarial valuation (previously presented by them in notes to RSI)
 - Include reference linking the funded-status note disclosure to the multi-year schedule of funding progress in RSI
 - Describe **legal or contractual maximum contribution rates**, if any
 - Disclose that the maximum contribution rates *have not* explicitly been taken into consideration in the projection of pension benefits

Amendments for plans and sole and agent employers (cont.)

- If actuarial assumption is different for successive years (select and ultimate assumptions), disclose both **initial** and **ultimate rates**
- If **aggregate actuarial cost method** is used to determine the ARC:
 - Present required **funded status and funding progress information** prepared **using the entry age actuarial cost method**
 - Disclose that the purpose is to provide information about funded status and funding progress using entry age method as a surrogate

Additional Statement 25 modifications (plans)

- If fair value of investments is based on *other than quoted market prices*, **disclose the methods and assumptions used to determine fair value***

* **Note on application of fair value:**

- **Par. 24 of Statement 25 requires DB pension plans to report investments at fair value**
- **The provision of par. 2 of Statement 31 limiting fair value to equity securities “that have readily determinable fair values” *does not apply to DB pension plans* (see second sentence of paragraph)**
- **Statement 25 as amended by par. 7-12 of Statement 31 is Level A GAAP for financial reporting by SLG pension plans**
- **FASB Statement 157 has the status of other accounting literature for SLG entities**

Additional Statement 27 amendments

- Cost-sharing employers
 - Disclose **how the contractually required contribution rate is determined**
 - *If* the plan (1) does not issue stand-alone plan financial report following the requirements of Statement 25, as amended *and* (2) is not included in the financial report of another entity, *then each cost-sharing employer* should:
 - **Present as RSI a schedule of funding progress and schedule of employer contributions** (each for the plan as a whole)
 - Provide information about scale of information relative to the employer

Effective date

- Generally, periods beginning after June 15, 2007



Statement No. 51

Accounting and financial reporting for
intangible assets

Description

- An intangible asset is an asset that
 - Lacks physical substance
 - Is nonfinancial nature
 - Has initial useful life extending beyond a single reporting period

Common types of intangible assets

- Right-of-way easements
- Other types of easements
- Patents, copyrights, trademarks
- Land use rights
- Licenses and permits
- Computer software
 - Purchased or licensed
 - Internally generated

Basic guidance

- All intangible assets subject to Statement should be classified as capital assets
 - All existing authoritative guidance related to capital assets should be applied to these intangible assets
 - Since considered capital assets, not reported as assets in modified accrual financial statements
- Scope exceptions
 - Intangible assets acquired or created primarily for directly obtaining income or profit
 - Capital leases
 - Goodwill from a combination transaction

Recognition

- Only if asset is identifiable

EITHER

- Asset is separable (capable of being separated and sold, transferred, licensed, etc.)

OR

- Asset arises from contractual or other legal rights, regardless of whether rights are separable

Internally generated intangible assets

- Definition
 - Created or produced by the government or an entity contracted by the government or
 - Acquired from a third party but require more than minimal incremental effort to achieve expected service capacity
- Recognize associated outlays using a *specified-conditions approach*

Specified-conditions approach

- Outlays capitalized only when all of the following have been determined or demonstrated:
 - Objective of the project
 - Nature of the service capacity that is expected
 - Technical or technological feasibility for completing the project
 - Current intention, ability, and presence of effort to complete or continue development
- Outlays incurred prior to meeting criteria should be expensed as incurred

Internally generated computer software

- Specific guidance is provided on applying the specified-conditions approach to accounting for internally generated computer software
 - This is generally based on development stages similar to those in AICPA SOP 98-1

Amortization

- Existing capital asset depreciation guidance generally applies
- Exception for intangible assets with indefinite useful lives:
 - Should not be amortized
 - Reason: no factors currently exist that limit the useful life of the asset

Effective date and transition

- Periods beginning after June 15, 2009
- Retroactive application generally required
 - Permitted but not required for internally generated and intangible assets with indefinite useful lives at transition
 - Required for all other intangible assets acquired in fiscal years ending after June 30, 1980, by phase 1 or 2 governments
 - Encouraged but not required for all other intangible assets of phase 3 governments



Statement 53

(Issued in June 2008)



Accounting for derivative instruments

Examples of derivatives

- **Interest rate swap**

- Variable-rate to fixed-rate
- Fixed-rate to variable-rate

- **Basis swap**

- Exchange payments based on the changes of two variable rates

- **Swaption**

- Gives the purchaser of the option the right, but not the obligation, to enter into an interest rate swap

- **Commodity swap**

- Reduce exposure to a commodity's price risk

Basic accounting approach

Fair value with hedge accounting

- Derivative instruments are measured on the statement of net assets at fair value
- Fair value changes are reported on the statement of resource flows as investment income
- Exception: effective hedges
 - If there is an effective hedge, changes in fair value of derivative instruments would be reported on the statement of net assets as deferred charges or deferred credits
- Scope exclusion: measurement of derivatives in governmental fund types

Methods of evaluating effectiveness

Effectiveness is determined by using a specified method of evaluating hedges

- Qualitative method
 - Consistent critical terms
- Quantitative methods
 - Synthetic instrument
 - Linear regression
 - Dollar offset
 - Other method – *see characteristics*

Note Disclosures

- Summary of derivative instrument activity by:
 - 1) Government activities, business-type activities, and fiduciary activities
 - 2) Then by fair value hedges, cash flow hedges, and investment derivatives
 - 3) Then by type:
 - Notional amount
 - Fair values & changes and where reported
 - Fair values & amounts reclassified from hedge to investment

Note disclosures (continued)

- Disclosures for *HEDGING* derivatives
 - Application of TB-2003 disclosures
 - Significant terms
 - Risks: Credit, Interest Rate, Basis, Termination, Rollover, Market-access, Foreign Currency
 - If an “other evaluation method” is used, the identity of that method and its critical values
- Disclosures for *INVESTMENT* derivatives
 - Risks: Credit, Interest Rate, Foreign Currency

Note Disclosures (continued)

- Contingencies (e.g., collateral postings)
- Synthetic guaranteed investment contracts
 - Description and nature
 - Fair values
 - Wrap contract
 - Underlying investments



What's ahead

Due process documents and other current
agenda projects

Recently issued public comment documents

- Fund balance reporting—
 - Exposure draft issued in February 2008
- Services efforts and accomplishments (SEA)—
 - Exposure draft issued in April 2008, on proposed amendments to Concepts Statement 2 regarding SEA reporting
 - Request for response on suggested guidelines for voluntary reporting of SEA performance information issued July 31, 2008; responses due by October 31, 2008



Other projects



Issues on the current or research agenda

Projects currently in active or research status

- Comprehensive Implementation Guide annual update
- Statement 14 revisited + financial reporting by reporting units that are part of legally separate governmental entity
- Conceptual framework: recognition and measurement attributes
- **Postemployment benefits accounting and reporting***
- Investments omnibus
- Public and private partnerships
- Codification of AICPA and pre-1989 guidance
- Economic condition reporting
- Electronic financial reporting

* **Look for an Invitation to Comment focusing on pension accounting and financial reporting issues scheduled to be issued in April 2009. Please monitor the GASB website for updated information.**

Calling all issues

- Agenda reviewed three times per year
- Agenda is full; however, emerging issues still need to be addressed
- If you have identified that warrants the GASB's attention, please submit that issue via e-mail to director@gasb.org



Resources



How to obtain additional information

GASB resources

- Comprehensive Implementation Guide
 - 2008–2009 available in early fall
 - New intangible assets (Statement 51) section
 - Additional questions & answers on other issues
- GASB website (www.gasb.org)
 - Project pages
 - Technical plan & recent decisions/activities
 - Plain language summaries
 - Implementation information
 - Summaries of standards
 - Publication ordering information (Statements, Implementation Guides, Technical Bulletins, etc.)
 - Technical inquiry submission